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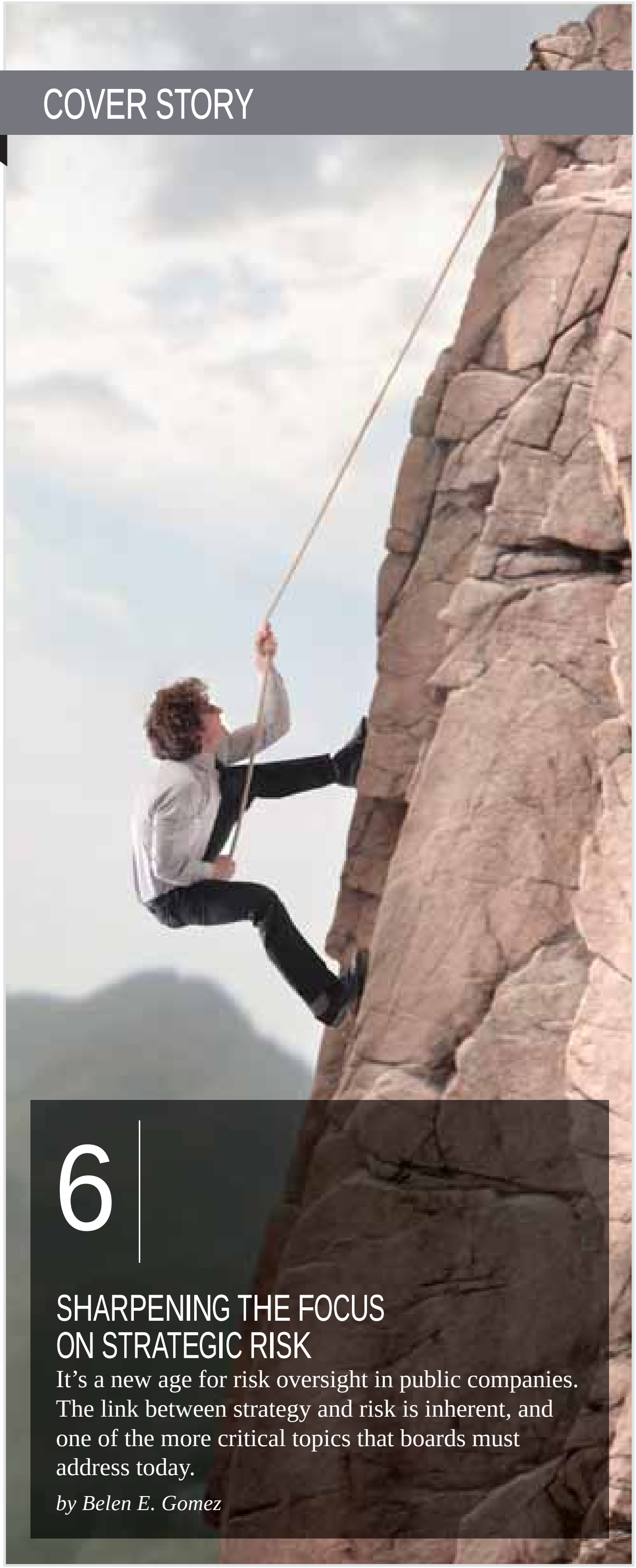

COVER STORY

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ISSUE 12 2013

AS FEATURED IN

The New York Times

SUNDAY, SEPTEMBER 22, 2013

A Better Way to Compare C.E.O. Pay

By GRETCHEN MORGENSON

HOW much pay is too much pay? It's a question shareholders have been asking for years.

Now the Securities and Exchange Commission has dipped its toe into the executive pay pool with a rule issued last week that would require companies to publish a comparison of their chief executives' pay to the median compensation of most other company employees.

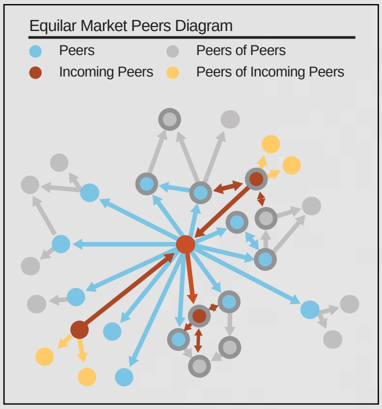
Unless you were born yesterday, you already know there's a vast gulf between C.E.O. pay and that of the public company rank and file. So the rule, if it goes into effect (it is now undergoing a 60-day comment period), won't be that revelatory. Sure, there will be noteworthy numbers. But the new rule will do little to help shareholders understand whether the executive pay awarded by their companies is appropriate and if not, how off the charts it is. A far more meaningful comparison for regulators is the peer groups public companies choose to use as benchmarks when setting their pay packages.

These peer groups, which are supposed to include similar companies, often don't. In many cases, companies choose peers that are far larger or more complex and whose executives are paid more to manage that size and complexity. Therefore, the inclusion of these companies in a peer group can skew an executive's pay higher. Investors have a name for such companies: aspirational peers.

Peer groups certainly are ubiquitous — in 2012, some 86 percent of companies in the Standard & Poor's 1,500-stock index said they used them, according to **Equilar**, the executive compensation analytics company in Redwood City, Calif. But they can be pretty blunt instruments for comparing executive pay.

Aware of the potential for questionable choices of companies within these peer groups, institutional investors are examining them more closely. **Equilar** has been assisting these investors with a system that generates a separate peer group for a company. Shareholders can use **Equilar**'s peer groups — and the pay they provide to their executives — to vet the groups chosen by their companies.

Aeisha Mastagni, investment officer at the California State Teachers' Retirement System, says her organization uses **Equilar**'s peer groups as a gut check before voting on executive pay at companies. When wide disparities emerge between a company's peer group and the **Equilar** alternative, Calstrs officials have brought up the matter with company officials.



"The peer group aspect is one piece of the puzzle that we look at when we cast votes on company pay practices," Ms. Mastagni said in an interview last week. "Far too many companies use the peer groups as a starting point when they really need to be that reasonableness check."

Peer groups chosen by companies don't always differ significantly from those **Equilar**'s system produces. But many do.

ONE is Hain Celestial Group, a food company based on Long Island whose founder and chief executive, Irwin David Simon, received $6.5 million in pay last year.

In its proxy statement, Hain discloses two different peer groups that it uses to benchmark pay. One consists of many food and beverage companies, including Chipotle Mexican Grill, Mead Johnson and United Natural Foods. Most have higher revenue than Hain's and half have larger market capitalizations. And yet Hain's chief executive received far more than the $3.9 million median pay for the C.E.O.'s at those larger peers.

The other peer group used by Hain consists of companies whose founders, like Mr. Simon, still run the show. This peer group is made up of 14 companies, including Costco and Starbucks. The revenues of most of those companies were significantly higher than Hain's — Costco, for example, has $99 billion in revenue compared to $1.4 billion for Hain. Nevertheless, these peers paid their executives less — a median of $4.8 million versus Hain's $6.5 million.

Equilar's suggested peer group for Hain, adds two companies to Hain's list, with median revenues that were much more in line: Post Holdings and SunOpta. This group paid their C.E.O.'s a median $2.6 million last year, far less than what Mr. Simon at Hain received.

Mary Anthes, a spokeswoman for Hain, said that its peer group was selected by its board's compensation committee and that for the last two years Hain's sales, earnings and stock price had been markedly higher, justifying the pay.

Kelly Services, the staffing company, provides another example. Its disclosed peer group has just two companies — ManpowerGroup and Robert Half International. Carl T. Camden, Kelly's chief executive, received $3.3 million in pay last year. This sounds reasonable enough, given that the median pay received by the top executives at Kelly's peers was $8.7 million.

But when you look at revenues, the peer group comparison makes less sense. Manpower's revenue was more than three times the $5.5 billion Kelly generated last year, and the market capitalization of both peers was far in excess of Kelly's $585 million.

As an alternative, **Equilar** chose a larger group — 14 companies, most of them in the employee staffing field — with median revenue of $1.24 billion and market capitalization of $775 million. In this case, **Equilar**'s more representative group was not so out of whack with Mr. Camden's actual pay. The median pay dispensed to the top executives at these companies was $2.8 million, slightly below what Mr. Camden received.

Kelly Services did not respond to an e-mail seeking comment.

Equilar came up with the idea of creating alternative peer groups because its officials believed that in an age of big data, it could improve on the standard, more limited approach taken to come up with peer groups. Rather than just look at industry groups and revenues, **Equilar** builds relationship maps.

Equilar uses an algorithm to tap into peer group data found in S.E.C. filings and employ social media to generate what it contends are credible alternatives to company peer groups.

For example, **Equilar** consults all filings for mentions of peers and then matches them up. Say, for example, company A is identified as a peer by company B but A does not include B as one of its peers. **Equilar** feeds this information into its system. It also includes what it calls second-degree peers — when company A lists B as a peer and B lists company C as one, **Equilar** will consider adding company C.

Equilar maps these ties and identifies the strongest connections among them. The result is what it calls market peers for each company.

Investors have to weigh many elements when assessing the fairness of executive pay. Peer groups are just one of those, of course. But as the **Equilar** examples show, some peers are more equal than others.

CSUITE INSIGHT

C-Suite Insight is published by

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1100 Marshall St.
Redwood City, CA 94063
Phone: (650) 241-6600
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David has led Equilar from a pure start-up since its inception in 2000 to one of the most respected and trusted names in the executive compensation industry.

RISK

RISK—A SIMPLE WORD YET carries tremendous weight in today's business world, especially when it comes to executive compensation and corporate governance. Our cover story provides a historical view of risk in the C-Suite, the challenges today's corporate leaders face, and emerging trends in risk oversight. To give context to potential threats and risk mitigation strategies, our interviews in this issue feature compensation and benefits expert Joe Yaffe from Skadden Arps, Managing Partners Michael Powers and Jim Wolf from Meridian Compensation Partners, and Priya Cherian Huskins, a recognized authority on D&O risk and liability at Woodruff-Sawyer.

Our newly named "Ask the Experts" feature (formerly "Consultant's Corner") presents a lineup of experts with a variety of opinions on the issue of risk. For the boardroom perspective, TK Kerstetter, Chairman of Corporate Board Member, provides a provocative thought leadership piece regarding cyber security threats. We've also included a detailed examination of board compensation and proxy voting analytics drawn from Equilar's latest research.

Of course, no issue of *C-SUITE Insight* is complete without Seymour Cash's final word. This time, Seymour has to profoundly think through a major risk in his world. Please enjoy and feel free to contact me directly with your comments and suggestions. C

David Chun
CEO and Founder, Equilar
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Sharpening the Focus on Strategic Risk

By Belen E. Gomez

Over the past decade, corporate America has experienced quite an upheaval as preeminent businesses stumbled during the recession, the regulatory environment tightened, and the competitive landscape evolved. As a result, the topic of risk dominates today's business headlines, permeating all aspects of corporate governance.

Risk oversight and risk management have remained critical topics for board members and executives. More than ever before, business leaders are under constant scrutiny as they navigate their companies through rough economic times, rapid globalization, and sometimes disruptive innovation. The near extinction of Kodak, Netflix's product gaffes, and the rise and fall of former tech darling Groupon, are prime examples of strategic missteps in which risk was either not recognized, or recognized but underestimated. In both cases, the failure of a company's top people to properly oversee risk in all its forms—financial, strategic, operational, and environmental—tends to precede negative outcomes.

The lessons learned from these high-profile examples are fresh on the minds of business leaders as the topic of strategic risk rises to the top of business discussions today. As we have learned, both financial and non-financial risks need to and should be brought to the attention of the full board and analyzed accordingly. Strategic risk, it may be argued, is paramount. A company's strategic direction will influence operational, environmental, and financial risk exposure in both the short and long term.

THE ROLE OF THE AUDIT COMMITTEE

Historically, risk has been defined in terms of financial or capital risk and boards have typically delegated risk oversight responsibilities to the audit committee. Intuitively, this is aligned with the board's need to monitor financial risk.

According to Peter Manzetti, Director at Friedman LLP, "The audit committee has been viewed as the 'go to' body for risk oversight. The role of the audit committee as it relates to risk is to bring concerns to the full board for discussion." However, Manzetti also notes that the transfer of information is not without challenges. "When information does reach the full board," he says, "it is often edited by management and the audit committee so that its utility becomes diminished. Risk information can get compartmentalized in the audit committee and not adequately make its way to the full board."

As the audit committee's responsibilities continue to increase, and with audit committee agendas packed with specific review requirements, it is not surprising that boards are changing the processes by which they address risk oversight. NYSE listing standards require audit committees to discuss their company's risk oversight policy, however, boards can no longer rely on the audit committee to be completely responsible for the increasing demands of risk oversight. An effective risk oversight process requires the board to source information and data from multiple channels and to consider risk in all areas, not just financial.

Today's business environment calls for a more comprehensive approach to risk oversight. The evolving risk profiles of companies today require the attention, knowledge and expertise of the full board. Dennis Whalen, Partner in Charge and Executive Director at the KPMG Audit Committee Institute (ACI), in his commentary for *C-SUITE Insight* says that for boards, "oversight of risk has to be a team sport, with risks allocated appropriately and clearly among its committees." The full board must be engaged in discussions regarding "risk culture" and "risk appetite" and the board must leverage its expertise to ensure that risks are mitigated effectively.

NEED FOR IMPROVEMENT

It is imperative that a board have a clear understanding of the specific risks facing the company, and how those risks affect or reflect company strategy. In a recent joint report, *Legal Risks on the Radar*, published by Corporate Board Member and FTI Consulting, Neal Hochberg, Senior Managing Director at FTI, highlights how strategic business decisions are influencing risk oversight processes. "Boards increasingly are concerned about operational risk in the context of emerging markets, where rising economic prosperity offers opportunities to expand operations and grow market share, yet also poses heightened governance risk," stated Hochberg. "To make informed decisions about these market opportunities, corporations increasingly are conducting proactive market risk assessments that identify and prioritize the risks that need to be evaluated."

Interestingly, in the same report referenced above, only 59% of companies surveyed believed that their boards are effective at managing operational risk. This naturally begs the question: why is the other 41% not more confident in the abilities of boards to oversee operational risk, which is directly linked to strategic decisions? And perhaps the greater question: what processes can be implemented to support the board's broader risk oversight responsibilities?

CURRENT TRENDS

In a recent Lead Director Network *ViewPoints* report regarding strategic risk, lead directors who form the elite group noted the need to "creatively assign risk ownership." In the report, one member stated that "certain risks fall naturally to other standing committees, it makes sense for those committees to take

“THE LINK BETWEEN STRATEGY AND RISK IS INHERENT AND WITHOUT DOUBT ONE OF THE MORE CRITICAL TOPICS THAT BOARDS MUST ADDRESS TODAY.”

the lead on issues relating to those risks” rather than “throwing everything difficult the audit committee’s way.” This sentiment certainly reflects the notion that board members are reevaluating how risk oversight is being implemented and are proponents of more effective solutions involving the entire board.

For example, there is wider adoption by boards of enterprise risk management (ERM) processes. As reported in The Conference Board’s report, *Risk in the Boardroom*, more than 70% of companies surveyed across industries are utilizing an ERM framework. The report concluded that “under ERM, risk management is an enterprise-wide series of coordinated activities that aim at elevating to the senior executive and board level any material risk that could affect the company’s ability to achieve its strategic objectives.” A properly implemented and executed ERM system should provide the board with risk analyses from all areas of the organization, communicated by the senior leadership team. Thus, the ERM process should enable the board to be more effective in ensuring that management is appropriately addressing each risk area and thus guiding the company in a sound strategic direction.

Also, more and more companies are creating risk committees. Though primarily still concentrated in the financial sector, a risk committee or the consideration of establishing a risk committee at the board level is becoming more prevalent in non-financial sectors. Typically risk committees are tasked with defining the risk culture of the organization, overseeing risk management strategies put in place by the senior leadership team, and ensuring that risk oversight responsibilities are assigned appropriately across the board.

Current disclosure requirements allow great flexibility in the way boards explain to shareholders how risk oversight responsibilities are executed. Boards must also communicate whether risk is managed through the audit committee, one of the new methods as discussed above, or through some other unique alternative. Despite recent efforts by boards to revamp risk oversight processes, it is clear that the detail being provided is not sufficient to satisfy shareholders and regulators. Thus, there is consistent urging for more information regarding how strategy and the resulting risk exposure will materially affect companies.

NEW AGE FOR RISK OVERSIGHT

Delegating risk oversight beyond the audit committee, adopting an ERM framework, and considering or establishing a dedicated risk committee are just some recent trends in how companies and their boards are refreshing their approaches to addressing risk. Ultimately, a company’s risk management lies in the hands of senior management. However, the board is in the best position, and has the responsibility, to ensure that senior management has the right processes and checks in place to mitigate undue risk without being too risk averse.

No matter what process is implemented, the link between strategy and risk is inherent and without doubt one of the more critical topics that boards must address today. As companies and their business strategies change and grow, so do the accompanying risks. Therefore, fresh methods for managing the risk oversight function are necessary to ensure that boards remain vigilant and effective at guiding strategic discussions and ultimately steering their companies toward success. C

Executive Compensation at Banks in the Dodd-Frank Era

BY BRIAN SOHMERS

At the end of 2008, the global economy stood on the brink of collapse, in large part due to the misuse of overly risky and little-understood financial instruments. With the collapse imminent, the American public's elected representatives did the unimaginable — a full-scale bailout of America's banks. The banks had put their industry on the edge of a widespread systemic failure, but would be bailed out to save the American economy.

The Troubled Asset Relief Program (TARP) injected $700 billion into America's troubled banking system providing immediate and needed liquidity for a hopelessly stagnant financial system. As part of TARP, Treasury Secretary Paulson stipulated that recipient banks comply with certain provisions surrounding executive pay, clawbacks, and golden parachutes.

Although by March 2009 the immediate crisis had passed, the public's distaste for the bailout lingered, as did the desire for accountability (and perhaps retribution). When it was revealed that AIG, a significant beneficiary of TARP funds, distributed more than $165 million in year-end bonuses to the same executives responsible for its near failure, displeasure turned into anger in a rare display of bipartisan outrage.

Senator Richard Shelby (Republican, Alabama) said, "These people brought this on themselves. Now you're rewarding failure. A lot of these people should be fired, not awarded bonuses." Representative Barney Frank (Democrat, Massachusetts), Chairman of the House Financial Services Committee, said that paying the bonuses was "rewarding incompetence."

With the AIG bonus scandal as a backdrop, the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed into law in 2010, expanding and codifying the provisions introduced under TARP. It was widely believed that the pay packages of banking executives encouraged the rampant risky behavior that brought about the near collapse. In an effort to prevent further financial turmoil, regulators sought to rein in compensation programs that promoted unnecessary and excessive risks.

Although much of the TARP funds have been returned and the associated TARP restrictions lifted, the Dodd-Frank regulations remain. Financial institutions, like all public companies, are now faced with the challenge of designing pay programs in compliance with regulations under the Dodd-Frank Act.

However, with the Dodd-Frank regulations in place, financial institutions are finding it difficult to appease both regulators and shareholders who have different views on effective pay plans and associated risk mitigation.

KEY FINDINGS

- Banks are being pulled in different directions by regulators and shareholders regarding effective pay plan design. The resulting design of bank pay plans is significantly different from other industries.
- TARP had a significant effect on bank pay opportunity and plan design.

THE TARP YEARS

"TARP worked," the Treasury Department asserted in its July 2013 monthly report to Congress. "It helped stop widespread financial panic, it helped prevent what could have been a devastating collapse of our financial system, and it did so at a cost that is far less than what most people expected at the time the law was passed." A *Wall Street Journal* study shows that a total of $217 billion has been repaid in the form of dividend payments, interest, and repayments from the $205 billion that TARP provided. Today, $2.51 billion remains outstanding from the 113 banks that remain in the TARP program. Many of these banks plan to repay in the very near future since the dividend payments on preferred stock are scheduled to rise from 5% to 9% on TARP's fifth anniversary.

However, recipient banks may not agree with the Treasury's assessment that TARP was effective. Many share the opinion that the capital the banks received under TARP came with an unfavorably high dividend rate and executive compensation restrictions that made it extremely difficult to retain talent. The executive compensation restrictions that financial institutions were subject to under TARP were:

- Prohibition on paying or accruing bonus, retention, or incentive compensation for up to 25 of the most highly-compensated individuals
- Prohibition on golden parachute payouts
- Prohibition on tax gross-ups for the top five executives and the next 20 most highly-compensated employees
- Mandatory clawbacks
- Limit on grant of restricted stock to one-third of annual compensation. The award was not fully transferrable while under TARP, and would only vest after the employee provided at least two years of service
- Reduction of the IRS tax deduction maximum under IRC Section162(m)(5) from $1 million to $500,000

During the TARP years, there was a significant decrease in pay opportunity and a major change in pay design for banks. The prevalent pay design element that banks used during this time was the use of salary stock to compensate bank executives. Salary stock is the payment of fully-vested shares at each payroll period as part of base salary. The primary reason for utilizing salary stock while under TARP was that it did not conflict with any of the TARP restrictions. However, salary stock was highly unpopular throughout the industry, as evidenced by banks reinstating their annual bonus plans upon coming out of TARP.

During the recession, CEO pay decreased across all industries, but this decrease was more pronounced and longer for bank CEOs. The median compensation for bank CEOs in 2009 was less than half the median pay for CEOs in other industries, $1.4 million compared to $3.2 million. However, since 2009, pay opportunity for bank CEOs recovered and the pay gap has been significantly reduced. In 2012, the median pay for bank CEOs and other industry CEOs was $3.8 million and $4.6 million, respectively (See Chart 1).

POST TARP

Even though bank CEO pay opportunity has recovered post TARP, banks are still subject to regulations governing pay, resulting in pay plans distinctly different from their peers in other industries. Under the Dodd-Frank Act, regulators are empowered to ensure bank compensation does not promote unnecessary and excessive risks. In practice, however, this directly conflicts with the general industry trend of establishing a better link between pay and performance. Companies are increasingly using performance shares, which is equity that is contingent on meeting specific performance criteria. Shareholders and their advisors, Glass Lewis and ISS, have promoted the use of performance shares in pursuit of meeting pay for performance goals. "These formulaic awards require proper metric selection and calibration to ensure that incentives are adequately aligned with the long-term health and success of the firm," states Eric Marquardt, Partner at Pay Governance.

Given the previous backlash against the pay structures of bank executives, regulators have been skeptical of the use of performance shares as they fear this form of equity may promote excessive risk taking. Thus, senior leaders and boards find themselves in a sensitive position in which shareholders encourage their use while regulators disagree. "Anytime you have some sort of incentive metric, there is a potential for risk to be brought into the plan," says Eric Marquardt, "it all hinges on how your metrics and goals are selected."

In 2011, only 37.1% of banks used performance shares, compared to 48.9% of other industries. The prevalence of

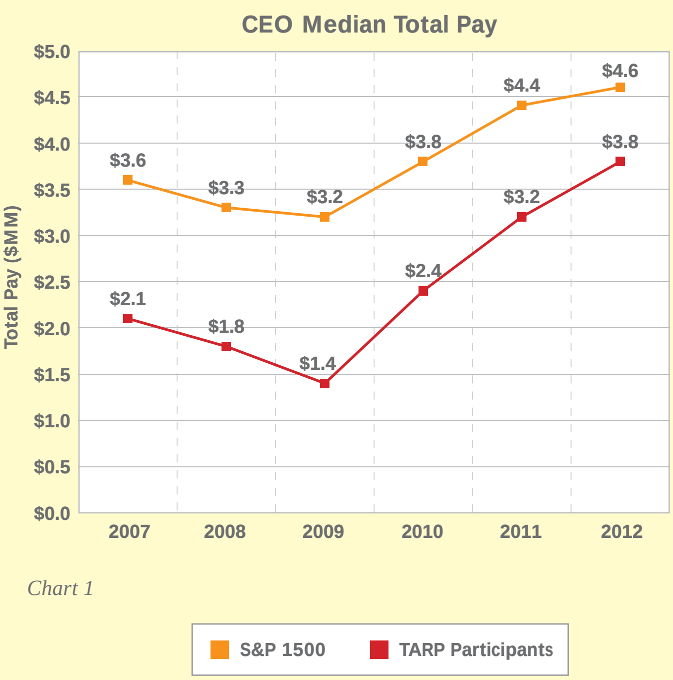


Chart 1

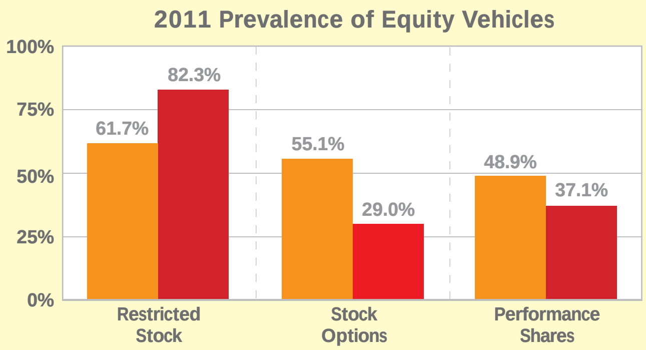


Chart 2

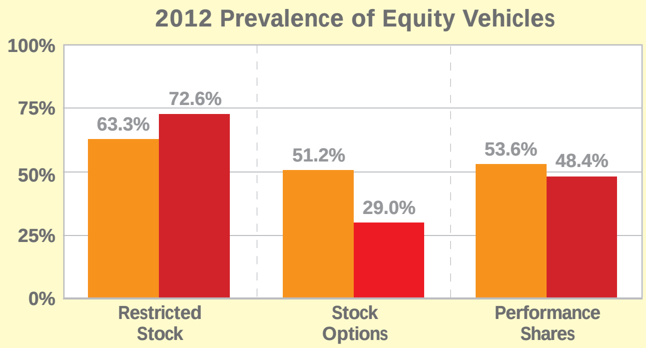


Chart 3

performance shares is on the rise for both banks and non-banks, increasing to 48.4% for banks and 53.6% for non-banks in 2012. Instead of prohibiting the use of performance shares, it is clear that regulators are allowing them but are scrutinizing how they are used to ensure they don't promote risky behavior. "Prior to the financial crisis a typical incentive plan would have 200% upside," says Susan O'Donnell, Partner at Meridian Compensation Partners. "Now, since the regulators don't like variability and they don't want a lot of upside, they have put pressure on the largest banks to cap their incentive plan upsides so you are seeing them typically max out at 125% to 150% of the target."

Stock option use has been on the decline for years and this is certainly true in the banking industry where only 29.0% of companies use them (See Charts 2 and 3). For non-bank companies the use of stock options decreased from 55.1% to 51.2% between 2011 and 2012. Shareholders and regulators both have issues with stock options, but for different reasons. Regulators are worried that stock options may add too much risk since they are leveraged, while shareholders would rather see performance-contingent vehicles. Some shareholders and their advisors, including ISS, do not consider time-vested stock options to be performance-based, even though the pay realized is contingent on stock price performance.

Options are less prevalent and when they are used, they make up a very small portion of total compensation. In 2012, options accounted for 7.7% of total pay granted to bank CEOs compared to 32.1% in 2007. Companies in other industries have also significantly decreased the portion of compensation delivered through options, but displayed a less dramatic decrease, down to 16.4% in 2012 from 26.2% in 2007 (See Charts 4 and 5).

In 2011, restricted stock was used in 82.3% of bank pay plans compared to 61.7% for companies in other industries. Although the use of restricted stock declined from 2011 to 2012 as banks became free of TARP restrictions, it is still the most prevalent equity vehicle, used in 72.6% of bank CEO plans and in 63.3% of non-bank CEO plans (see Chart 2). "There's time-vested restricted stock, which is essentially what TARP allowed. A lot of these banks are overloaded on that vehicle, which the regulators like, but shareholders don't because there's no performance," says Susan O'Donnell of Meridian Compensation Partners.

"In general, pre-recession executive pay programs in banking were not overly risky, most of the risk-inducing incentive programs were below executive levels," says Eric Marquardt of Pay Governance. "Executive pay programs, however, did not encourage the necessary oversight. Proper oversight of both management and rank-and-file pay are necessary to ensure that good governance practices are being followed throughout the organization."

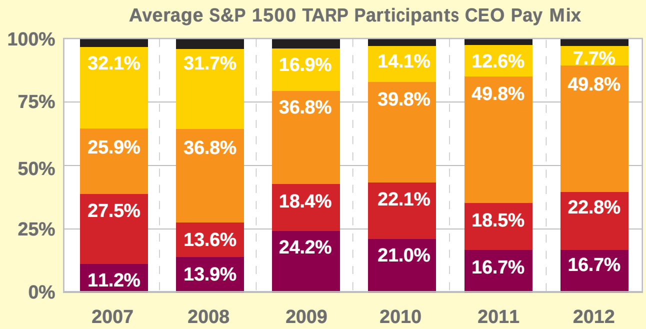
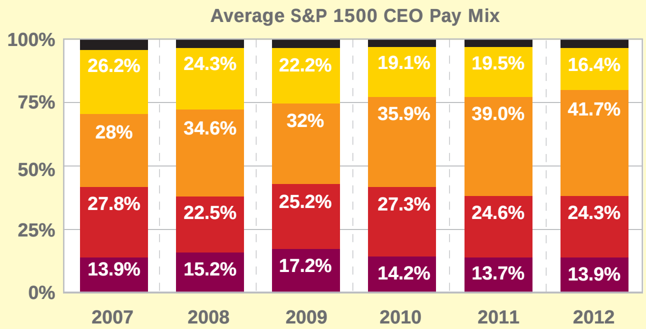


Chart 4



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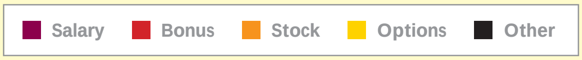

Regardless of whether executive compensation pay designs were too risky prior to the recession, it is clear that TARP had a significant impact on executive pay plan design. Now that most banks are out from under TARP, pay plan design for banks will continue to be different from other industries. While there is some regression toward the mean for bank CEO pay design, the ongoing regulatory oversight put in place by Dodd-Frank will influence executive compensation in the banking industry and present unique challenges resulting from the sometimes contradictory demands of regulators and shareholders. C

ASK THE EXPERTS

From your perspective, how has the notion of risk changed for C-Suite executives since the financial upheaval of 2008?

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

In the wake of the financial crisis, we have seen a growing trend toward greater transparency and more meaningful disclosure across a variety of industries and around the globe. While calls for tailored disclosure need to be carefully considered, I believe a move toward greater disclosure can help reduce risk in the C-Suite and the boardroom to the benefit of investors and company management.

Cynthia M. Fornelli has been honored five times by *Directorship* magazine as one of the 100 most influential people on corporate governance and in the boardroom, and *Accounting Today* named her one of the 100 most influential people in accounting for the seventh consecutive year.

She serves on the Financial Accounting Standards Board's Financial Accounting Standards Advisory Council and the Securities and Exchange Commission Historical Society's Board of Trustees, Class of 2014. She is a graduate of Purdue University and received her J.D. at The George Washington University.

CENTER FOR AUDIT QUALITY

Eric M. Pillmore
Senior Advisor
Center for Corporate Governance
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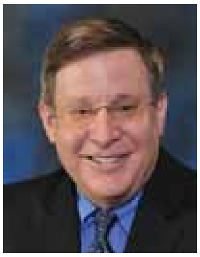

The 2008 financial upheaval highlighted the impact risk can have on a company's sustained health and vitality. Consequently, many C-level leaders re-examined their risk practices, particularly with respect to concerns from three key constituent groups:

- **Boards**—Recognizing an increased risk oversight role, directors want management teams to provide more appropriate levels of information that are needed to advise on, challenge, and oversee risk.
- **Regulators**—To provide shareholders with greater insight into a company's risk practices, regulators want more attention devoted to proxy disclosures on risk.
- **Management**—Managers are increasing the focus on the risks within their companies' cultures and monitoring employee behavior toward risk.

The C-Suite should consider more effective risk oversight practices as a means to strengthen both company and shareholder value, and not fear or view it as a burden.

Prior to joining Deloitte, **Eric M. Pillmore** served as the senior vice president of Corporate Governance for Tyco International Ltd. Through his governance, risk management and ethics work with Tyco and its board of directors, Mr. Pillmore helped transform Tyco into a leader in corporate governance.

Eric also previously served as chief financial officer to organizations within the technology, plastics and medical systems sectors. He also served as an officer in the U.S. Navy and as an auditor with the Naval Audit Service in Washington, D.C.

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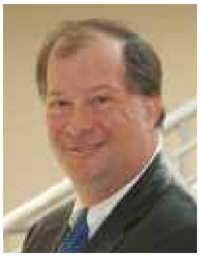


One of the biggest lessons learned from the 2008 financial crisis was that a company can face unanticipated financial catastrophe due to a lack of rigor around enterprise risk management. The companies that found themselves in dire straits during the crisis were those that had failed to manage their exposure to investment risk.

As a result, the oversight of enterprise risk management has been ratcheted up with much more serious attention at the board level. Enterprise risk management is about looking at your company's current exposures as well as its emerging risks (e.g., global warming, economic recession, political risk, changes in the regulatory climate) to determine how to mitigate or eliminate the risks and continue to profitably run the business. Adherence to enterprise risk management is critical to managing risk in the future, unless we want to watch history repeat itself.

Evan Rosenberg oversees CSI's worldwide specialty lines coverages and new product development. Evan joined Chubb in 1983 as an operations supervisor in White Plains, New York. In 1991, he joined Marsh & McLennan, Inc. as vice president and Finpro manager in San Francisco.

Evan rejoined Chubb in 1992 as an assistant vice president and assistant professional liability underwriting manager. He assumed his current responsibilities in 2004. He earned a B.S. degree in economics from Pennsylvania State University in 1980.

Erica Salmon-Byrne
Executive Vice President,
Compliance & Governance Solutions
NYSE Governance Services, Corpedia

The past five years have seen an increasing recognition on the part of C-level executives—CEOs, CFOs, GCs and Chief Compliance Officers—that at the end of the day most risk is people-created risk. After all, a corporation cannot act without employees acting on its behalf.

Some of the biggest issues companies face have at their root either an employee not understanding the behaviors expected of them, or an employee not being comfortable raising a concern or reporting misconduct. That's why we have seen a corresponding significant rise in the focus paid to the quality of an organization's ethics and compliance program.

Such programs teach employees how to recognize red flags that implicate the company's key risk areas, and encourage them to come forward with questions and concerns, all of which help the organization effectively mitigate risk.

Erica Salmon-Byrne works closely with Corpedia's varied clients in addressing their compliance needs, including evaluating compliance programs against the hallmarks laid out in the U.S. Federal Sentencing Guidelines and drafting training programs.

Prior to joining Corpedia, she practiced with DLA Piper in Washington, DC. She received a BA from George Washington University, an MA with Highest Distinction from Northeastern University, and a Juris Doctor *cum laude* from the Georgetown University Law Center.

Dennis Whalen
Partner in Charge & Executive Director
KPMG Audit Committee Institute (ACI)

In the aftermath of the financial crisis, risk was largely viewed through a defensive lens. While there continues to be a defensive focus, we're seeing more companies today thinking about risk through an offensive or strategic lens as well.

We believe that being good at risk management—clearly-defined risk appetite, using quality information and transparently communicating about the company's "big bets", compensation programs that offer the right incentives and driving the right culture—positions the company to better manage its business and deal with the inevitable uncertainty of business.

But it's easier said than done—particularly given the pace of technological change, globalization, regulation, and sheer complexity of business today. From the board's perspective, oversight of risk has to be a team sport, with risks allocated appropriately and clearly among its committees.

Dennis Whalen leads ACI's initiatives to provide audit committee and board members with practical insights, resources, and peer-exchange opportunities. With over 30 years of public accounting experience, Dennis has served several of KPMG's top clients, has led KPMG's audit practices in Houston and Kansas City.

From 1995 to 1997 Dennis was seconded to Hong Kong to help KPMG meet the needs of GE and Pepsi as they expanded their operations in the Asian marketplace. He joined KPMG in 1982 in Stamford, Connecticut and he was admitted to the Firm's partnership in 1995.

Cyber Security
Will Reshape Boards of the Future

BY TK KERSTETTER

When I discuss the issue of a board's duty of overseeing enterprise risk management for the company that it governs, I would be categorized as an "Oppto-Pessimist"…meaning I know that every task must be approached with the right attitude to be successful but I can't help but become a little depressed when I look at the magnitude of the task at hand.

There is no question that most companies have benefited from the advances and innovations in technology and digital communications, but at the same time those same advances have opened up a new world of cyber risk that is unfamiliar to most board members. It is my opinion that corporate directors, particularly those of large global corporations operating multiple companies in multiple countries, can't possibly understand all the risks associated with countries' cultures, regulations, economies, or even business operations themselves.

This means that corporate directors are reduced to doing the best job they can at setting a prudent cultural tone at the top, ensuring that management has a risk/reward strategy review process as part of its strategic planning exercise, confirming that procedures are in place to mitigate known and black swan risks, and finally, that a crisis plan and procedures are in place should something go awry, which it often does. The facts are that today these foundational best practices are not enough. The complexity of risk oversight coupled with the new risks associated with all that is digital has created a new risk paradigm.

My inability to get my arms around this new challenge was further magnified when I had the chance to discuss this topic with Jim Noble, an acquaintance I trust in this digital space due to his experience as the Chief IT Strategy Officer for both GM and BP, and more recently an advisor to the U.S. Department of Homeland Security. Our recent conversation was based around one simple question: "What IT or cyber risks are currently present that board members should be aware of?"

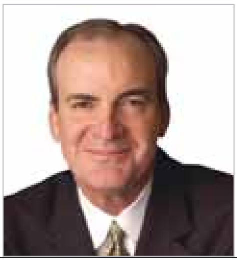
VIRTUALLY ENDLESS PORTS OF ENTRY

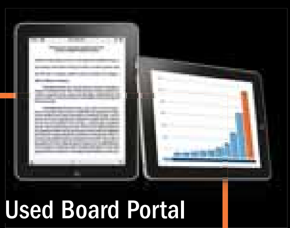
Unfortunately, I have limited space here, yet this discussion could fill this magazine. But the point that he made painfully clear throughout our discussion was with all the digital devices available to consumers and employees today, that the invisible ports of entry for IT theft or fraud are virtually endless. For example, I wasn't totally surprised when he told me he could track my location, listen to my conversations, and read my text messages, 24/7, all through my smartphone.

What I hadn't considered was that the multi-function copier/scanner/printer has an accessible hard drive, or that anytime I sync a device with my new car electronics the information is stored on the vehicle's hard drive and that IT hackers have been accessing previously leased executive automobiles to gather certain information and intelligence. I was also surprised to hear that a company has as much risk internally through its employees as it has from the infamous hacker community attacking from outside the corporation.

In the case of IT security…what you don't know can hurt you. And while we don't expect directors to be experts in cyber security, we will see an increased need for board members to understand what questions to ask management. Ultimately, this paradigm change will subtly change board recruitment criteria, the demographic makeup of boards, and how we go about preparing directors to be successful in their key responsibility of overseeing risk. It's still management that has the tough job of getting a handle on the benefits and risks of the digital age but as we have learned in the recent past, shareholders aren't afraid to hold the board responsible for what happens on its watch.

TK Kerstetter is the chairman of Corporate Board Member and is a second generation pioneer of governance thought leadership and board education.





INTERVIEW WITH PRIYA CHERIAN HUSKINS

Priya Cherian Huskins is a recognized expert in D&O liability risk and its mitigation. In addition to consulting on D&O insurance, she counsels clients on corporate governance matters, including ways to reduce their exposure to shareholder lawsuits and regulatory investigations. Priya is a frequent speaker nationally and internationally on D&O issues and a regular guest lecturer at Stanford's Annual Directors' College, among others. She has authored articles for publications as diverse as *Directors & Boards*, *Stanford Law Review*, and *Insurance Journal*.

Priya is on the board of directors of Realty Income Corporation, The Monthly Dividend Company®, (NYSE: O), where she serves on the Strategic Planning Committee and is chair of the Corporate Governance and Nominating Committee. She is also on the advisory board of the Stanford Rock Center for Corporate Governance as well as the board of directors of the Silicon Valley Directors' Exchange (SVDX).

Priya began her career as a corporate and securities attorney at Wilson Sonsini Goodrich & Rosati (WSGR), one of Silicon Valley's leading law firms.

A member of the California Bar, Priya earned her undergraduate degree with high honors from Harvard University. She was awarded her juris doctorate with honors from the Law School at the University of Chicago, where she was managing editor of the University's Legal Forum publication. Following law school, she was a law clerk to the Honorable Judge Frank Magill of the United States Court of Appeals for the Eighth Circuit.

WS &Co WOODRUFF SAWYER & COMPANY

"BUT WELL-MEANING ADVICE CAN SOMETIMES TREND TOWARD NOT JUST BEST PRACTICES, BUT IDEAL PRACTICES."

C-Suite Insight: Please tell our audience about your work and the key things they should know about insurance and liability for directors and officers (D&O).

Priya Huskins: My charge at Woodruff-Sawyer is to help directors and officers of public companies and fast-growing private companies mitigate their risk of unlimited personal liability. The pain point I'm addressing comes from the fact that business is risky, directors and officers can be sued even when they have done nothing wrong, and their liability is personal.

Directors and officers naturally do their best when they are secure in the knowledge that, provided they have acted in good faith, their companies will protect them. We place insurance for these directors and officers. In addition, we want to talk to directors and officers about the things that they can do to improve their risk profiles.

CSI: How have things changed over the last few years as we went through the Great Recession and the reforms related to it?

Priya: We see a picture of escalating litigation risk for individual directors and officers, and escalating exposure for the companies they serve. For example, while securities class action suits are down in absolute numbers, the percent of public companies that are sued each year remains stable. Suits related to mergers and acquisitions, or related to breaches of fiduciary duty, are up. We've seen an increase in regulatory enforcement-type activities as well. Overall, we see a landscape in which there is continuing, if not escalating, scrutiny and litigation against directors and officers.

CSI: You've been a member of the board of directors of a NYSE-listed company for several years. You chair that company's governance and nominating committee. How does this affect your viewpoint and the way you do your job?

Priya: I have long been an advisor in a public company environment, first as a corporate securities attorney at a major Silicon Valley law firm and now in my role at Woodruff-Sawyer. The impact of my own board service on my client has been, I think, that over time my advice has become that much more practical and that much more calibrated to what is possible in the public company environment. Public company directors and officers get a lot of advice, much of it good, from a lot of advisors. But well-meaning advice can sometimes trend toward not just best practices, but *ideal* practices.

CSI: It sounds like sometimes the advice can be more like pie in the sky, but your experience keeps you firmly in the real world.

Priya: Right.

CSI: How has Dodd-Frank, as implemented so far, influenced your work and advice?

Priya: One key area has to do with the office of the whistleblower, a new office at the Securities and Exchange Commission.

Dodd-Frank purports to encourage whistleblowers by paying them a bounty in certain circumstances. The problem is that the implementation seems to ignore all of the good work that corporate America has done since Sarbanes-Oxley in terms of setting up hotlines and other confidential ways for employees to blow the whistle if there's a problem.

CSI: Interesting...

Priya: Public companies, since Sarbanes-Oxley, have done a ton of work to create an environment where whistleblowers will feel comfortable bringing their concerns to management and the board of directors without fear of retaliation. To the extent that a company is honestly trying to listen to whistleblowers and make timely remediations, the office of the whistleblower is arguably a distraction. It may encourage people to ignore a company's good faith efforts to set up procedures and protocols that are designed to catch wrongdoers sooner than later.

CSI: This view seems to be part of the argument of Dodd-Frank as being a blunt instrument.

Priya: I am sure that all of the folks who contributed to Dodd-Frank sincerely believed that the legislation would benefit the United States economy, and some of it surely does. Unfortunately, when you have a few bad actors creating havoc in the economic system, the results can be implementation of a blunt instrument that is miscalibrated, especially if you examine all the good work that was done after Sarbanes-Oxley.

CSI: Meanwhile, the specter of cyber threats has emerged as a huge topic. You've published a paper on this topic and how it relates to a board's role. What are your main concerns about cyber threats to public companies, and how steep is this learning curve going to be for board members to learn what's going on concerning cyber threats?

Priya: Cyber threats are just one of the things that a board has to consider when it comes to enterprise risk management. Cyber threats, however, have acquired some urgency in the current environment as we see more and more situations in which very good companies have cyber problems ranging from third party attacks to the collapse of their electronic infrastructure, leading to potentially very serious consequences both for themselves and for their clients.

CSI: Do you break them down into different categories to help people understand the nature of what's going on and the dimensions of it?

Priya: My advice for boards when they're thinking about enterprise risk management and cyber threats in particular is to be disciplined about examining their specific risks. One problem, however, is that cyber risk as a topic can be intimidating, or at least off-putting, for boards to analyze this issue starting from a very technical point of view, a point of view that often has a very steep learning curve.

What I recommend is for boards to start with a framework that asks management questions in three categories: the risk assessment process, the inventory of vulnerable assets, and of course risk mediation and/or transfer—including insurance. In my experience this three-category framework can serve as a useful starting point for boards.

CSI: We are focusing on the topic of risk in this issue of *C-Suite Insight*. Based on your experience, what differences have you seen in the appetite for risk associated with companies in various stages of their development?

Priya: In a venture-capital, startup culture, maybe even right before going public, the culture is often highly risk tolerant if not outright risk-loving. This isn't surprising since companies at this stage so routinely face so many bet-the-company inflection points. Imposing a lot of formal risk management controls and procedures on companies at this stage makes no sense. There comes a moment, however, when a company has to start to make a transition. This moment is often when a company starts to prepare for an IPO.

Accessing the public markets generally means gaining a group of owners who are significantly less risk tolerant—and much more likely to sue when things go wrong—compared to venture capitalists and other private company, early stage investors. Because of this and numerous regulatory requirements, part of the IPO process inevitably includes a company's putting in place more processes and procedures that mitigate risk, including insurance as well as other risk transfer strategies.

"MY VIEW IS THE AMERICAN ECONOMY IS AT ITS BEST WHEN WE FOSTER AN ENVIRONMENT THAT REWARDS INNOVATION AND EXPERIMENTATION."

Additionally, right now and especially in Silicon Valley, we are seeing the interesting phenomenon of dual-class voting structures. The goal, at root, is for a company to be able to access capital and liquidity in the public markets while maintaining its ability to chart its own course, which often means continuing to function with a high level of risk tolerance. This is a grand experiment, and I mean that in the best way.

CSI: That topic heads us back to the notion of D&O insurance. Do you find that you might have people who may be unaware of what they are going to be exposed to when they become a public company, with dual-class voting or not, which may further encourage them to maintain a higher level of risk than others might?

Priya: This gets us back to asking what does D&O insurance and other risk mitigation for the personal liability of directors and officers really do? Why do we care? My view is the American economy is at its best when we foster an environment that rewards innovation and experimentation. Doing so requires recognizing that some experiments fail, and some innovations turn out not to be great ideas.

But if every time a company bets wrongly the directors and officers go bankrupt personally, you're not going to see a lot of robust experimentation and innovation—the very things that make an economy great.

This is where D&O insurance, when properly done, can do something really noble. By providing directors and officers with personal financial protection, this insurance gives these business leaders the security they need to be bold in their business dealings and, in doing so, encourage a culture of innovation and experimentation in their companies. C

INTERVIEW WITH JOSEPH M. YAFFE

As head of the Executive Compensation and Benefits Group on the West Coast, Joseph M. Yaffe handles tax and securities law matters arising in equity compensation arrangements and employee benefits issues in corporate transactions, such as mergers and acquisitions. His experience includes representing companies from the biotechnology, entertainment, Internet, medical supply, retail, and software industries. He also counsels senior executives at companies throughout the country in connection with executive compensation matters.

Mr. Yaffe advises on tax-qualified plan issues, including issues relating to 401(k) and 403(b) plans. In addition, he represents clients in negotiations with the Internal Revenue Service and Department of Labor regarding compliance issues under the Internal Revenue Code and ERISA.

He frequently lectures on tax, benefits, and compensation matters, including equity compensation issues for emerging growth companies and tax-qualified plan issues.

Mr. Yaffe is ranked by Chambers USA: America's Leading Lawyers for Business and The Legal 500: U.S. Guide as one of the country's leading benefits and compensation attorneys. In 2013, Chambers also recognized Skadden's Executive Compensation and Benefits Group with its Award for Excellence, given annually to a select group of firms on the basis of preeminence in key practice areas.

Before joining Skadden in September 2009, Mr. Yaffe was a partner at global law firm Latham & Watkins, where he served as chairman of the tax department for the firm's Silicon Valley office. He holds an A.B. from Columbia University and J.D. from University of California, Davis School of Law.

"SAY ON PAY HAS HAD A MAJOR IMPACT ON THE DECISION-MAKING PROCESS IN THE COMPENSATION COMMITTEE MEETING ROOM."

C-Suite Insight: How does your work relate to executive compensation, and how do you approach the topic of risk as you advise your clients?

Joe Yaffe: I practice exclusively in the area of executive compensation, and have since I started practicing as a lawyer. That practice involves working with both companies and individuals. My practice involves everything from executive employment agreements, change of control agreements, design and implementation of incentive plans, complicated questions under ERISA, and corporate governance as it relates to executive compensation issues. There's a heavy tax component on this, Section 162(m), Section 280G, certainly 409A, and so on.

We spend a lot of time working with companies to navigate around the changing landscape of executive compensation regulations, specifically dealing with disclosure issues and regulatory requirements under Sarbanes-Oxley and Dodd-Frank. In the context of that, risk finds its way into the discussion in different ways.

I think a simple, common way in which risk enters the discussion is when we work with companies that are designing pay programs, implementing pay programs, or executing on already established pay programs. We discuss whether the way in which pay is being delivered is incentivizing risky behavior.

CSI: How do you evaluate this?

Joe: The most relevant discussion is to consider incentive-based compensation programs that reward people for attaining targets or metrics, and helping companies understand and assess what the consequences or unintended consequences may be of creating those incentives.

For example, is a program encouraging people to engage in behavior primarily for the purpose of generating compensation income for themselves, which may have the unintended consequence of causing them to engage in risky behavior or create additional or unappreciated risk for the company?

CSI: We'd also like to discuss succession planning a bit. How does risk factor into getting the right people into the top positions?

Joe: The first step in considering what role risk analysis plays in the executive compensation world is, as I mentioned before, looking at whether the compensation programs are driving risky behavior. But there's a second level of analysis, which in some respects may be more subtle, but can be a lot more important. This involves assessing whether or not the management team and how it interacts with the board is giving rise, either in the short or long term, to increased risks for the company.

This is where succession planning becomes critical, because if you're looking holistically at what you're trying to do if you're on a board of directors or compensation committee, you're trying to retain, incentivize, and motivate the best possible leadership team for the company.

CSI: Do you mean how you structure executive compensation packages?

Joe: It means not only the day-to-day tasks of granting stock options and setting base salaries, but assessing whether or not you've got the right people in the right positions and what you would do in the circumstance in which one or more members of the team were to leave. How are you planning for the future in connection with their departures or changes in the management team going forward?

I think failure to appreciate the importance and nuances of succession planning gives rise to significantly greater risk at the company. Appreciating the nuances that go into a proper succession plan is an appropriate step to take if you're really looking, again, holistically at the risks to the company that you should be taking into account if you're on the board.

CSI: How does your experience with succession planning differ from company to company?

Joe: Succession planning and how you grapple with it necessarily varies from company to company, certainly. I would say not necessarily by geography or even by specific industry, but based on a company's historical trajectory and growth over the preceding years, as well as the status and environment within which a company finds itself today.

You can take two companies which may have identical financial metrics, even engaged in exactly the same industry, and yet may have a multitude of other internal factors that would cause you to look at succession planning very differently.

CSI: For example?

Joe: You could have a company with a founder CEO, where the issues associated with succession planning will be quite different from a company that, say, arose out of a private equity portfolio transaction that doesn't have a founder CEO or has a CEO with a completely different background than the first company.

But it's important to note that succession planning, if done properly, isn't focused on just an individual. It's focused on the interrelationships between that individual and the rest of the management team. You could have wildly disparate management structures in comparing two companies, in terms of experience and skill sets, and in how the companies are structured internally.

Is there a chief operating role, for example, as opposed to no chief operating role? Is the finance function treated as a more or less important part to the whole, and should it be treated as a more or less important part to the whole? So you need to take each situation as you find it, and understand the unique dynamics of the company for which you're looking at succession planning issues.

"SUCCESSION PLANNING TOUCHES ON ONE OF THE MOST SENSITIVE TOPICS IN THE BUSINESS WORLD."

CSI: What are some of the greatest risks within a succession planning process throughout an organization, and how are boards working to mitigate these risks?

Joe: Succession planning touches on one of the most sensitive topics in the business world. People don't like, and often find it difficult, to engage in a head-to-head discussion about individuals' futures at the company. The issue is even more acute when you're talking about the senior management team, because in the overwhelming majority of cases, the senior management team is comprised of people who are ambitious, who are successful, and who have earned their stripes, are intelligent, and have a lot of experience doing what they're doing.

The introduction of succession planning calls into question a person's destination within an organization. That's a binary question. It's either a satisfactory destination or it's not, in many cases, and the risk of getting or having to communicate an answer that is inconsistent with an executive's expectations is a discussion that people often shy away from.

CSI: Yet it seems critical for boards to address the topic. In fact, a recent report by PricewaterhouseCoopers states that more than 60% of directors say they want to spend more time on succession planning in the coming year. Do you see boards taking a more proactive approach to succession planning and how would they accomplish it? They already have much to cover during meetings.

Joe: I'm definitely seeing more board discussion with regard to succession planning. It's a topic that is being addressed much more frequently than it has been in the past. A related, but slightly different thing, is to then conclude that boards are actually more actively engaged in succession planning. It remains challenging for a board to start, implement, and complete a succession plan.

CSI: How have Sarbanes-Oxley and Dodd-Frank affected your work?

Joe: They've brought greater transparency to many things. Compensation-related disclosures are the most obvious. They've also brought more transparency to exactly what boards are doing, what their activities are, and what their functions and duties are.

CSI: Have they also driven board behavior?

Joe: They've driven behavior in a lot of different ways, among them thinking about succession planning in the context of risk and moving forward. Two of the most important board functions, for example, are deciding when and how to hire and fire a CEO and other senior executives, and deciding whether and how to sell the company.

CSI: How closely do Say on Pay votes affect your advice, your clients' executive compensation procedures and practices, and evaluation of risk?

Joe: Say on Pay has had a major impact on the decision-making process in the compensation committee meeting room. On the plus side of the column, Say on Pay has directly and beneficially led to greater engagement with shareholders, and probably a more sophisticated understanding of the issues that concern a particular company's shareholders. On the negative side, Say on Pay is a simple vote that purports to address what is usually a much more complex set of issues.

The consequence of that is companies need to understand that the duty of the compensation committee is to do what it thinks is right and appropriate for the company.

CSI: How do you mean?

Joe: It's the duty of the compensation committee to do what the members of the compensation committee think is right, and not drive toward an end result that is driven solely by a desire to garner favorable Say on Pay results. I mean this even if in the short term some people don't appreciate or understand or agree with the philosophy of the compensation committee, and may reflect that disagreement in a negative Say on Pay approval.

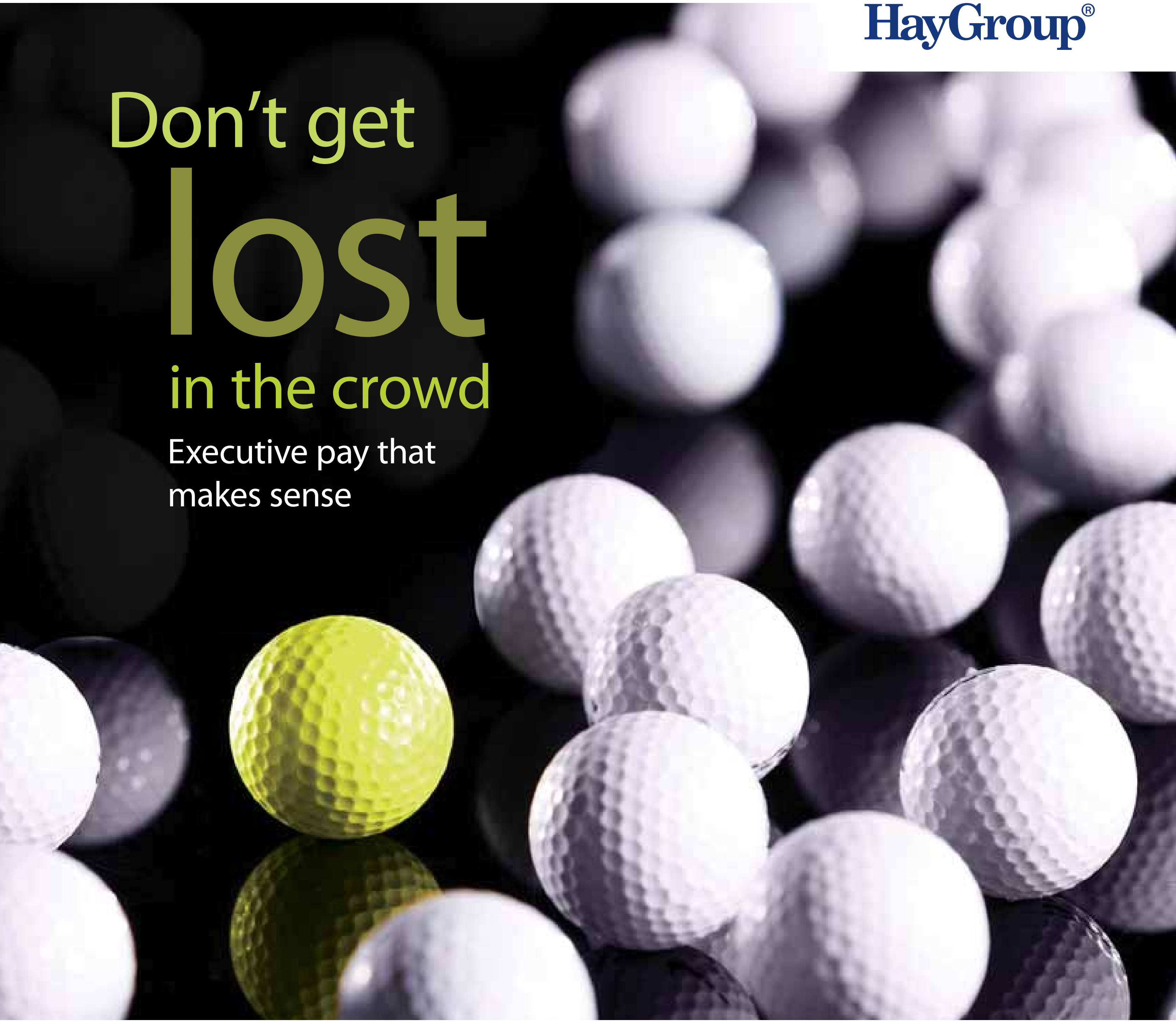
CSI: This seems to speak to good governance. So what underlying principles of good governance do you stress?

Joe: First and foremost, it's critical for members of compensation committees, and others involved in the compensation design process, to do their best to adhere to a compensation philosophy that they personally and individually find to be rational in light of the dynamics of the company that they're engaged with.

Second, and this is sometimes more challenging in a busy world, is to develop an appreciation for the fact that we live in a highly-regulated environment with significant transparency, with a lot of media attention and shareholder interest in the decisions that you're going to be making. This requires a heightened degree of technical understanding of the compensation, design, and setting process that I don't think existed ten years ago.

There's a duty, as a result, for members of the board and members of the committee to have an appreciation for things like the basics of tax deductibility under Section 162(m), how the Say on Pay voting rules work, what the disclosure obligations are in connection with compensation decisions and whether, and to what extent, they can rely on outside experts to guide them through the technical and regulatory morass.

At the end of the day, those issues have become so profound that they need to be appreciated as part of executing on your underlying philosophy. C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INTERVIEW WITH MICHAEL POWERS AND JIM WOLF

Michael Powers is a Managing Partner for Meridian Compensation Partners. He was formerly Hewitt's global practice leader for executive compensation and corporate governance consulting prior to the spin-off of Meridian. Michael has over 25 years' experience consulting on executive compensation design issues, including substantial experience at the board of director level. Michael has testified to Congress, the SEC, and the FASB on executive pay issues.

Michael is a frequent lecturer at national conferences and author of many articles, including in *The WorldatWork Journal*, *Journal of Compensation and Benefits*, and *Directors & Boards* magazine. Michael was recently named to the NACD Directorship 100 list, which honors top corporate directors and governance leaders who exert a significant influence on boardroom practices and performance.

Michael is an attorney and was a licensed certified public accountant. Michael has a JD and master's degree from the University of Illinois at Champaign, and is located at the company's headquarters in Lake Forest, Illinois.

Jim Wolf is a Managing Partner for Meridian Compensation Partners and has over 20 years' experience providing consulting services to a wide variety of organizations in the areas of executive compensation, governance, and performance-based pay. Jim was formerly Hewitt's North America practice leader for executive compensation and corporate governance consulting. Jim serves as a lead advisor to board compensation committees and senior management.

Jim speaks frequently on compensation practices and governance strategies, including energy industry compensation and the alignment of compensation with performance in commodity-based businesses. He has participated or written in governance forums hosted by the National Association of Corporate Directors, Corporate Board Member and Equilar.

Jim has an M.B.A. from The Wharton School of Business at the University of Pennsylvania and a B.S. Economics and German from Williams College.

MERIDIAN
COMPENSATION PARTNERS, LLC

C-Suite Insight: Do you think the notion of risk has changed since the Great Recession of a few years ago, and if so, how?

Michael Powers: The overall notion of risk has not changed dramatically, but the interest in risk assessment at the board level has increased substantially. Most of our clients are becoming more sophisticated about both their assessment and management of risk and the topic is usually on each board meeting agenda in some form or fashion.

We've also seen risk assessment move beyond the audit committee with regard to financial risks to the compensation committee with respect to executive pay program designs.

Jim Wolf: To add to that, it's not that the Great Recession introduced a new notion of risk, but it did put a new perspective on whether compensation programs are motivating the right behaviors.

CSI: It seems like the challenge of defining "risk" varies from industry to industry. So, for example, the oil and gas industry has inherently high risk in exploration and R&D.

Jim: Yes, that's an excellent example, and also provides a great comparison to the banking industry where most of these concerns about risk management were originally focused.

In the oil and gas industry, it was not banking issues that caused the increased focus on risk, it was the Deepwater Horizon incident. This was a great reminder of the different levels of risk associated with being in oil and gas, including environmental, safety, and business risk. The business risk here developed not just due to the event itself, but from the moratorium on all drilling in the Gulf of Mexico for well over a year.

Michael: Also consider the contrasting risks faced by consumer product and energy companies. While consumer product companies must be much more nimble in terms of consumer expectations and changing buying patterns, companies in the energy business sometimes make very long-term bets, with risks that are commensurate with those investments.

CSI: But there are some notions of risk shared by everyone.

Michael: Absolutely. One example that's emerging is cyber-risk. Most of our clients are hearing about and trying to understand the dimensions of cyber-risk. It's a high priority item on many directors' agendas. This is a topic that may be new to the organization and relatively new to the world.

Some of the best speakers and advisors in this area have governmental or security backgrounds. They often are several years ahead of the curve on this issue compared to corporate America.

CSI: Is their expertise primarily in IT?

Michael: They're concerned about investment and traditional IT risks, but are also concerned with people who could, through sophisticated cyber-crime, really wreak havoc on a company, especially those that are heavily dependent on the use of the Internet.

Jim: I can echo that by saying that cyber-risk now takes a place alongside other major aspects of business risk, such as safety or environmental risks that a company needs to manage. And it doesn't just involve a company's website. Management must examine how the company communicates, where and how it stores information critical to the business, the confidentiality of that information, and the governance processes that are exposed as a result.

CSI: How do you factor risk into your advice regarding executive compensation?

Jim: A lot of it is about balance—a balance of the metrics you're using to evaluate performance. Rather than focusing on any one single metric, are you really looking at the balance of factors of your company's performance?

Secondly, there's the time element. You need to strike a good balance between short-term and long-term incentive compensation. On the one hand, you may be thinking, we've got to grow our sales by x percent this year, or our margins have to increase by this many basis points this year or quarter. On the other hand, you need an ongoing, sustainable, consistent, long-term incentive program to balance out those cycles and to offset what might be any motivations to take on risk for the sake of short-term bonuses. You need some underlying long-term hook to be sure that people have that long-term perspective in mind.

"A LOT OF IT IS ABOUT BALANCE—A BALANCE OF THE METRICS YOU'RE USING TO EVALUATE PERFORMANCE."

Michael: I'd add a few other items. First, in cyclical businesses, we're often asked to evaluate the performance metrics that make sense over the long term. Often that's with a focus on relative performance in a more direct way than in some other industries.

So if there's a cycle that's impacting all of the major players in a particular industry, how has management performed vis-à-vis those direct peers? Boards are much more comfortable paying strong performance incentives in the cases where you're able to demonstrate it's not just the macro-factors that are impacting your returns, margins, and results for shareholders, but also how you've done against comparable peers in your industry sector.

We're also often asked to weigh in or help boards make informed business judgments around the degree of stretch in bonus plans. We're able to bring discipline to bear on what has historically been achievable, what is the company's business plan, what are the shareholder or analyst expectations, and then, also, what is the performance of comparable peers.

Second, as Jim alluded to, we're often asked by boards to do a comprehensive risk assessment of the pay programs. Here we look for red flags in terms of things that would increase risk significantly beyond reasonable shareholder expectations, but also factors that mitigate that risk.

CSI: What sort of mitigating factors?

Michael: These include having reasonable caps on incentive plans, having long-term ownership guidelines as a requirement for executives, having a clawback feature in case there's a financial restatement, and having a pay program that is designed in a pragmatic way.

CSI: What have the provisions of Dodd-Frank, as implemented so far, done to mitigate risk in your opinion?

Michael: In the financial services sector, we've seen a lot of activity and response to Dodd-Frank and related regulation. This sector is really in its own league on this issue. As we look more broadly at corporate America, we would say Dodd-Frank has clearly had an impact in terms of focus of attention on both senior management and directors.

One illustration is the mandatory Say on Pay that came out of it, giving shareholders the right to vote on executive pay packages. Even with the very high pass rates we have seen, Say on Pay does force companies to be more forthcoming in their disclosures, including pay risks and pay program philosophies and designs.

CSI: And this is a good thing?

Michael: Yes, I think there's been a positive outcome in terms of having more transparency today than there was over the last five to ten years.

Jim: I'd say that outside of financial services, our sense is that the large majority of companies were already doing a good job of managing these elements. In this context, you could view Dodd-Frank as a necessary response to some very isolated instances of poor risk management.

So I don't think Dodd-Frank has necessarily resulted in a dramatic change in how companies manage risk, because most of them were doing a good job already. The implications of Say on Pay haven't resulted so much in a change in risk profile, as they have in aspects like transparency and objectivity, and how companies tell their stories in their public proxy statements. It has certainly had a pretty significant impact on those kinds of things in compensation and governance.

"ONE OF THE KEY FUNDAMENTALS OF VIRTUALLY ANY PROXY IS PAY FOR PERFORMANCE, BUT ALSO PAYING COMPETITIVELY."

CSI: Has it also caused companies to avoid being outliers, with the result of a certain homogenization of pay?

Jim: Yes, there's absolutely less willingness to be an outlier. It's hard to say whether that's a matter of risk and the perception or reputation that comes with that or whether it's strictly a Say on Pay management tactic. Boards and management don't want to have a bottom-quartile shareholder vote outcome.

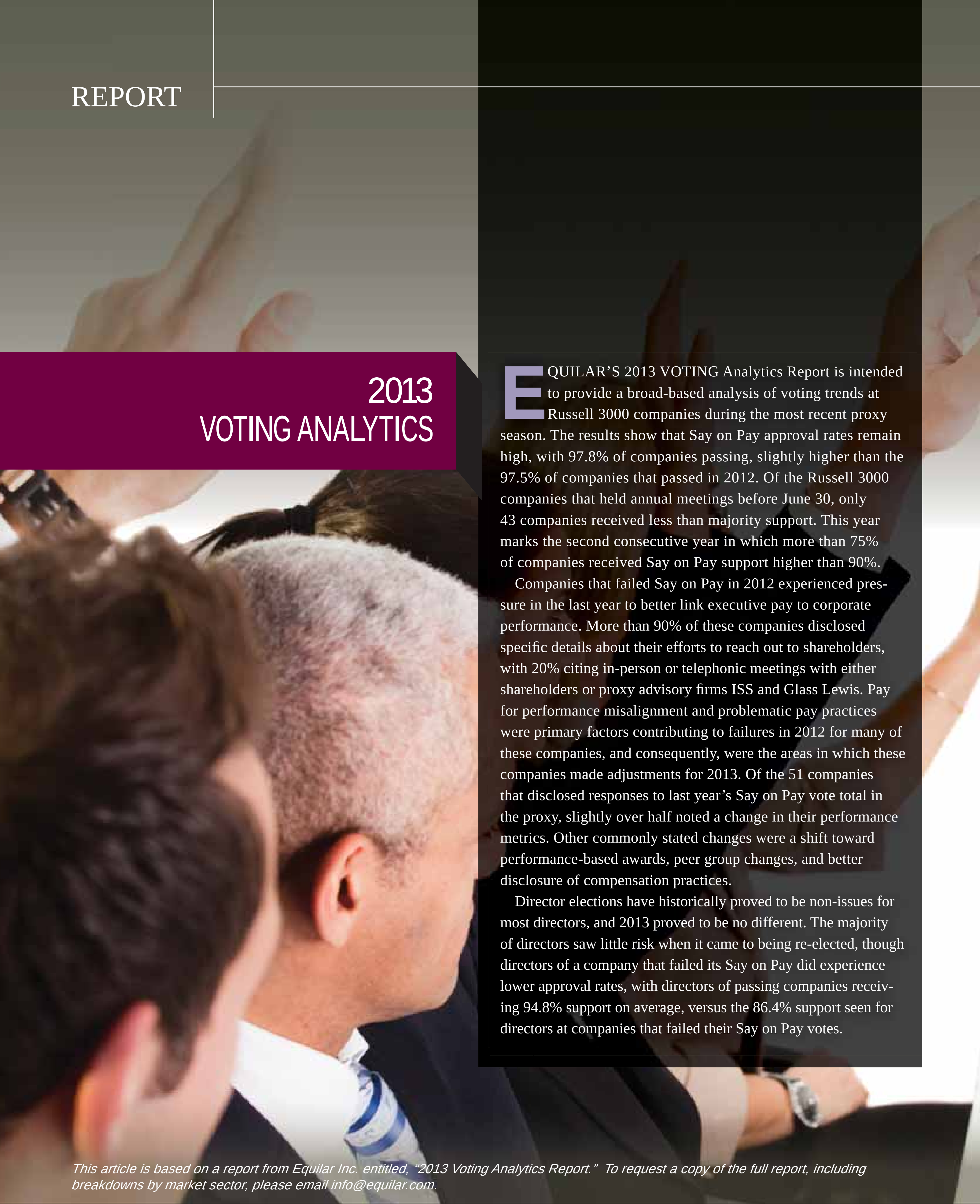
Michael: We do see certain segments that would be willing to take on the risk of having a unique pay structure or program designs, such as start-up companies. However, as you move to large-cap public companies, you clearly see homogenization of program design and governance practices.

One of the key fundamentals of virtually any proxy is pay for performance, but also paying competitively. That second dynamic really means a company must have executive compensation programs that are both easy to explain and consistent with what critical executive talent may command at direct competitors. In fact, the pressure to make competitive equity grants is fairly acute right now.

CSI: Let's zoom out a little bit and look at underlying governance principles. What principles do you stress in advising your clients about undertaking risk? What are the big issues? What are the fundamentals?

Jim: Both Michael and I would say that we ground our approach by helping companies make informed business decisions. Do you have all the information you need to make a good decision, to take an informed risk, and do you have a good process around monitoring that risk, monitoring its outcomes, and having a plan for acting on whatever outcomes may arise from the risks taken? All of these come into play when evaluating how both the company and board have performed. There are aspects of good governance of any board of directors, so process and information are the best tools to manage risk, from our perspective.

Michael: And process does matter. We're not talking about a check-the-box kind of thing here—if there's an important decision on a pay program or design and one that may be viewed externally in a more controversial light, we want to make sure that the board reviews the proposal at multiple meetings, is fully informed about the cost of the program, how it is designed to mitigate risk, and how to report back to the full board on the progress of strategic initiatives and the resulting pay outcomes. C



2013 VOTING ANALYTICS

EQUILAR'S 2013 VOTING Analytics Report is intended to provide a broad-based analysis of voting trends at Russell 3000 companies during the most recent proxy season. The results show that Say on Pay approval rates remain high, with 97.8% of companies passing, slightly higher than the 97.5% of companies that passed in 2012. Of the Russell 3000 companies that held annual meetings before June 30, only 43 companies received less than majority support. This year marks the second consecutive year in which more than 75% of companies received Say on Pay support higher than 90%.

Companies that failed Say on Pay in 2012 experienced pressure in the last year to better link executive pay to corporate performance. More than 90% of these companies disclosed specific details about their efforts to reach out to shareholders, with 20% citing in-person or telephonic meetings with either shareholders or proxy advisory firms ISS and Glass Lewis. Pay for performance misalignment and problematic pay practices were primary factors contributing to failures in 2012 for many of these companies, and consequently, were the areas in which these companies made adjustments for 2013. Of the 51 companies that disclosed responses to last year's Say on Pay vote total in the proxy, slightly over half noted a change in their performance metrics. Other commonly stated changes were a shift toward performance-based awards, peer group changes, and better disclosure of compensation practices.

Director elections have historically proved to be non-issues for most directors, and 2013 proved to be no different. The majority of directors saw little risk when it came to being re-elected, though directors of a company that failed its Say on Pay did experience lower approval rates, with directors of passing companies receiving 94.8% support on average, versus the 86.4% support seen for directors at companies that failed their Say on Pay votes.

This article is based on a report from Equilar Inc. entitled, "2013 Voting Analytics Report." To request a copy of the full report, including breakdowns by market sector, please email info@equilar.com.

SAY ON PAY VOTING RESULTS

The third year of Say on Pay proved to be a non-issue for most companies in the Russell 3000 Index. Shareholders from 98% of companies approved their companies' compensation programs and positive votes were marginally higher than in the two previous years. With strong shareholder support, 77% of companies received greater than 90% support, which is an increase from both 2012 and 2011 levels. These higher levels may be evidence that companies have become familiarized with the process and have adjusted as necessary. However, the improved economy may have also improved this year's results as many companies experienced stronger financial performance in 2012.

Despite the overall success for most companies, 43 companies failed their 2013 Say on Pay votes, slightly less than the 2.5% failure rate in 2012. The relatively low vote failure rate over the first three years has increased the negative attention received by each of the 43 companies that failed. As a result, companies have continued to take the Say on Pay vote seriously, in order to avoid having the company portrayed negatively, and to stifle any doubts about the board's ability to properly align management interests with that of shareholders. The 43 companies that failed in 2013 can be expected to more actively engage shareholders and reevaluate compensation programs in advance of 2014 votes.

Voting Analytics

KEY FINDINGS

- **Say on Pay pass rates remained high in 2013.** Of those Russell 3000 companies that have held their 2013 annual meetings, approximately 98% passed their Say on Pay votes. This year 77% of companies achieved greater than 90% Say on Pay approval, which represented an increase from levels seen in 2012.
- **A change in performance metrics was the most common adjustment following a 2012 Say on Pay failure.** More than 50% of the companies that disclosed changes following a failure in 2012 made changes to performance metrics.
- **Annual frequency remains the standard for most Say When on Pay votes.** Of the 108 Russell 3000 companies that voted on the frequency of Say on Pay votes in 2013, 73% of companies chose an annual vote.
- **Board declassification and majority voting proposals received the most majority votes in 2013.** Proposals calling for annual elections of directors and the adoption of majority voting standards for director elections received the most passing votes, with 24 and 15 proposals receiving majority support, respectively.
- **Majority voting for director elections continues to spread.** 68% of majority voting proposals voted on in 2013 received shareholder approval, and today more than 80% of the S&P 500 has adopted the majority voting standard.

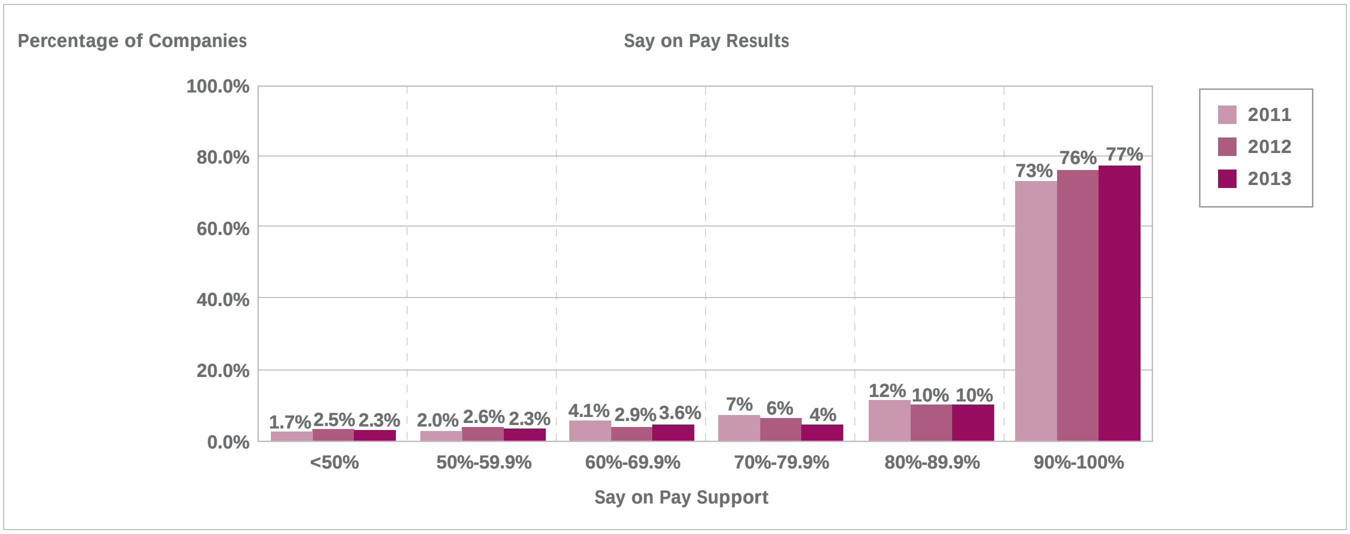


Chart 1

COMPANY RESPONSES TO SAY ON PAY

Unlike Switzerland, which approved a binding advisory vote on compensation in March, and the UK, which is anticipated to do the same this fall, Say on Pay in the U.S. remains a non-binding vote that does not require companies to adjust pay programs in response to a failed vote. This does not mean companies have taken Say on Pay voting results lightly. In the three years Say on Pay has been in effect, companies have made sweeping reforms to their pay programs in response to shareholder dissatisfaction. In 2012, 58 companies failed their Say on Pay votes, 51 of which have since filed their 2013 definitive proxies. The majority of companies address their prior years' failed votes within their Compensation Discussion & Analysis sections and in many cases, have gone into great detail about the steps they have taken since their votes to improve any ill-perceived compensation practices.

CHANGES IN PAY PRACTICES

Pay for performance misalignment and problematic pay practices were frequent themes that led to a Say on Pay failure in 2012 and were consequently the major areas of adjustment for companies that revamped their compensation practices for 2013. Of the 51 companies that discussed last year's Say on Pay vote in the proxy, slightly more than half noted a change in their performance metrics, the most common adjustment for 2013. Total Shareholder Return was the most-introduced new metric for these companies attempting to re-align pay with shareholder interests. However, not all metric changes were pay for performance related. Eight companies also cited overlapping metrics between short and long-term awards as a reason for new metrics, since that overlap is viewed as a poor practice by proxy advisory firms.

A general shift toward performance-based awards, peer group changes, and better disclosure of compensation practices were the next most commonly cited changes, with each addressed in more than 35% of the responses. In regard to corporate governance, changes to stock ownership guidelines, additions of claw-backs, double-triggers, and anti-hedging and pledging policies each appeared in more than 20% of the analyzed companies' disclosures, showing a uniform push to implement what have become standard governance practices. The following graph displays the top 11 compensation-related changes made by companies following a failed 2012 Say on Pay vote.

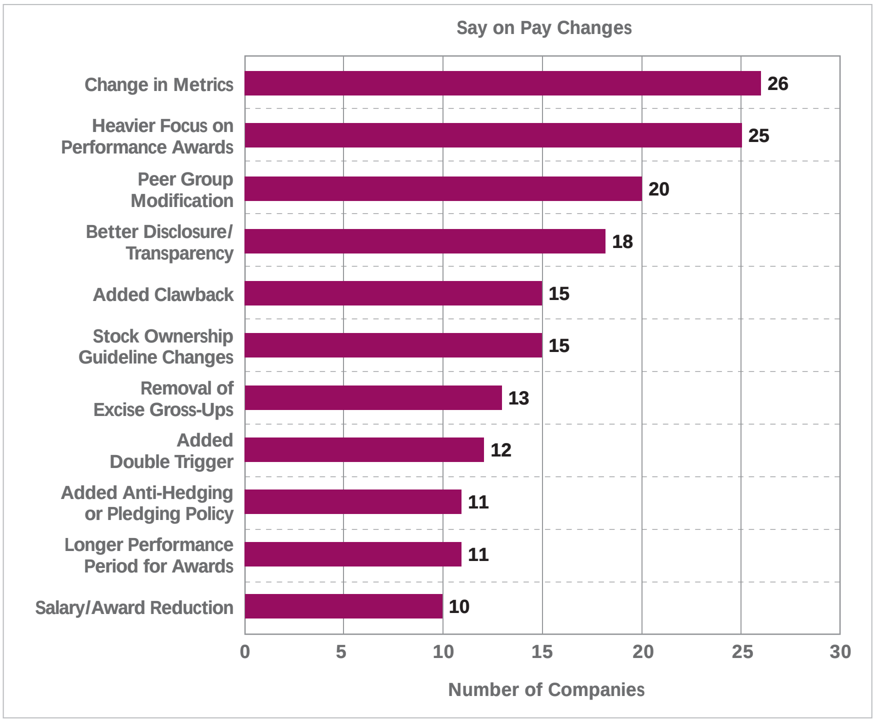


Chart 2

CHANGES IN PERFORMANCE METRICS, A GENERAL SHIFT TOWARD PERFORMANCE-BASED AWARDS, PEER GROUP CHANGES, AND BETTER DISCLOSURE OF COMPENSATION PRACTICES WERE THE MOST COMMONLY CITED CHANGES.

SAY WHEN ON PAY

The Dodd-Frank Act signed into law in 2010 presented companies a host of issues to think about moving forward. Among the first items companies had to consider was how often the new Say on Pay vote should be held. The new rules allowed shareholders to voice their opinions on the frequency of the vote through what became known as the Say When on Pay vote, which must be held at least every six years. There has been overwhelming support for the annual vote on compensation, particularly at the largest public companies. While nearly 81% of Russell 3000 companies have an annual advisory vote on compensation, 94% of the S&P 500 holds the Say on Pay vote annually. Triennial votes are used at nearly 19% of Russell 3000 companies, while slightly less than 6% of S&P 500 companies hold the vote every three years. Biennial votes are not used often in either index. In fact, less than 1% of companies currently hold their votes every other year.

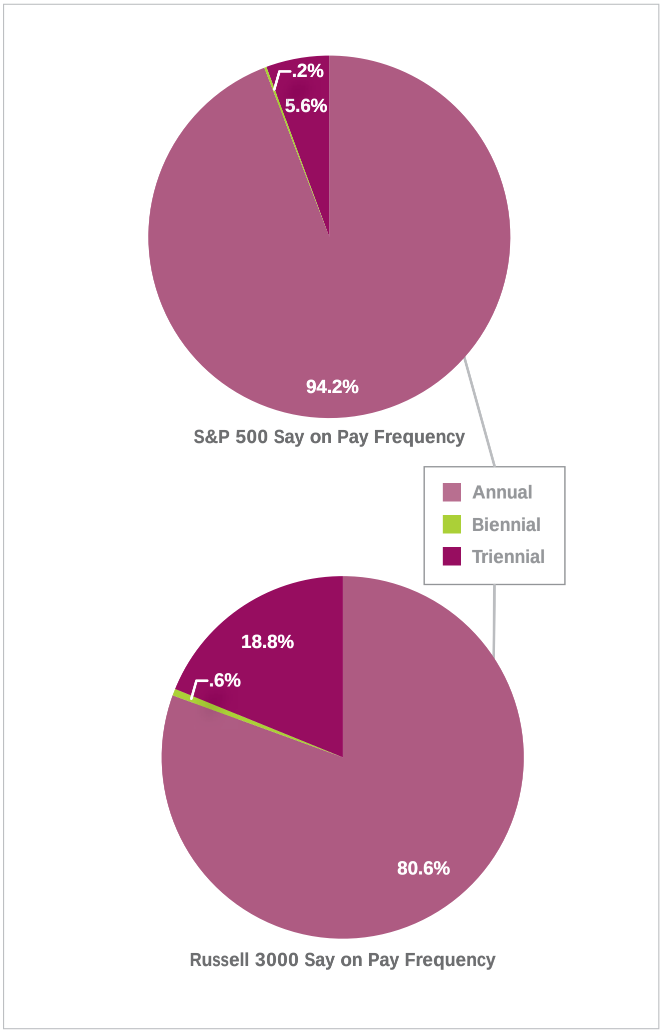


Chart 3

SHAREHOLDER PROPOSAL VOTING RESULTS

In terms of success in driving the change sought at companies, shareholder proposals are rarely approved. It was a similar story in 2013. The 465 shareholder proposals voted on at annual meetings prior to June 30 averaged only 33.1% of the votes cast and experienced considerable variation in levels of support based on the topic. However, certain proposals did experience higher support among shareholders than others. These included proposals related to requiring an independent chairman, adopting a majority voting standard in director elections, board declassification, and elimination of supermajority voting requirements.

Shareholder Proposal	Total Submitted	Number Receiving Majority Votes	Average Support
Independent Chairman	55	4	31.8%
Majority Voting	28	15	57.4%
Board Declassification	27	24	77.9%
Supermajority Voting	16	12	70.8%

Table 1

ELECTION OF DIRECTORS

Director elections without a proxy battle have not been an issue historically for most corporate boards. Nominated directors failing to receive approval from shareholders are rare occurrences and the 2013 proxy season was proof of this again. Out of 14,466 directors up for election, 99.7% were approved by shareholders. The 14,429 directors who passed had an average of 95% of votes cast in favor.

Only 37 directors were not elected and seven of those had above 50% approval rates. Interestingly, directors of companies that failed their Say on Pay votes in 2012 saw a drop in their average board election approval rate to 84%, and those that served on the compensation committee of companies that failed the Say on Pay vote had only a 76% election approval rate.

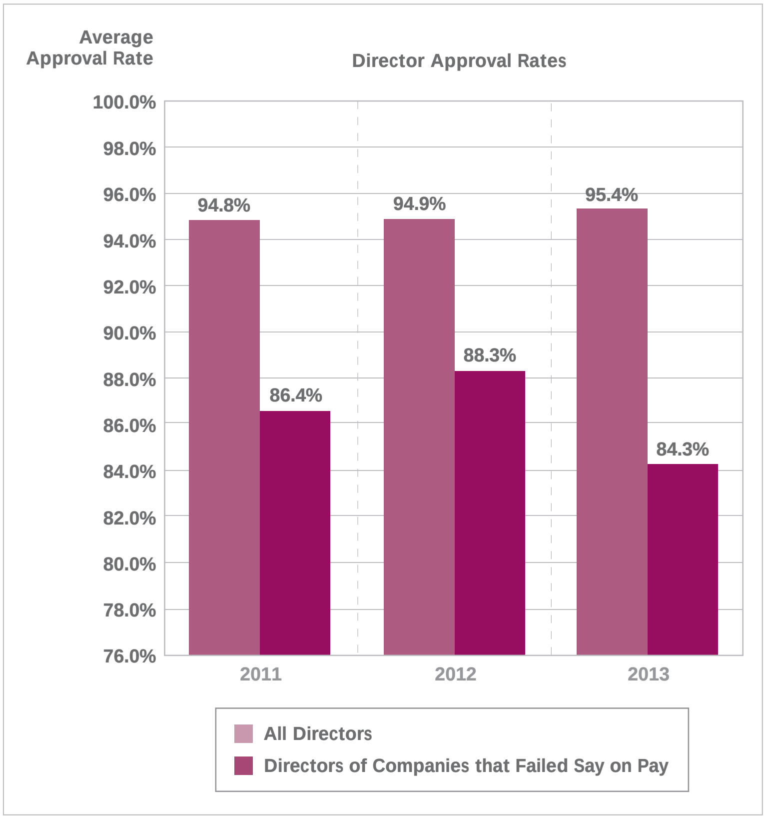


Chart 4

For more information, please contact Aaron Boyd at aboyd@equilar.com. Aaron Boyd is the Director of Governance Research at Equilar. The contributing authors of this report are Hardeep Dhillon, Senior Research Analyst, and Greg Leyrer and Silas Kwong, Research Analysts.

S&P 1500 BOARD PROFILE

BOARD FEES

EXECUTIVE SUMMARY

FOR MANY EXECUTIVES, serving on a board of directors is viewed as the pinnacle of one's career. Individuals invited to join boards, particularly for public companies, have made their marks in the corporate world and are often recognized as industry luminaries and thought leaders. Given the responsibilities and fiduciary duties of board members today, companies make significant investments in recruiting and securing top talent to serve on their boards. It follows that directors should be compensated accordingly for their expertise, time, as well as the risks, both personal and financial, that they assume by accepting a board position.

However, boards of directors have a unique position in the corporate world, as they have the unusual responsibility of setting their own compensation. Attention to this aspect of board governance intensified during the 2008 financial crisis that crippled economies across the globe. Since directors uphold the responsibility of overseeing company management to ensure strategies are in place to create shareholder value, director pay has become a topic of increased scrutiny. This has led to heightened interest in the process by which boards set their own pay levels, and how board pay and composition practices align director behavior with the best interest of shareholders.

To provide a comprehensive board profile, we researched companies within the S&P 1500 to produce a three-part report series covering board retainers, committee fees, and board composition. For the first report of the series, we partnered with the Society of Corporate Secretaries and Governance Professionals and Meridian Compensation Partners LLC to provide this detailed overview of board retainers and board meeting fees. To complement the in-depth data review, the Society and Meridian provide additional analysis and practitioners' perspective in several key areas.

Report Partners:

SOCIETY of Corporate Secretaries & Governance Professionals

MERIDIAN COMPENSATION PARTNERS LLC

This article is based on a report from Equilar Inc. entitled, "S&P 1500 Board Profile: Board Fees". To request a copy of the full report, including breakdowns by market sector, please email info@equilar.com.

Board Fees

KEY FINDINGS

- **Upward trend in director retainers continues.** Across the S&P 1500, the median director retainer increased 29.4% between 2008 and 2012, from $130,000 to $168,270.

- **A shift toward equity**. Over the past five years, the median equity component of director retainers has increased. In 2008, the median equity component was $90,000. From 2010 to 2012, the median equity component increased from $100,000 to $107,415, now 60.8% of retainers.

- **Premium pay for lead directors increasing in prevalence and in value.** More boards are paying a premium to lead directors, 44.9% today compared to 29.9% five years ago. The median premium value has increased 12.7%, from $17,750 in 2008 to $20,000 today.

- **S&P 500 median retainer nearly double that of small-cap issuers.** S&P 500 companies pay the largest director retainers with a median of $220,000. Mid-cap companies follow with a median director retainer of $160,000, and small-cap issuers' median director retainer was $119,280.

- **Significant gap in industry medians.** The Healthcare and Basic Materials industries have the highest median director retainers, with $235,000 and $200,000, respectively. The Utilities and Financial industries have the lowest median director retainers, with $150,000 and $127,750, respectively.

- **Board meeting fees fall in prevalence but increase in value.** The percentage of companies paying board meeting fees has steadily decreased from 58.8% in 2008 to 38.7% today. Of the companies that continue to pay meeting fees, they range from $500 to $60,000 per meeting with a median fee of $1,750, up from $1,500 over the last five years.

Methodology

For these analyses, Equilar analyzed data from S&P 1500 companies with fiscal years ended after May 1, 2012 and proxies filed as of June 1, 2013. Data for 1,046 companies are included in this study.

Equilar employs the Black-Scholes formula, a stock-option pricing model, commonly used to estimate the grant date fair value of new-employee stock-option awards. Key assumptions used in this formula include the option-term length, dividend yield, risk-free rate, and stock-price volatility.

BOARD RETAINER ANALYSIS

Upward trend in director retainers continues

Across the S&P 1500, the median director retainer increased 29.4% between 2008 and 2012, from $130,000 to $168,270. Since 2010, median director retainers increased 14.3% from $147,169. This upward trend may be influenced by the general increase in responsibility of the board of directors in the wake of the 2008 financial crisis. Legislation such as Sarbanes-Oxley, and most recently, Dodd-Frank, has not only increased the time commitment of directors, but arguably the exposure and reputational risk of serving on a board, especially a board of a company in crisis. Thus, it follows that the increase in pay should be commensurate with an increase in responsibility, time commitment, and risk.

Within the S&P 1500, 32% of boards now pay retainers of $200,000 or more compared to 19.7% just five years ago. Two companies in the S&P 500, as well as one mid-cap company, have the highest retainers, paying directors $769,815, $593,920, and $522,672. Conversely, the percentage of companies with director retainers less than $75,000 has decreased from 20.3% in 2008 to 8.4% today.

Retainer pay components increase in value, options stay relatively flat

Since 2008, the median cash component experienced the largest increase of 50% from $40,000 to $60,000 today. The median stock component increased 38.3% from $63,170 to $87,338. The median value of units increased from $80,410 to $103,567. Options are the only component not continuing the upward trend. From 2008 to 2010, the median options value increased from $62,843 to $74,180. However, from 2010 to 2012, the median options value decreased to $64,887.

WITHIN THE S&P 1500, 32% OF BOARDS NOW PAY RETAINERS OF $200,000 OR MORE COMPARED TO 19.7% JUST FIVE YEARS AGO.

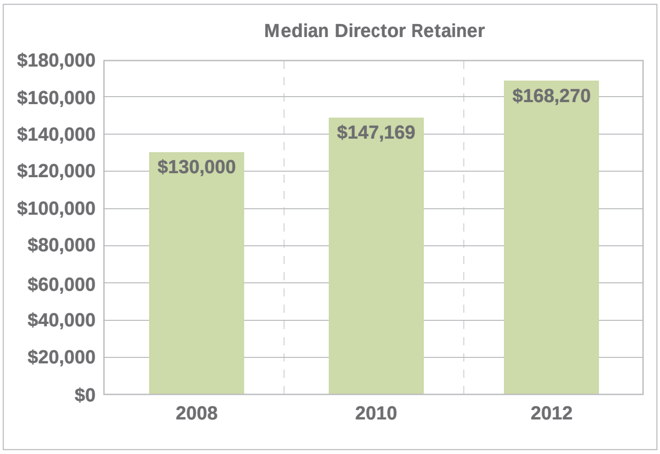


Chart 1

MERIDIAN ANALYSIS

Cash retainers have risen due to increased time commitments, committee-related work, transparency and not just financial skill but industry skill (resulting in a smaller pool of qualified candidates) now required to effectively serve on a public company board. The annual growth rate that cash retainers have increased per the data above is just over 5%. Comparing that rate to the 3% to 3.5% annual base salary increases observed in the broader marketplace for executives over the same time period, the rise in median cash retainers seems justified when considering how the scope and exposure of the director's role has changed. In addition, as discussed later in this report, a portion of the increase in cash retainer values can be attributed to the shifting of dollars away from per-meeting fees. Companies are acknowledging that directors' time requirements have increased outside of scheduled meetings, which should be reflected in their base compensation.

The chart to the right illustrates the breakdown of director retainers by component, including cash, stock, options, and units.

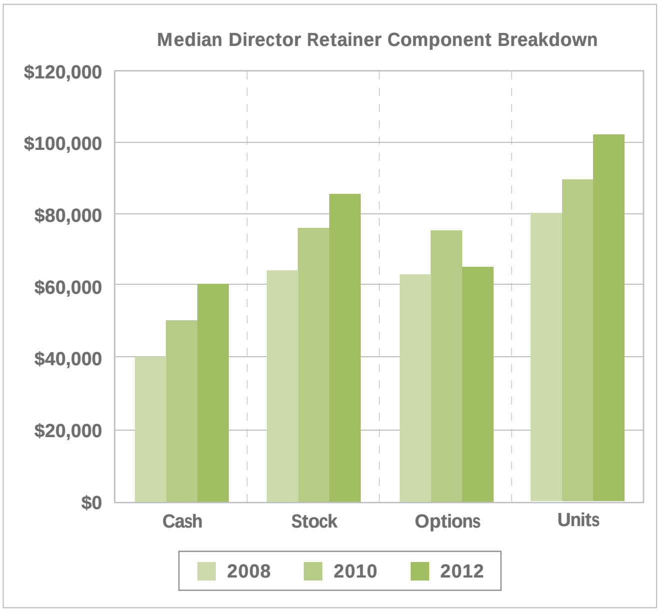


Chart 2

SOCIETY ANALYSIS

The decrease in value of options and options as a component of retainers over the past few years has mirrored the broader trend of de-emphasizing options among executive compensation packages. While there is something approaching consensus that directors should receive part of their compensation in equity to align them with shareholders, there appears to be a pull-back from options for the same reason there was for executives, although perhaps with even more concern on effects on objectivity of decision-making. Given their leverage, options can incentivize holders to take big risks with shareholder assets, and directors often are in the position of approving significant strategic initiatives. Finally, options in general were tainted by the backdating scandals that came to light in the mid-2000s.

Shift toward equity

In 2012, the median percentage of director retainers paid in equity was 60.8%, with the remainder paid in cash.

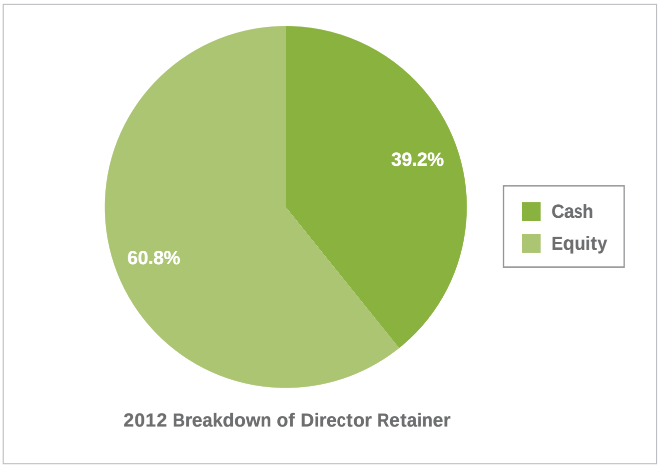


Chart 3

IN 2008, THE MEDIAN EQUITY COMPONENT WAS $90,000. FROM 2010 TO 2012, THE MEDIAN EQUITY COMPONENT INCREASED FROM $100,000 TO $107,415.

Over the past five years, the median equity component of director retainers has increased, indicating an emphasis on ownership and alignment with shareholders. The concept of the directors having "skin in the game" as they oversee management is widely believed to mitigate undue risk, as well as provide incentive to drive increased shareholder value in the long term.

In 2008, the median equity component was $90,000. From 2010 to 2012, the median equity component increased from $100,000 to $107,415.

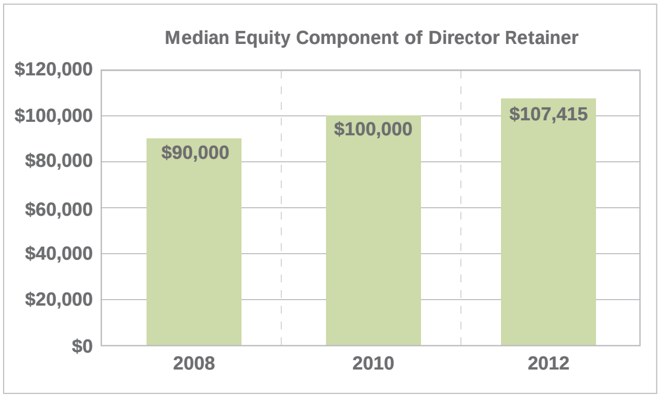


Chart 4

MERIDIAN ANALYSIS

In our experience, companies are increasingly granting equity to non-employee directors in the form of deferred stock, whereby the director does not have the ability to take unrestricted possession of the shares until they leave the board. This facilitates even greater alignment with long-term investor interests. Using deferred shares allows for an even longer time horizon than stock options, which typically expire after 10 years.

BOARD LEADERSHIP RETAINER ANALYSIS

Premium pay for lead directors increasing in prevalence and in value

Board leadership positions including chairman of the board, lead director, and vice chairman had higher median retainers, with $195,000, $180,000, and $170,000, respectively.

Today, 35% of boards within the S&P 1500 pay a premium to chairmen compared to 25% five years ago. More boards are paying a premium to lead directors, 44.9% today compared to 29.9% five years ago. Though paying a premium to the lead director has become more prevalent, the median premium value has only increased 12.7%, from $17,750 in 2008 to $20,000 today. Premium pay for vice chairmen only increased 9.3% with a median value of $50,000. Though, the prevalence of a vice chairman premium has remained relatively unchanged with a low 1.7% to 1.9% over the past five years.

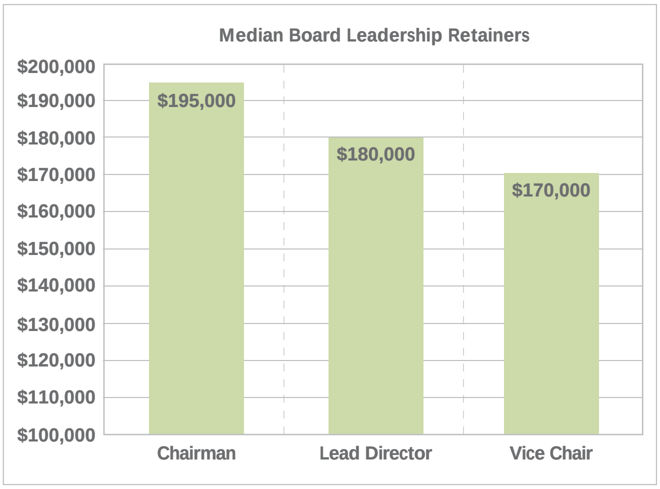


Chart 5

SOCIETY ANALYSIS

The increase in the amount of retainers for board leaders is not surprising, particularly in light of significant pay for non-executive chairs in some markets abroad. In fact, some might argue that all boards should pay their non-executive board leaders a premium, and the premium should be significant if the role is to be taken seriously. Investors (or at least a certain set of them) have pushed for ever-increasing responsibilities for non-executive board leaders. There will likely be continued debate in the United States over whether the existence of a formal non-executive chair is a superior governance model, but there does appear to be general agreement that there should be a person in the boardroom with some standing to act as a counterbalance to the CEO. That position should arguably carry with it a significant premium in compensation to other board members.

S&P INDICES ANALYSIS

S&P 500 retainers nearly double that of small-cap issuers

An analysis of the S&P indices indicates that S&P 500 companies paid the largest director retainers with a median of $220,000. Mid-cap companies follow with a median director retainer of $160,000, and small-cap issuers' median director retainer was $119,280.

Further analysis indicates that the largest increase in median retainer is within small-cap companies, with a 32.5% increase from $90,000 in 2008 to 119,280 in 2012. For mid-cap issuers, the median retainer increased from $126,695 in 2008 to $160,000 in 2012, or 26.3%. Though the S&P 500 has the highest median retainer, it experienced the smallest increase from 2008 to 2012, $185,000 to $220,000, respectively.

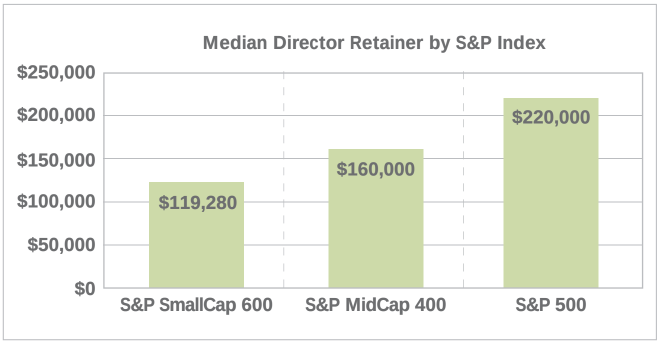


Chart 6

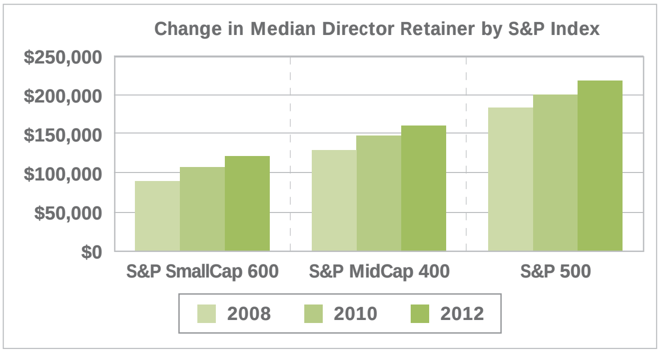


Chart 7

INDUSTRY ANALYSIS

Significant gap in industry medians

The Healthcare and Basic Materials industries have the highest median director retainers, $235,000 and $200,000, respectively. The Utilities and Financial industries have the lowest median director retainers, $150,000 and $127,750, respectively.

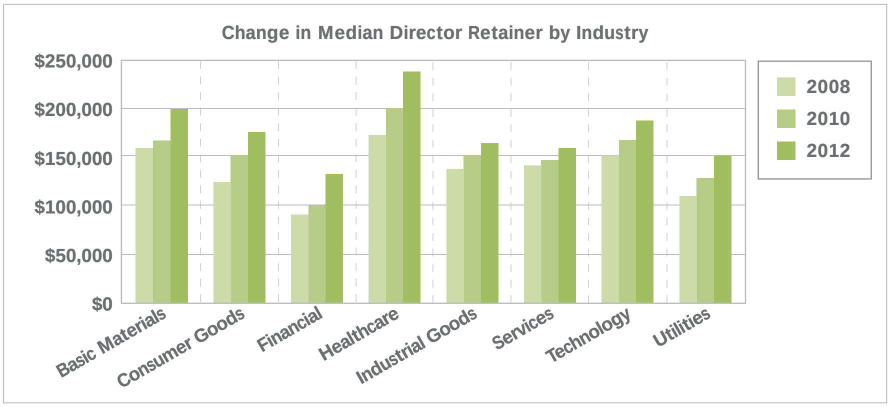


Chart 8

SOCIETY ANALYSIS

The significant increase in the median retainer in the financial sector coincides with the global financial crisis,and reflects increased demands on those directors. Many individual companies did experience significant turmoil, which necessitated sometimes weekly board meetings to manage through the crisis. However, over the longer term, the increase more likely reflects a reaction to the widely held opinion, true or not, that many financial sector boards were not staffed with directors that understood well enough all of the different and sometimes very complicated product lines of their large financial institutions. Higher fees were deemed necessary to recruit directors with those specialized skills, and to spend extra time with existing directors. Increased perceived reputational risk to being on a bank board has also likely played a role in increased retainers.

Director retainers have increased above 2008 levels across all industries in the S&P 1500. The industries with the largest increases include the Consumer Goods and Financial sectors, increasing 43.8% and 40.7%, respectively. The industries with the smallest gains include the Industrial Goods and Services sectors with increases of 23.2% and 16.7%, respectively.

BOARD MEETING FEES ANALYSIS

Board meeting fees fall in prevalence, but increase in value

The percentage of companies paying board meeting fees in addition to retainers has steadily decreased from 58.8% five years ago to 38.7% today. Of the companies that continue to pay meeting fees, their fees range from $500 to $60,000 per meeting, with a median fee of $1,750. While the median board meeting fee remained unchanged from 2008 to 2010 at $1,500, board meeting fees increased 16.7% to $1,750 between 2010 and 2012.

Board meeting fees are most widely used within the Utilities and Financial industries with 56.6% and 46.0% of companies, respectively. The Consumer Goods and Technology sectors have the smallest prevalence of use with 34.7% and 27.7% of companies paying meeting fees, respectively.

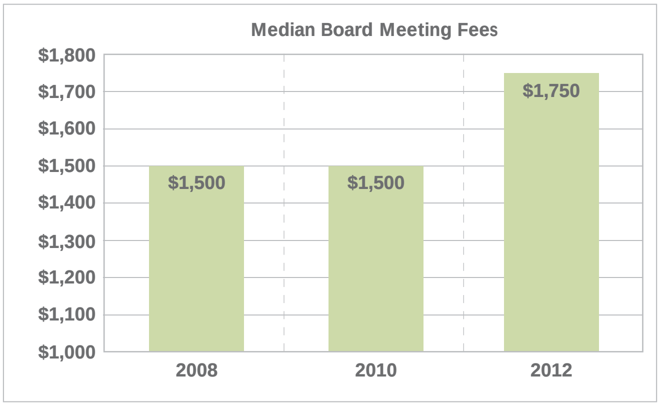


Chart 9

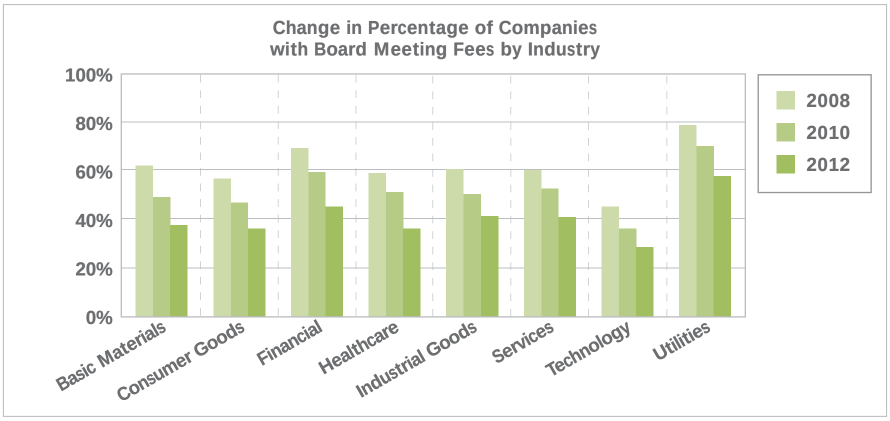


Chart 10

MERIDIAN ANALYSIS

Companies have been steadily moving away from per-meeting fees in an effort to simplify and streamline the non-employee director pay programs. Additionally, the threat of being called-out by proxy advisors or failing to be re-elected due to poor attendance is greater incentive to attend meetings than the $1,500 to $2,000 payment. Companies have realized this, and have opted to ease administration by folding these fees into cash retainer values or equity.

For more information, contact Aaron Boyd, Director of Governance Research, at aboyd@equilar.com. The contributing author of this report is Belen E. Gomez, Content Marketing Manager, bgomez@equilar.com.

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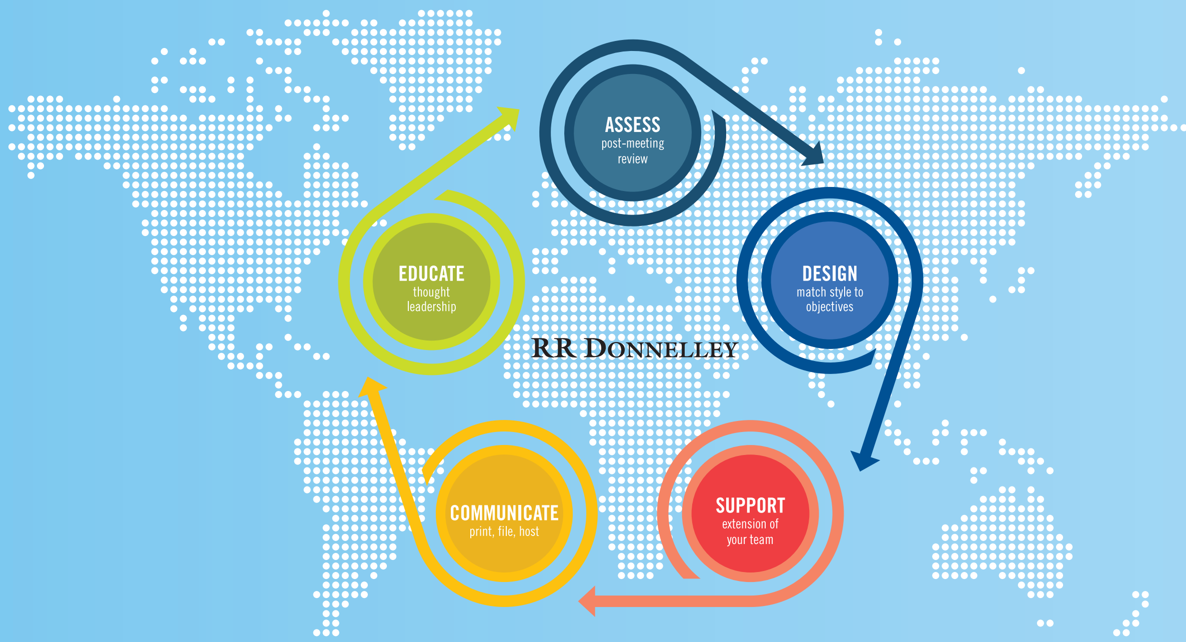

Assess.

- Conduct consultative review of your most recent proxy and annual meeting experience, examining voting results on key issues and proxy feedback received from investors, employees or other critical audiences.

Design.

- Review diversity of styles, layout and artwork used by other clients to help identify an appropriate format, or simply incremental changes. Proxy innovations should both align with your corporate culture and support your business, corporate governance and proxy solicitation goals.

Support.

- Confirm the identified approach and execute on these plans, keeping you apprised of progress throughout this process — our industry-leading support and production teams are an extension of your internal team.

Communicate.

- Produce, file, print and distribute both hard copy and electronic versions of your document through our integrated technology platforms.
- Host the web versions of your materials and provide a full suite of mailing, tabulation and inspector of election services — if requested.

Educate.

- Post successful shareholder meeting, participate once again in a consultative review of the recent meeting, the process and your results.
- Identify adjustments to the next year's timeline, and review any gaps or overlaps in the process to optimize the following year's process.
- Provide industry thought leadership throughout the year via a range of events, formats and tools, all designed to help you identify the unique approach that is right for your company — cognizant that this may change over time.

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