C-SUITE

Issue 19, Winter 2016

2016 Outlook

Companies step up outreach to improve shareholder engagement

Hot button issues for 2016

Choosing metrics for judging incentive plans

Spotlight on director pay

Transform your board into a competitive weapon

Interviews with The Santa Fe Group, Glass Lewis and PwC U.S.

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Issue 19, Winter 2016

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April 5, 2016 | New York, NY
November 3, 2016 | San Francisco, CA

Co-hosted by Equilar and Nasdaq, this forum will arm public company compensation committee members, general counsel, and senior HR and compensation executives with the necessary knowledge to make the right pay decisions that are most relevant to their businesses. Attendees will obtain independent viewpoints, unmatched insights, and noteworthy take-aways to drive long-term strategies to increase shareholder value.

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Focusing on Engagement

This past year showed us that every company needs a strategic shareholder engagement plan in place. Whether navigating new regulations from Dodd-Frank, lawsuits around director pay, diversity in the boardroom, CEO succession and a host of other issues, no company is immune to increased scrutiny from investors.

But shareholder engagement shouldn't be viewed as negative or as a threat. Yes, we've seen many activist investors come in with short-term goals to exploit certain issues. However, in most cases, shareholders are asking legitimate questions for the good of the company, and it often pays to listen.

This issue of *C-Suite* focuses on how companies are communicating with their shareholders on strategy for the coming year. Our one-on-one interviews include Cathy Allen of The Santa Fe Group and member of multiple corporate boards, who talks about the generation gap and what challenges boards face as retiring boomers pass the torch; Bob McCormick and Kevin Liu of Glass Lewis hit the high points of how to engage with proxy advisors; and Paula Loop of PwC discusses the firm's annual Directors survey, which pulls back the curtain on what directors are really thinking about the state of their boardrooms.

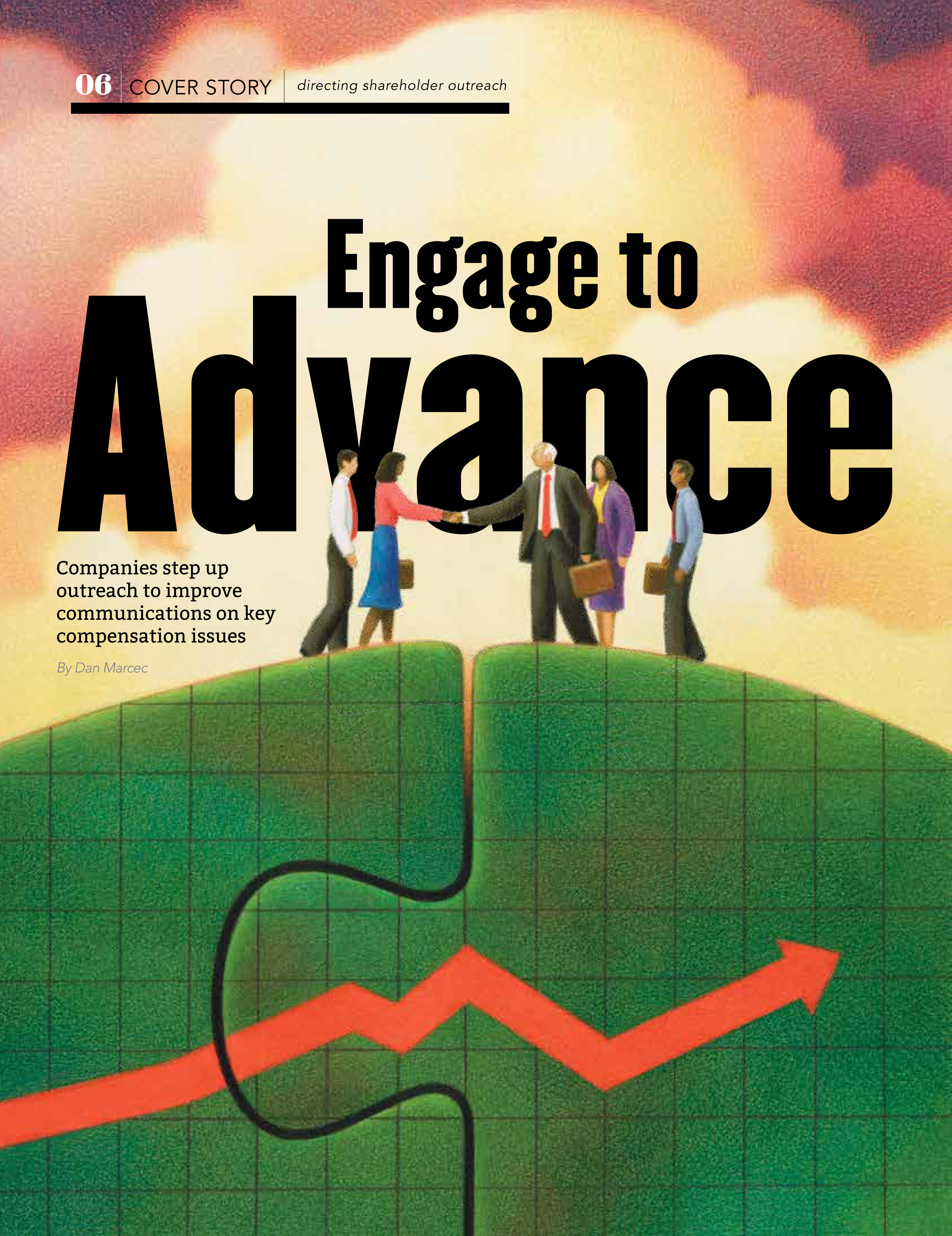
Our recurring "Ask the Experts" feature hits on the major hot-button issues in the 2016 proxy season—and there are many of them. Broadridge Financial Solutions, Korn Ferry, Meridian Compensation Partners, Nasdaq and Shearman & Sterling each provide a unique perspective on what to expect in the coming months.

Other topics include a Q&A with Pearl Meyer on why TSR is not a "magic" metric, Park Avenue Advisors on transforming your board for a competitive advantage, RR Donnelley on proxy disclosure trends, and TK Kerstetter on the building blocks of governance success. And finally, Seymour Cash takes Shareholder Engagement head on and in typical fashion, offers up a unique way to turn a challenge into an opportunity.

Please enjoy this issue and feel free to reach out to me directly with any feedback.

David Chun
CEO and Founder, Equilar
dchun@equilar.com

David has led Equilar from a pure start-up in 2000 to one of the most respected and trusted names in corporate governance.



Engage to Advance

Companies step up outreach to improve communications on key compensation issues

By Dan Marcec

Five years after going into effect, Dodd-Frank and Say on Pay have led the way into a new age of shareholder engagement. In particular, investors, proxy advisors and other stakeholders are paying more attention to how companies perform financially and how that performance relates to executives' compensation.

Since Dodd-Frank passed, the SEC has adopted 61 mandatory rulemaking provisions for companies to follow, considering the implementation of these rules integral to the protection of investors and perpetuation of market stability.

In 2015 alone, several key provisions to Dodd-Frank were either passed or proposed, each of which could have significant implications on the future of shareholder engagement around compensation. At the dawn of the 2016 proxy season, *C-Suite* looks at trends in past disclosures on each of these hot topics to see who was disclosing this information already in anticipation of what we can expect to see in the coming year.

CEO Pay Ratio

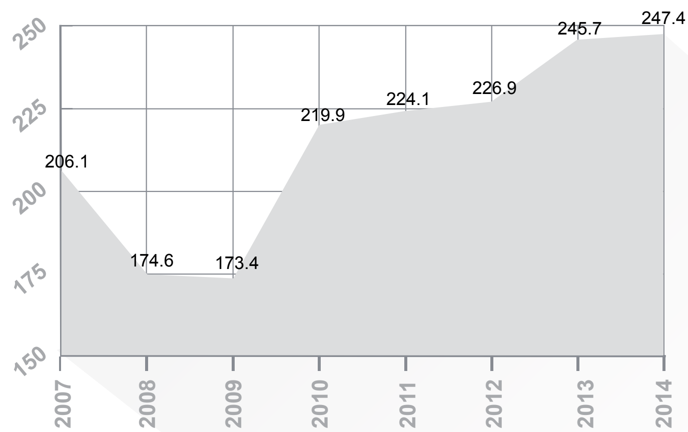
One of the most talked-about provisions, and the only one on this short list that has passed, may actually have the least impact on the 2016 proxy season. In August 2015, the SEC formally announced the adoption of a pay ratio disclosure rule requiring public companies to relate the compensation of their CEOs to that of a median employee. The rule, which will be mandatory as of January 1, 2017, attempts to further implement the provisions of Dodd-Frank and increase transparency amongst company stakeholders and the public at large.

At least one company in the S&P 500 voluntarily disclosed its CEO-to-median employee pay ratio in 2015, though there is little evidence of any other companies doing so explicitly. In fact, for the past several years, Noble Energy, Inc. provided its own calculation, although the process for identifying the median employee was not disclosed. In 2013, Noble Energy estimated that the ratio was approximately 85:1 when its CEO compensation was $9,720,334 and its median employee compensation was $114,376. The following fiscal year, Noble's CEO earned 82 times the compensation of its median employee. In both cases, the company's ratio was significantly lower than the median S&P 500 CEO to median U.S. employee ratio, which Equilar calculated to be 247.4:1 in 2014. (Graph 1)

"It is not anticipated at this time that the final CEO pay ratio rule will by itself impact the form or amount of executive compensation," noted Alex Bahn, a partner at Hogan Lovells, whose firm contributed independent commentary for Equilar's annual Governance Outlook research report. "Issuers are hard at work analyzing their employee base to estimate the potential pay ratio figures to be prepared to defend the disclosures to shareholders when required."

"The new CEO pay ratio is unlikely to materially change Say on Pay voting patterns, but it may influence some investors who consider internal pay equity to be an important factor, or in cases where the ratio is dramatically different than a company's peers," added John Beckman, also a partner at Hogan Lovells.

Graph 1
S&P 500 CEO to Median U.S. Worker Pay Ratio



Source: Equilar (CEO pay) and U.S. Dept. of Labor Statistics (median employee pay)

Pay Versus Performance

The SEC proposed a rule in April of 2015 that, if passed, would require public companies to disclose executive pay and the company's performance for themselves and their peers. The regulation would stipulate that company performance be measured by total shareholder return (TSR) and require each company to display the last five fiscal years of TSR relative to its peer companies.

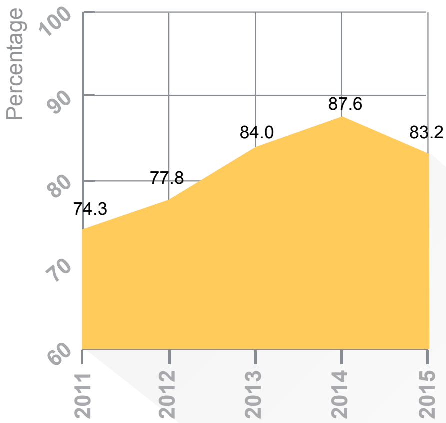
While currently not required, companies already share similar information voluntarily, evidenced by the upward trend in the disclosure of the words "pay for performance" in proxies from 2011 to 2015, which increased from 74% to 83% of S&P 500 companies. (Graph 2)

"Many issuers already address the relationship between executive compensation and TSR, partially in response to proxy firms' views on linking pay for performance in its voting recommendations," said Bahn. "However, the SEC's proposed pay versus performance rule would demand greater disclosure of this relationship, which may cause compensation committees to select more TSR-based performance measures for executive incentives compensation in future years."

Clawbacks

As with pay for performance, many companies have anticipated forthcoming rules by the SEC related to clawback policies. In July 2015, the SEC officially proposed rule 10D-1, requiring companies to adopt guidelines for the recovery of certain pay incentives that an executive would have otherwise not received as a result of a financial restatement. Because executive pay has been increasingly linked to performance, a restatement could alter whether or not an actual

Graph 2
Prevalence of S&P 500 Companies Disclosing Pay for Performance in Proxy Statements



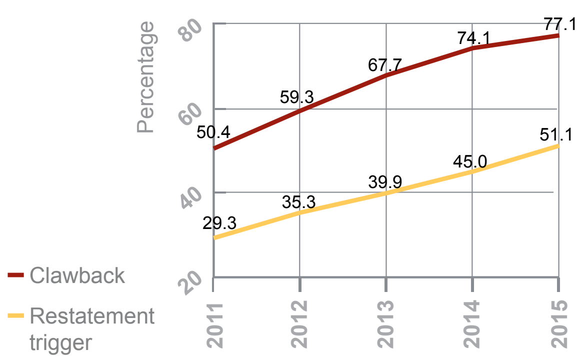
performance target was achieved and thus incentive awards paid out. In a press release, SEC Chair Mary Jo White stated "the proposed rules would result in increased accountability and greater focus on the quality of financial reporting, which will benefit investors and the markets."

From 2011 to 2015, the percentage of S&P 500 company proxies disclosing a clawback policy increased significantly, from 50.4% to 77.1%. Moreover, the prevalence of clawback policies explicitly triggered by a financial restatement was shy of but close to doubling from 29.3% to 51.1% over the last five years. (Graph 3) There has been a general expectation that this rule will be approved, and companies have responded by gradually adopting policies that conform to such a proposal.

Realized Pay

In addition to a company performance disclosure, the SEC's proposed rule would also require

Graph 3
Prevalence of Clawback Disclosures Among S&P 500 Companies



public companies to disclose a table displaying their NEOs' "actual pay" as compared to the Summary Compensation Table (SCT). Though methodologies for calculating realized pay differ, the SEC's formal definition of actual pay is total compensation for the covered fiscal year as provided in the SCT with two modifications.

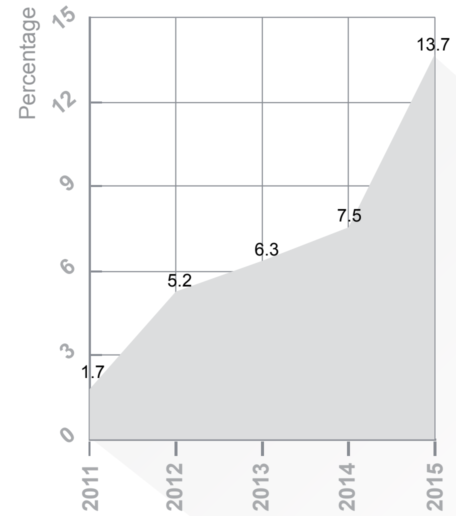
First, the aggregate change in the actuarial present value of the accumulated benefit under all defined benefit pension plans, plus the service cost under all such pension plans will be deducted from SCT total compensation. And second, equity awards, including options, stock, units and performance shares, will be valued at the vesting-date fair value instead of grant-date fair value. As such, actual pay would exclude certain long-term compensation, such as equity and incentive awards that have not yet vested. Once the new rules are finalized, companies will need to provide a clear explanation of both the actual pay of the CEO and the average actual pay to the other NEOs. Although only 14% of companies in the S&P 500 mentioned "realized pay" in their proxy statements in 2015, that marks an increase from just 2% in 2011. (Graph 4)

Each of these compensation-related items hearkens back to the initiation of Say on Pay and the influence this shareholder vote has on company pay practices, and moreover, communications about those pay practices.

"Say on Pay has changed the way public companies engage with their shareholders on executive compensation, prior to which engagement on executive compensation occurred but was less prevalent and tended to be more issue specific," said Beckman.

Given the extensive disclosures now required by the SEC, shareholders have more access to information and a better understanding of their portfolio companies' overall operations than ever before. Likewise, investors are more actively expressing their opinions and suggesting changes they feel appropriate. As a result, issuers have established active shareholder engagement and outreach programs to ensure they proactively distribute relevant information and establish open lines of communication with their investors. With more regulations pending from the SEC in 2016, transparency on compensation matters will continue to be front and center. CS

Graph 4
Prevalence of Realized Pay Disclosures by S&P 500 Companies



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For more data and information on this topic, please visit ***marketing.equilar.com/governance-outlook-report***.

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Breaking Through Boardroom Barriers

A growing number of women are serving on boards at home and around the globe

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Report compiled by Amit Batish. For more information on this topic or to request our full report on gender diversity in the boardroom, please visit marketing.equilar.com/board-composition-report-2015.

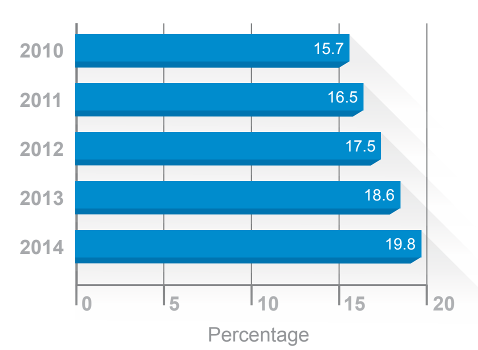
A board of directors serves a crucial role for every company, undertaking a wide range of responsibilities including hiring management, ratifying company financials and shaping a company's strategic agenda, to name a few. Additionally, a number of factors, such as financial crises and movements in cultural sentiment and public policy, have contributed to unseen requirements for U.S. boardrooms over the past decade.

This new landscape has contributed to a shift in focus towards diversity, particularly gender diversity. As pressure mounts for boards to align with the demographics of their investors and the population at large, female representation on corporate boards ranks as a high priority among many shareholders.

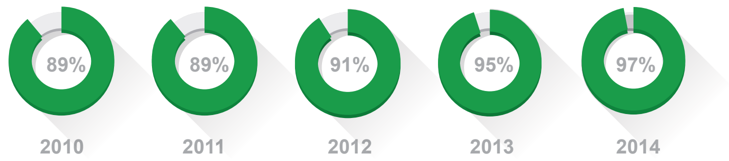
Trends in Gender Diversity on S&P 500 Boards

The percentage of female directors on boards has seen a steady, but slow growth rate for S&P 500 boards. In 2014, about one in five S&P 500 directors were female, up from 15.7% in 2010. (Graph 1) For many, it's difficult to understand why the growth rate is so small, especially since women represent 46.8% of the U.S. workforce, according to the U.S. Bureau of Labor Statistics.

Graph 1
Percentage of Women on S&P 500 Boards



Graph 2
Percentage of S&P 500 Boards with At Least One Woman



Because seniority often dictates leadership roles, tenure has also come into focus in the boardroom diversity discussion. Average tenure for male directors is now 9.3 years, compared to 7.3 for females. Mandatory term limits offer one potential solution to influence change and board refreshment. If members assume directorship is a lifetime gig, there's less opportunity to bring in new directors. However, if term limits are implemented, expectations must be set early and up front.

Though the growth rate for females on boards remains slight, overall female representation has been increasing consistently across companies in the S&P 500. Women are now represented on nearly all boards, with 97.1% of S&P 500 companies having at least one female director, an increase from 88.8% in 2010. (Graph 2)

However, the average number of female directors on boards is just 2.2, as average board size has grown to nearly 10.9. Rachel Soares, Director of Research at Catalyst, noted that in order for overall representation of woman to rise, companies can't stop after adding just one woman.

Linda Chen, Vice President of Governance Strategy and Marketing at Equilar, added, "If you only have one woman on your board, you risk that one director being labeled the 'token' female, overlooking the diversity of ideas, energy, background and skills she has."

Diversity by Sector

Despite the fact that more than 93% of companies in all S&P 500 industry sectors have at least one female on their boards, no particular industry stands out. The consumer goods sector has the highest percentage of female directors at 22.9%, while the technology sector and basic materials sectors continue to lag. (Graph 3)

Aeisha Mastagni, Investment Officer at CalSTRS, explained that this may have to do with companies putting an emphasis on direct industry experience, rather than focusing on overall candidate skill set, which consequently narrows the scope of potentially qualified directors in the talent pool.

At the company level, several leaders have emerged in female board representation, but there are still very few companies that have more than 50% women directors. Avon has the highest among Fortune 1000 companies, with 66.7% representation, while Dollar General saw the highest increase in percentage of female board members in recent years, increasing from 0% in 2009 to 37.5% in 2014.

"The lack of defining what diversity means and leaving that up to individual companies has lead to a smattering of success stories of companies who already had been considering this before disclosure rules went in effect in

Corporate Leaders Convene on Women in the Boardroom

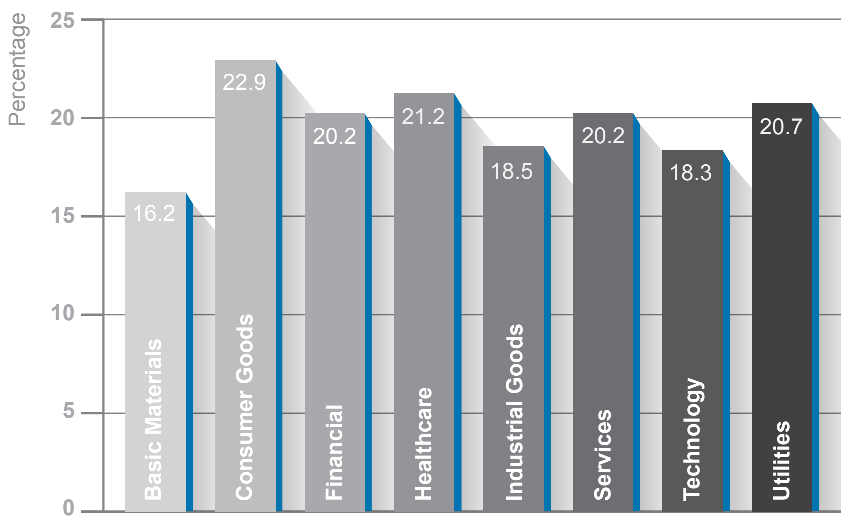
In Fall 2015, the Johns Hopkins School of Advanced International Studies (SAIS) hosted its sixth annual Global Conference on Women in the Boardroom in Washington, D.C. Centered on "engaging the levers of power to accelerate change," hundreds of executives and board members from major global companies joined together with investors, government officials and other corporate governance stakeholders to consider and communicate the most effective ways to increase diversity at the highest corporate levels.

What exactly is a "lever of power," and how can individuals and companies effectively influence these pressure points? Susan Ness, Senior Fellow at the SAIS Center for Transatlantic Relations and chair of the conference, said that the levers of power refers to those who have the clout and tools at their disposal to effect change at a broad level. From corporate leadership to board members to institutional investors, as well as stock exchanges and U.S. state governments, there are myriad powers that can play a crucial role in the initiative not only to propel dialogue but also achieve results in diversifying the boardroom.

For highlights of the program, and to read essays associated with the topic from participants and other thought leaders in corporate governance, please visit boardroomdiversity.org/2015-conference/2015-essays.

Graph 3

Percentage of Women on S&P 500 Boards in 2014, by Industry



2009," Soares explained. "I do think that the overall global conversation for gender diversity around the world has helped companies recognize that if they don't take action they are going to be left behind."

Global Trends

When examining female representation on boards in Europe, Norway paves the way with 35.5% representation. Finland, France and Sweden are approaching 30%, according to Catalyst data. Soares noted that it's not surprising that we are seeing higher numbers in this particular region, since many European countries have introduced quota legislation among other interventions to try to increase women on boards.

Susan Ness, Senior Fellow at the SAIS Center for Transatlantic Relations, noted that most of the quotas that have influenced progress are the results of serious government engagement on the issue, coupled with cultural transformation of the business community to really work together to build diversity.

A prime example of Ness' point is the goal of 25% female representation over a five-year span on FTSE boards, set by former UK trade minister Lord Mervyn Davies in 2011. Today, representation is at least 26.1% across all boards in the FTSE, and Ness stated that a number of actions contributed to the success of this benchmark, particularly the support from the UK government and a champion influencer in Lord Davies.

Additionally, the group leading the charge set clear, achievable targets with timetables, while government and company leaders opened doors with peer pressure and mandatory term limits.

Women make up…

50.8% of the U.S. population

46.8% of the U.S. workforce

51.4% of professional occupations in the U.S.

36.8% of MBAs earned in the U.S.

51.4% of doctoral degrees held in the U.S.

Starting the Dialogue on Gender Diversity

Institutional investors such as CalSTRS (whose constituency is more than 70% female) and BlackRock explicitly outlined board diversity guidelines in 2015, which are just two examples speaking to the immediacy of this issue among shareholders. Investors view gender diversity as integral to successful operation of a board of directors for myriad reasons, not the least of which is to more accurately represent all stakeholders—from executive leadership to employees to customers. Currently, women comprise 50.8% of the U.S. population, represent 51.4% of all professional occupations[1] and earned 36.8% of all MBAs in 2014[2].

As a high-profile example of the scrutiny this issue receives, Fitbit recently made headlines when it went public without a single female on its board, despite having a customer base comprising 70% women.

In the U.S., Mastagni noted that a reasonable goal such as 30% is a good start, but we shouldn't view that as the end game. To make progress stateside—where there is unlikely to be legislation around quotas, she said—encouraging companies to bring in an independent third party to conduct board evaluations is an effective approach in driving change, since outsiders tend to be more open and honest in their evaluations. She went on to note that if there were a disclosure of a board member's gender on proxy statements, then that could also be a factor in driving change.

Realistically, numerous factors must come into play for gender diversity to make progress across U.S. boards. Soares explained that nationally, quotas are still a non-starter for U.S. companies, and that it is going to take grass roots and local cities' efforts to start movement from the bottom up.

Ultimately, no one single factor will drive gender diversity on U.S. boards, but there are a number of factors in place to create a noticeable impact on U.S. boardroom gender diversity in the coming years.

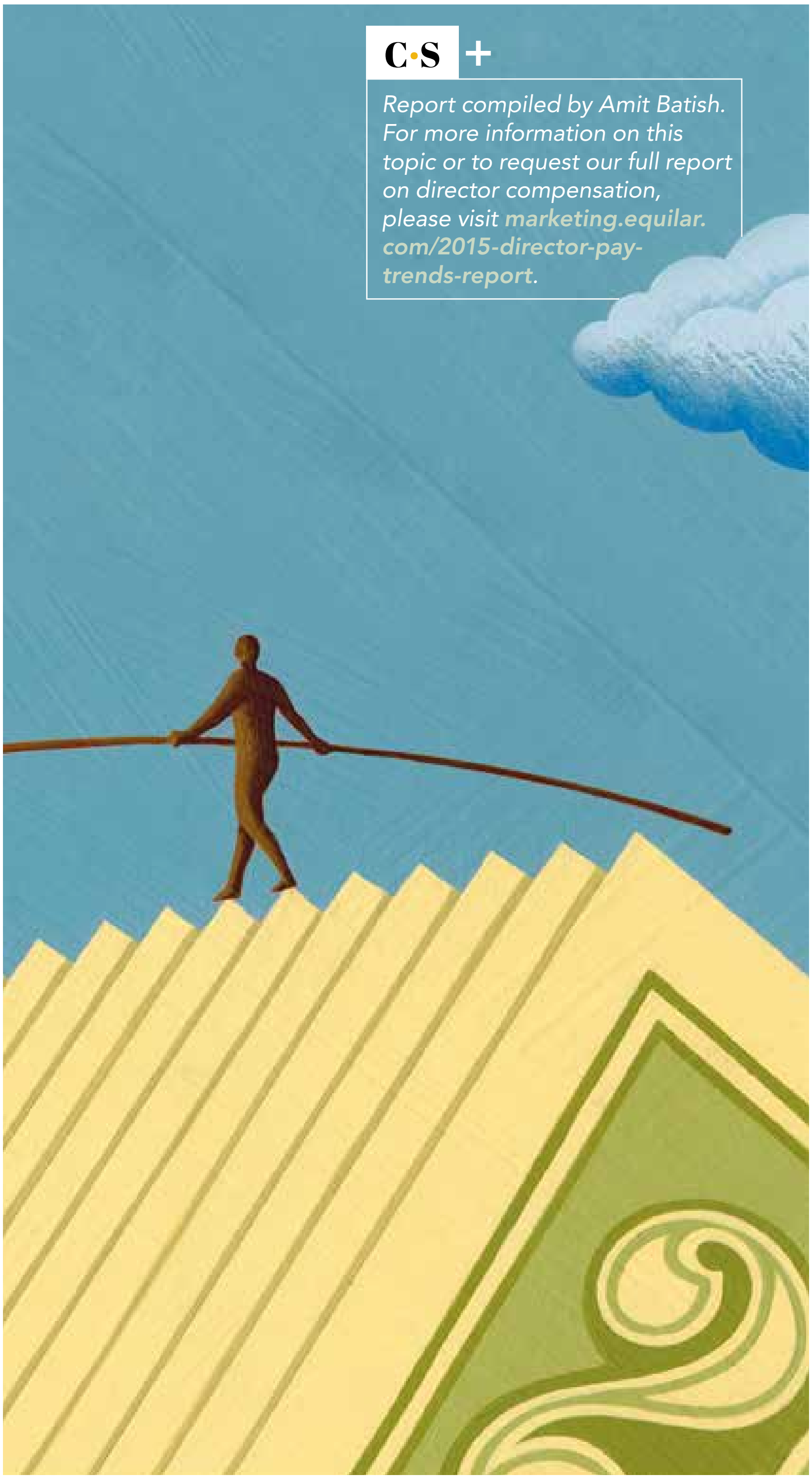
"The prevalence of females on boards is a generational and cultural issue," Mastagni noted. "Both of those take time to change, and while growth right now is just 1%, I think there will be a tipping point at some time in the near future." CS

1. U.S. Department of Labor Statistics

2. The Association to Advance Collegiate Schools of Business

Director Pay Spotlight

Board responsibilities pave the way for rise in retainers



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Report compiled by Amit Batish. For more information on this topic or to request our full report on director compensation, please visit marketing.equilar.com/2015-director-pay-trends-report.

As Dodd-Frank continues to influence the activities of corporate America, board directors have taken on greater responsibilities. Due to an increased focus on shareholder engagement and outreach, the effort to hire board and executive talent, and the ability to effectively shape strategies, board members have seen an increase in compensation in recent years. In fact, median retainer for S&P 500 directors increased by 16.8% in the last five years, reaching $233,600 in 2014. (See Graph 1 for more details.)

As directors occupy the precarious position of setting their own compensation levels, potential consequences loom if they fail to be transparent about what they choose to award themselves, particularly with the increased compensation they are earning.

As a result of this changing landscape, director pay has been placed under the microscope. Activist shareholders have gone so far as to litigate regarding excessive director pay, emphasizing the importance of setting reasonable limits on board compensation levels. The spotlight further brightens on directors not only because they make pay decisions for themselves and fellow members, but also because they decide on premiums paid to individuals in leadership and committee roles. Ultimately,

> Board members are more frequently being called into service throughout the year than ever before, which is a direct cause of rising retainers.

directors possess the difficult task of ensuring their board members are compensated properly while addressing the interests of shareholders.

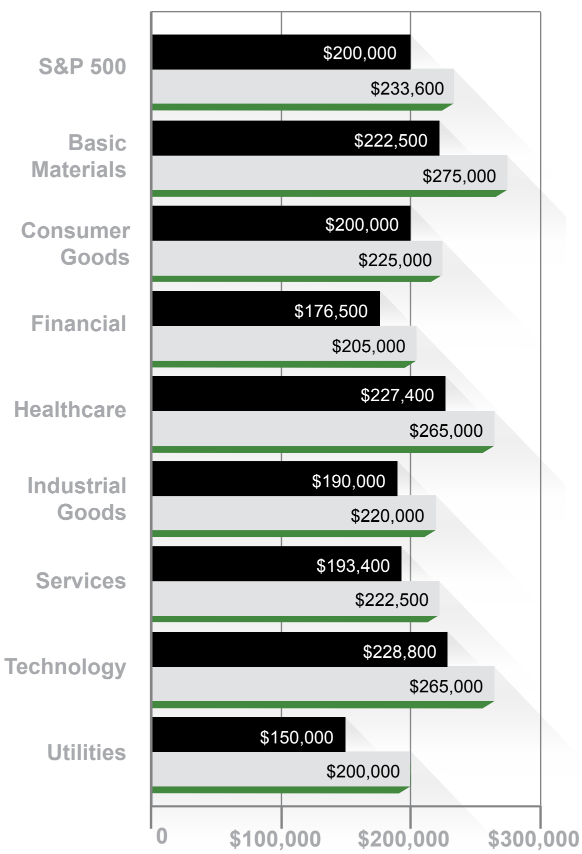
Director Compensation Trends

Similar to executive pay, director compensation is directly tied to shareholder interests. Consequently, there has been a rise in equity awards for directors, and pay-offs are targeted with an eye toward long-term returns.

Overall, cash has been the most common component of director retainers. In 2014, 97.8% of S&P 500 directors received some portion of their retainers in cash form, with the median value of those cash awards being $80,000. On the other hand, options have been on a steady decline over the last five years, with just 14.5% of companies granting options in 2014. As a whole, median option grant values decreased from 2010 to 2013, maintaining the lowest median among pay components offered to directors.

Board members holding leadership positions are generally compensated more for their increased responsibilities, and non-executive board chairs earned 65.9% higher than the median for all S&P 500 directors at $387,500 in 2014. Lead directors earned $265,000 at the median.

Graph 1
Median Director Pay at S&P 500, by Industry



Director pay varies at the median across industries, with the basic materials sector—consisting mainly of oil and energy companies—seeing the largest retainers, and the second largest gain since 2010.

Equity vehicles commonly used for director grants have materially shifted.

Board members are less likely to receive incentives to attend board meetings on a one-off basis.

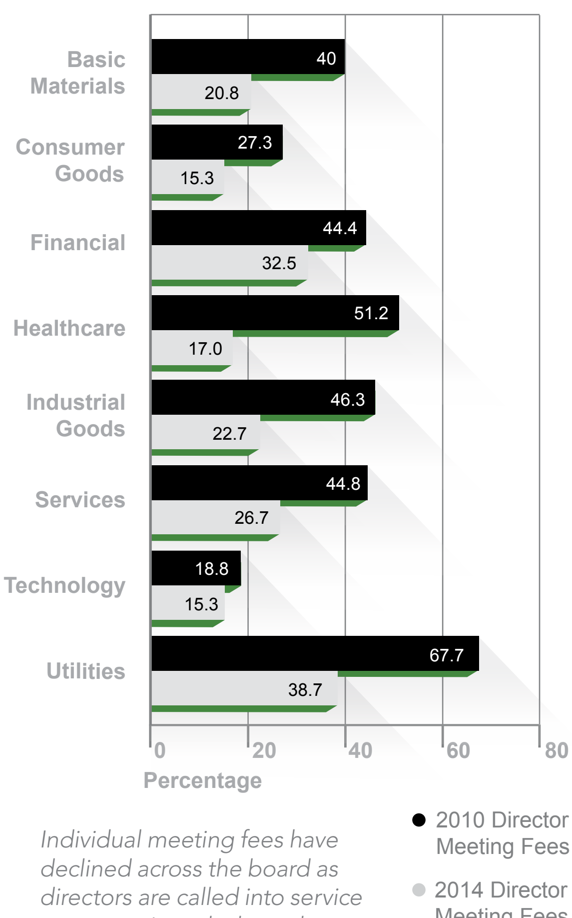
The Decline of Meeting Fees

With the consistent rise of shareholder engagement, board members are more frequently being called into service throughout the year than ever before, which is a direct cause of rising retainers. In conjunction, board members are less likely to receive incentives to attend board meetings on a one-off basis and, as a result, meeting fees have experienced a steady decline among S&P 500 companies, reaching a new low of 23.2% in 2014, a 43.9% decline since 2010.

On a sector-basis, board fees were most popular in the utilities sector, at 38.7%, while lowest in the consumer goods and technology sectors at 15.3% in both sectors. (Graph 2) Although the overall use of board meeting fees has decreased in popularity, median fee values have remained constant over the last five years at $2,000. CS

Graph 2

Percentage of S&P 500 Companies That Pay Meeting Fees



Individual meeting fees have declined across the board as directors are called into service more consistently throughout the year, resulting from many factors including increased shareholder engagement.

Matt Wolfson is a Senior Consultant with Meridian Compensation Partners LLC. He has over 10 years of professional consulting experience primarily focused on executive compensation and corporate governance matters.

Meridian Compensation Partners Commentary

In developing their own pay packages, directors should focus on a program that is market competitive, reflective of their responsibilities, attractive to high-quality nominees and takes into consideration potential personal liability risks. These considerations have led to certain changes in pay components over time, specifically with regard to the elimination of meeting fees, increased use of restricted stock/units and ownership guidelines for directors.

One relatively new consideration relates to equity grant levels. Two recent court decisions have indicated that since directors are not disinterested parties when approving their equity grant levels, "business judgment rule" protection from corporate waste lawsuits may not apply absent meaningful grant limitations in a company's omnibus equity plan. As such, companies are considering amendments to their plans to include such limitations.

The trend away from meeting fees has been significant in recent years, in part due to directors wanting to send a message to shareholders that they understand attendance is mandatory. Furthermore, equity vehicles commonly used for director grants have materially shifted. Once highly prevalent, granting stock options is now a minority practice. Instead, boards favor full value shares such as restricted stock/units or common stock, which are considered more appropriate given directors' fiduciary duties, which differ from executives who are primarily tasked with running the company.

Messaging, proxy advisory firm views and simplicity all contribute to the recent decline in prevalence of board and committee meeting fees. First, the trend towards more detailed and transparent proxy disclosures is resulting in boards placing more focus on the message pay structures send. As such, boards continue to move away from meeting fees in favor of increased cash retainers to communicate to shareholders that attendance is not only expected, but mandatory, and that all board members shoulder a share of the burden.

Second, proxy advisory firms hone in on the section of proxy statements disclosing whether directors attended at least 75% of meetings during the last year. Directors not meeting this threshold will typically be called out in the proxy advisory firm's shareholder reports, and it may factor into their vote recommendation upon the director's next election.

Finally, eliminating meeting fees is much simpler to administer. Confirming meeting attendance, determining fees owed and ensuring corresponding proxy disclosures align can be a burdensome task, especially for a pay element that is typically less than 10% of a director's total compensation. Furthermore, much of a committee's work is now completed outside of its three to five regularly scheduled meetings, and paying for all of the interim ones—especially for short telephone meetings—can become somewhat impractical.

State of the Compensation Conversation in 2016

Recapping Equilar and Nasdaq's Compensation Committee Forum

By Dan Marcec

From left to right, David Wicks, Vice President, Nasdaq, Corinne Costa Davis, SVP, Human Resources, E*TRADE Financial, and David Chun, CEO of Equilar.

Dodd-Frank turned five years old in 2015, and last year the SEC proposed and passed several more rules and regulations that will have significant influence on the way companies communicate compensation strategies to stakeholders going forward. In addition, as we enter the sixth year of Say on Pay, shareholders are becoming even more attuned to issues surrounding executive pay, and to a greater degree director compensation as well.

With this backdrop, public company compensation committee members, senior HR executives and industry advisers gathered at the Nasdaq MarketSite in New York City on October 27, 2015 for Equilar and Nasdaq's first-ever Compensation Committee Forum, where they discussed these latest issues impacting governance and shareholder engagement. This feature details key takeaways and key quotes from each of the day's sessions.

Driving Change – What Investors and Regulators Expect in 2016

Key takeaways:

The SEC has been particularly active in 2015, passing the CEO pay ratio and pushing forward proposals on pay for performance, clawbacks and other issues. With shareholder activism intensifying around compensation matters, companies have to pay close attention not only to following the rules, but also transparently communicating pay strategies to investors.

Key quotes:

"I can't remember a time that the SEC has been so prolific in such a short period of time."

"The CD&A should be treated like a project, and the companies who are doing so are getting better Say on Pay results."

"Disclosure of CEO pay ratio won't be particularly useful for investors, since it has little to do with performance. Because companies have latitude to do things differently, it's difficult to use it to make clear comparisons."

Supporting Transformation through Your Compensation Plans

Key takeaways:

Changes in compensation strategies no longer support a business-as-usual approach, and compensation committees are focused on what they will have to do differently over the next few years. Their responsibility to clear roadblocks and create pay packages and plans that can drive change throughout an organization are coming to the forefront. Striking a balance between short-term incentives and long-term rewards as they relate to company performance is becoming a more and more complex puzzle.

Key quotes:

"Transformation is innovation on steroids. Comp committees have to think ahead and see what's changing in the world, and have the ability to convince the board to move in a different direction when it is warranted."

"Compensation is derivative of other things you're trying to do, and there must be alignment and congruence across the organization."

Peer Group Selection and Data Sources: Making Sure the Foundation is Solid

Key takeaways:

Because investors view pay decisions as a sign of board effectiveness, setting compensation levels against a peer group skewed to companies that are not viewed by investors as relevant may raise concerns. With increased scrutiny surrounding pay for performance, companies have become more transparent about their compensation policies. Shareholders are interested not only in how much executives are being paid, but also the foundation on which those company leaders are paid.

Key quotes:

"From shareholders' perspective, what seems to be missing is a lack of an honest and forthright discussion. When you read a CD&A, everything seems rosy with some underperforming companies. Be honest about what challenges you're facing and lay it out there."

"Don't let peer groups guide your pay decisions exclusively, as they're one of many inputs. A majority of companies are doing a good job of this, and the rationale makes sense for most of them, but there are a number of intentional or unintentional slippery slopes."

"Benchmarking against market data is crucial, but always consider internal culture, strategy and what is right for your company first."

The Future of Long-Term Incentives

Key takeaways:

Equity, a cornerstone of executive compensation, continues to play an essential role in governance matters for proxy advisors, shareholders and companies alike. Shareholders' push for companies to tie equity and performance has resulted in companies continuing to increase their usage of performance equity, trending toward using restricted stock as the premier equity vehicle. Consequently, options awards have continued falling as a part of executive pay packages.

Key quotes:

"As shareholders, we're looking for a diversity of metrics, which allows us to provide benefits to our participants. Performance metrics should be longer than one year, and should be different than what's in the annual plan."

"There are pros and cons to measuring by TSR. The top executive group is connecting with an ultimate output for shareholders—if they outperform, good, if not, bad. But on the other hand, comparisons can be difficult, especially benchmarking against peer groups."

"There's no simple solution to attracting talent from the tech space or other startups with older pay models, but they understand the differences if they're entering into a mature business. It's a challenge, but you can integrate them into the pay structure over time."

Equilar and Nasdaq's Compensation Committee Forum

Linking Board Compensation to Shareholder Interests

Key takeaways:

Boards of directors sit atop the corporate structure, responsible for hiring executives, shaping strategies, and ensuring their companies meet regulatory and corporate governance standards. Due to an increased focus on shareholder engagement and outreach, directors have seen increased compensation in recent years. In contrast to executive pay, however, directors occupy the precarious position of setting their own compensation levels. Alongside additional scrutiny directors themselves have faced in a more complicated corporate environment in recent years, director pay has been placed under the microscope.

Key quotes:

"The whole industry in executive compensation is debating what advice to give to directors. If you're going to shareholders at all, it's advisable to think about some separate limit for directors."

"On average, directors have five full meetings a year and a lot of calls, but $250,000 is a lot of money. Directors are well paid."

"I think we're going to find a solution on this and it's going to go away. Proxy access and activism are more immediate risks. We will be thoughtful about how to increase pay."

The Time is Now: Engaging With Your Shareholders on Your Compensation Plan

Key takeaways:

With a seemingly endless amount of information available at shareholders' fingertips, investors can more easily and readily review comparable companies' policies and decide whether or not their company's policies are aligned with those of its peers. This shift towards shareholder engagement has effectively compelled companies to become more transparent about corporate practices.

Key quotes:

"There's a lot of science behind compensation, but engagement is the 'art'—having the right conversations with the right people."

"Five years into Say on Pay, we're now at an inflection point where the conversation is transforming. We've cleaned up poor pay practices, so now it's a question of how can we really affect and drive shareholder value?"

2015 Compensation Committee Forum Speakers

- Tim Bartl, President, Center on Executive Compensation
- Ken Bertsch, Partner, CamberView Partners; Former President & CEO, Society of Corporate Secretaries & Governance Professionals
- John Borneman, Managing Director, Semler Brossy Consulting Group
- Peter Browning, Lead Director, Acuity Brands; Director, ScanSource Inc.
- John Cannon, Partner, Shearman & Sterling
- David Chun, Chief Executive Officer, Equilar Inc.
- Joan Conley, SVP & Corporate Secretary, Nasdaq
- Corinne Costa Davis, SVP, Human Resources, E*TRADE Financial
- James Curtiss, Compensation Committee Chair, Cameco Corp.
- Matthew DiGiuseppe, Director, Corporate Governance, TIAA-Cref
- Rich Fields, Principal, Tapestry Networks
- Steve Halverson, Compensation Committee Chair, CSX Corp.
- Victoria Haynes Ph.D., Compensation Committee Chair, Nucor Corp.; Director, PPG Industries and Axiall Corp.
- TK Kerstetter, Host, Inside America's Boardrooms; Chief Executive Officer, Boardroom Resources
- Charley King, Principal, Frederic W. Cook & Co.
- Adam R. Kokas, EVP, General Counsel, Chief Human Resources Officer & Secretary, Atlas Air Worldwide Holdings, Inc.
- Diane Lerner, Partner, Pay Governance
- Kelly Malafis, Partner, Compensation Advisory Partners
- Edna Morris, Compensation Committee Chair, Tractor Supply Co.
- Regina Olshan, Partner, Skadden, Arps, Slate, Meagher & Flom LLP
- KT Rabin, Chief Executive Officer, Glass, Lewis & Co.
- Peter Reali, Senior Manager, Corporate Governance, Lord Abbett & Co.
- Haroon Saed, Vice President, Compensation, Prudential Financial Inc.
- Ron Schneider, Director, Corporate Governance Services, RR Donnelley
- David Swinford, President & CEO, Pearl Meyer
- Marc Ullman, Partner, Meridian Compensation Partners

Compensation As a Catalyst

Why TSR is not the "magic metric" for incentive plans

Q&A with David Swinford

PEARL MEYER

Total Shareholder Return (TSR) is a popular metric companies use to benchmark and reward executive compensation—in fact, nearly 50% of all companies pay their top employees at least partially based on this measurement. However, research shows that TSR may not be the most accurate portrayal of improved company performance in the short term. *C-Suite* spoke with David Swinford, President and CEO of compensation consultant Pearl Meyer, to discuss the ramifications of using TSR as a cornerstone of incentive programs, and why other metrics may work better to depict a more direct line to company performance in the short term.

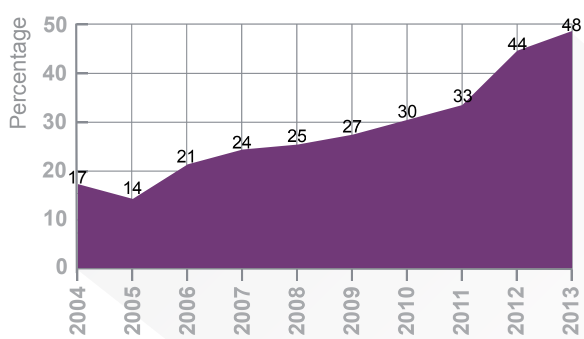
Pearl Meyer

David Swinford is President and CEO of compensation consulting firm Pearl Meyer. He can be reached at david.swinford@pearlmeyer.com.

What do boards need to do first when they begin thinking about compensation as a tool for creating value?

David Swinford: It's important to set aside the notions that compensation is primarily about compliance or controlling costs. Economies, companies and markets all evolve, and we must as well. Compensation is fundamentally linked to building a strong pipeline of leadership talent for the long run and to communicating the organization's priorities, both strategic and tactical. It is a tool that can drive change and reinforce the behaviors that lead to the achievement of planned goals. Those that do this effectively are able to accomplish more than just planning for change. They operate according to a healthy balance of short- and long-term business objectives, and it allows them to achieve a point of differentiation in how they execute strategy.

Figure 1
Percent of Companies Using TSR as an Incentive Metric



How can boards begin to align pay and business strategies?

Swinford: First, move away from the idea that conforming to the norm, or matching best practices, is a healthy approach. You want to incorporate market intelligence and data, but let it inform, not dictate, your compensation program. This is especially important when new regulations introduce complexity.

As the companies we work with begin this journey, we suggest maintaining a sharp focus on what's best for the organization and adopting a long-term mindset. Where you can truly achieve success is by identifying the unique compensation approach that drives value for your company.

So how do you measure value creation?

Swinford: This is a great question. Over the long-term—meaning in the neighborhood of ten years or so—total shareholder return or "TSR" is a very good indicator of value creation, and it aligns corporate results with shareholder gains. However, when we start to talk about TSR, things become confused very quickly. That's because there are some very important distinctions between using TSR as a true long-term indicator of having built value—where we believe it does work and work well—and using TSR to try and measure value creation over a relatively short time period. Even three or five years, which are often thought to be long term, are not long enough for the TSR measure by itself to tell you whether or not you've been successful. The other place where TSR can pose a real problem is when it is used as an incentive measure, instead of as a long-term alignment measure.

Roughly half of public compensation committees have adopted TSR as a cornerstone of their incentive programs. How do you suggest managing this, now that your firm has begun to suggest this is not the right or "magic" metric?

> "TSR is a great alignment tool and an excellent way to measure long-term value, but as an incentive, it cannot drive a management team to perform the steps that need to be executed to achieve that long-term value creation."

Swinford: Our research with Cornell University uncovered some interesting findings—chiefly, that there is no evidence use of TSR as an incentive metric improves company performance. That's an incredible discovery! We had suspicions that this might be the case, but the empirical research of data from S&P 500 companies over a 10-year span is definitive and it represents a sea change in how boards should think about the use of TSR.

In very simple terms, companies should not think about TSR in relation to incentivizing management teams. Instead, compensation committees should understand their company's business objectives and their long-term value creation strategy and then design the incentive component of the compensation program to reflect achievement of milestones toward those goals.

> "There are some very important distinctions between using TSR as a true long-term indicator of having built value and using TSR to try and measure value creation over a relatively short time period."

smooth out market movements and industry cycles. Those are reasonable goals, but not realistic in this context and not how TSR actually works. It is a great alignment tool and an excellent way to measure long-term value, but as an incentive, it cannot drive a management team to perform the steps that need to be executed to achieve that long-term value creation.

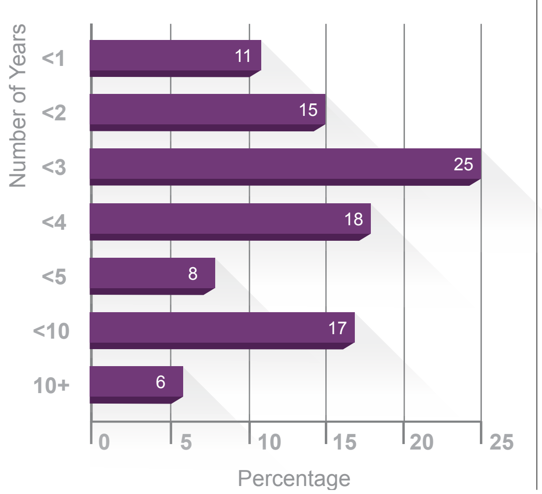
With that being the case, why do you think so many companies are using TSR as an incentive measure?

Swinford: Some of the additional findings of our research touch on this question. We found that larger, less profitable firms are more likely to rely on TSR as an incentive measure. Also, while it is becoming more prevalent in long-term incentive plans—jumping from 17% in 2004 to 48% in 2013—those who are more recently incorporating TSR are not putting as much weight on it.

We think that's likely because they are doing it as a way to bow to external pressure, but they recognize that as an incentive measure, it simply doesn't work and therefore don't want to put the entire plan on the line.

Among the proponents of TSR, there seems to be a broad assertion that somehow using TSR as an incentive can level the playing field among peers and help

Figure 2
Length of Time Using TSR as an Incentive Metric

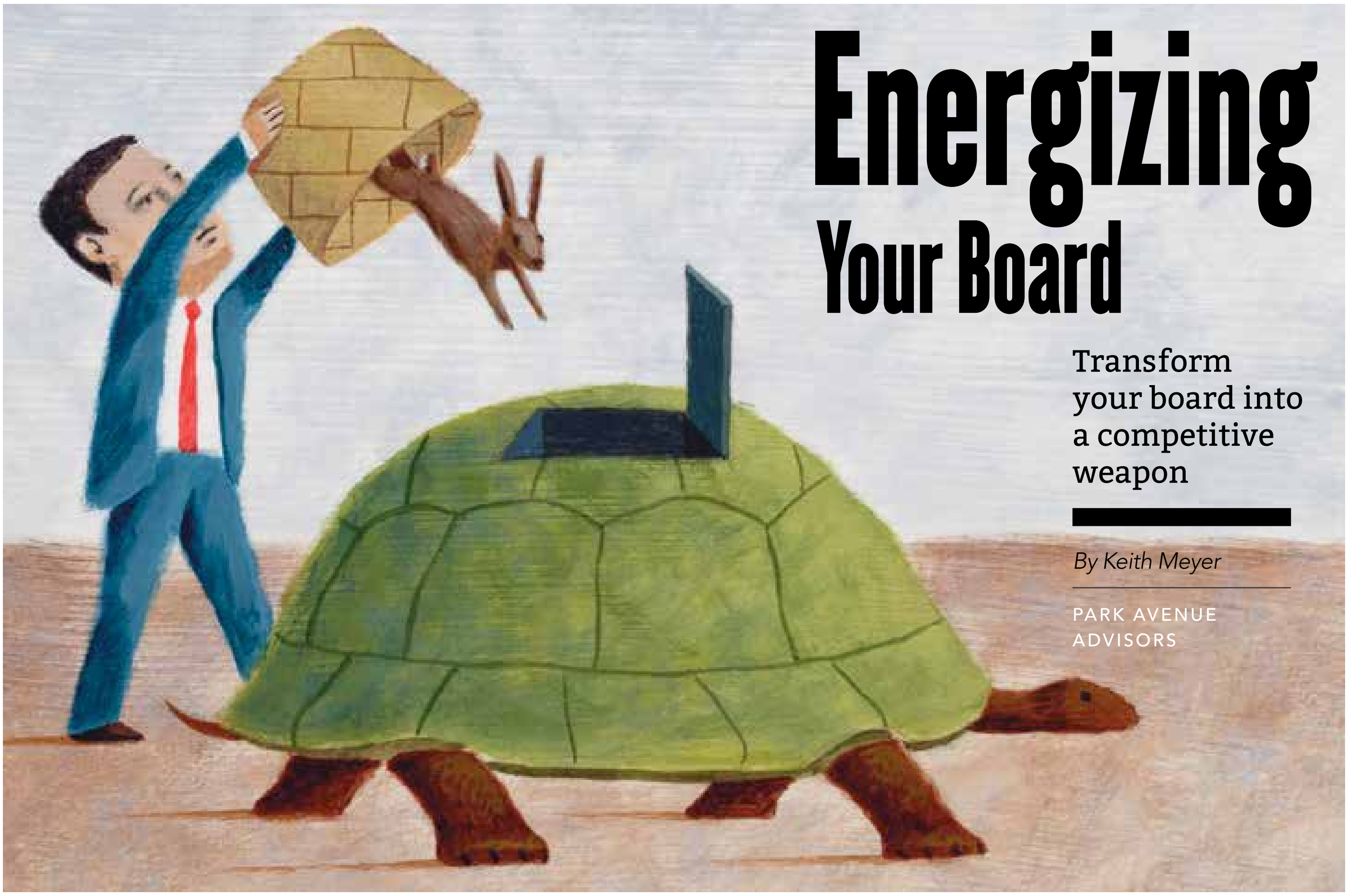


If TSR is not the best incentive metric, what works better?

Swinford: I'm glad you asked! As we said, the research shows that TSR is not a magic metric and unfortunately, there is no single alternative measurement that will fill the gap. It really comes down to the individual value drivers for a company. That means taking a look at your company-specific path to value creation, incorporating your business and financial strategies, along with considerations for your industry, your competitive position, the general market economics, etc.

For example, does a consistent increase in market share over a set time period signal success or is a competitive roadmap of new products more critical in your industry? Maybe it's geographic expansion that drives the business. Each of these will have very different performance metrics, both short- and long-term.

Going further, you may also include financial measures that indicate a healthy balance between growth and returns or operational measures that directly tie to your business strategy. The key is that this matrix is going to be unique for each firm and if you analyze your value drivers and design the compensation plans accordingly, you've taken a huge step toward helping achieve strategy execution. In many cases, you've just set your firm above the competition in terms of laying a foundation for success, and that's a competitive advantage you don't want to leave on the table. CS



Energizing Your Board

Transform your board into a competitive weapon

By Keith Meyer

PARK AVENUE ADVISORS

Change is underway in corporate boardrooms. Boards are becoming more proactive in addressing the rapidly shifting external environment, and they are focusing more sharply on driving value creation agendas with their management teams. Rather than sitting back on their heels and playing defense while activists, potential suitors, governance groups, regulatory agencies and other parties take aim, high-performing boards are going on the offensive and shifting their governance structure, operating practices and cultural norms to accelerate value capture.

High-performing boards excel in three key areas. Most importantly, they help build high-performing companies—those enterprises that generate and then sustain a value creation advantage over their competitors. They also recognize potential brand and reputational risk and pay close attention to the company's social and environmental responsibilities, while in parallel setting high standards for corporate governance leadership.

I launched a research initiative in 2010 to answer the question of which governance attributes and practices define these high-performing boards. The study eventually involved the participation of more than 150 U.S. and European board leaders from both public and private companies, including private equity portfolio investments. The goal was to identify the central elements that differentiated high-performing boards from those that struggled during, and then immediately following, the 2008 global recession. Activist investors seemed to be making the same assessment, as they ramped up their attacks on complacent boards in the U.S. starting in 2010, targeting larger market-cap companies. Small groups of board leaders were engaged in candid and confidential discussions on what had worked well, and what had a negative impact on board performance. Most apparent in these discussions was the critical role board leaders played not only in driving the board's own performance through the turbulent times, but also in creating an environment that promoted high-performance from the CEO and the senior leadership team.

When distilling the research findings into key board performance drivers, as shown in Figure 1, it is evident that structural attributes such as board size, the range of expertise among members, and committee design significantly impact board performance. Operationally, the established expectations for individual director contribution, and the core practice of building an annual board meeting agenda cadence linked directly to the most important value creation decisions, prove to have a strong influence on the quality of the board's work. Culturally, the ways in which directors interact with each other and respect their peers' contributions, and how the board engages with the CEO and senior team, set the tone for making difficult trade-offs that will ultimately drive long-term value creation. In addition, maintaining an open and transparent relationship between the board and management will ensure that unplanned events and external shocks are rapidly addressed—a capability that is increasingly important in our 24/7 globally connected world.

Figure 1
Key Board Performance Drivers

Board leadership that fosters continuous improvement.

Structural
- Board size.
- Director experience and competencies.
- Committee charters and deliverables.
- Committee member expertise, rotation and succession planning.

Operational
- Annual cadence to board meeting content.
- Value creation plan directly linked to Board's agenda.
- Quality of the Committees' work.
- Quality of executive sessions and follow up with CEO.

Cultural
- Extensive director dialog/ debate of the most significant issues.
- Open and ongoing information flow between management and the Board.
- Board conducts a rigorous annual CEO assessment.
- CEO succession plan integrity and regular focus.

Ability to adapt to unplanned events and external shocks.

Figure 2
Build a High-Performing Board, Example

Step 1
Reset the Board's Performance Expectations
- Role of the Board
- Guiding principles
- Board composition
- Board leadership
- Key functions and operations
- Individual Director contribution
- Board culture

Step 2
Embed High-Performing Team Attributes
- Small number
- Complementary skills critical to the company's future success
- Common purpose and performance objectives
- Commitment to a unified working approach
- Mutual accountability

Step 3
Leverage Self-Assessment Insights
- Recruit new capabilities while reducing the size of the Board
- Shift Committee membership to enhance quality of deliverables to the full Board
- Expand CEO annual review to include 360° assessment
- Engage with key external stakeholders on a regular basis

Step 4
Align with Enterprise Value Creation Plans
- Sharpen Board leader role and responsibilities
- Increase frequency of CEO and management team communication on key issues
- Devote 75% of Board meeting time to critical near-term value delivery initiatives
- Elevate CEO pipeline development to regular full Board agenda item

Board is a Competitive Weapon

1. *Teams at the Top*, Jon R. Katzenbach, Harvard Business Review Press, 1998. *The Wisdom of Teams*, Jon R. Katzenbach and Douglas K. Smith, Harvard Business Review Press, 1993.

The transition to a high-performing board is a bespoke process tailored to fit the unique structural, operational and cultural factors that impact company performance. The starting point is a rigorous self-assessment, followed by a reset of performance expectations to ensure that the board's work is fully aligned with the future success of the company, as shown in Figure 2.

Embedding high-performing team attributes into the board improvement process is the next priority. As discussed in *Teams at the Top* and *The Wisdom of Teams*[1], high-performing teams comprise a small number of people with complementary skills who are committed to a common purpose, set of performance goals and approach for which they hold themselves mutually accountable. Board members who do real work together either in established or ad hoc committees, on special management-led initiatives, or as part of a CEO succession or strategy development process, tend to move more rapidly into a high-performing team mode, especially when the board has a culture of mutual accountability.

High-performing board leaders also leverage self-assessment insights to unlock specific full-board and committee improvements that align the most important enterprise value creation priorities with the board's own development plan. The objective is to closely link the board's capabilities and work practices with the company's near-term value capture agenda, with provision for regular external board engagement and ongoing shareholder communications.

From my experience, transitioning to a high-performing board only occurs when the board leader has full ownership of the process. With success, the board not only becomes a strategic asset for the CEO and the leadership team, but also a competitive weapon for the company. Directors should not feel they are constantly "on the hot seat," buffeted from all sides by outside forces for which they are unprepared, but instead are driving the value creation agenda with the CEO and, in effect, taking the ammunition away from activist investors. CS

Keith Meyer is the Founder of Park Avenue Advisors, an independent advisory firm focused on building high-performing boards. He can be reached at kmeyer@parkaveadvisorsllc.com.

Piecing the Team Together

The four key building blocks of effective board governance

By TK Kerstetter

BOARDROOM RESOURCES LLC

Remember this quote: *"It's not hard to find qualified candidates to serve on a public company board ... Getting them to function as an effective team—and bringing value to management and shareholders—is another story!"* For many years, this adage (which is an offshoot of a famous Casey Stengel quote) has characterized what an effective board is and should be. This quote still reflects the foundational attributes of a great board today, as I outline the four building blocks of effective board governance looking forward into the remainder of 2016.

1. Board Leadership

Maybe the most important building block of an effective board is the presence of board leadership, in some form. This holds true whether we are talking about a non-executive chairperson, lead director or an informally anointed spokesperson who commands the respect of the other directors and ensures critical board processes are in place and running smoothly. Board leaders' duties run the gamut, from fostering constructive CEO/board relations to confirming that crisis plans are in place. They also oversee the key processes I'll address throughout the rest of this article, particularly board chemistry and accountability to shareholders. The list of duties, both formal and informal, is too long to recite here, but rest assured, effective boards have effective leadership. Boards need to have a strategic plan for what they want to accomplish that will bring value to the CEO and shareholders, and it just won't happen unless someone organizes the board into a functional team.

TK Kerstetter is the CEO of Boardroom Resources LLC and is a second generation pioneer of governance thought leadership and board education.

2. The 3 C's – Composition, Culture, Chemistry

As stated above, these steps and attributes don't just happen. Creating an effective board with the needed skill sets and diversity unique to each company is an art. Finding independent, strong-willed and talented board members is only half of the challenge. Coordinating them into a functioning team that provides oversight while also bringing value to all constituencies—that is the quest. Does the board contribute to setting the right tone at the top? Is there the right chemistry and board culture to challenge management and each other constructively without concern or fear of repercussions? Does the board have the commitment to evaluate others' performance and provide feedback or make changes if necessary? All these questions address the chemistry and culture of a board. The better the chemistry and the more defined the foundational principles by which the board operates, the more effective the board.

3. Accountability to Shareholders

In the past, this key foundation was set by a legal responsibility outlined in a corporate director's duty of loyalty and duty of care. This, along with the responsibility to operate in good faith, framed how board members should evaluate their decision-making with respect to representing shareholders. Today, accountability to shareholders and the rise in the institutional shareholder's voice have expanded this responsibility. Proxies are growing in length, and activists want more transparency than ever before. For the last three years, the focus has been on shareholder engagement beyond management's typical quarterly earnings announcement or meeting with a company's largest investors. Shareholders, particularly institutional shareholders, want to hear from board leadership and committee chairs themselves. This paradigm shift will affect the future skill sets of board committee chairs and director recruitment. Boards that grasp this ever-changing environment and constructively engage with shareholders will feel little pressure from this rising trend, which will ultimately allow them more time to spend on strategy and value-building tasks.

> Creating an effective board with the needed skill sets and diversity unique to each company is an art.

4. Mastering the Board's Core Responsibilities

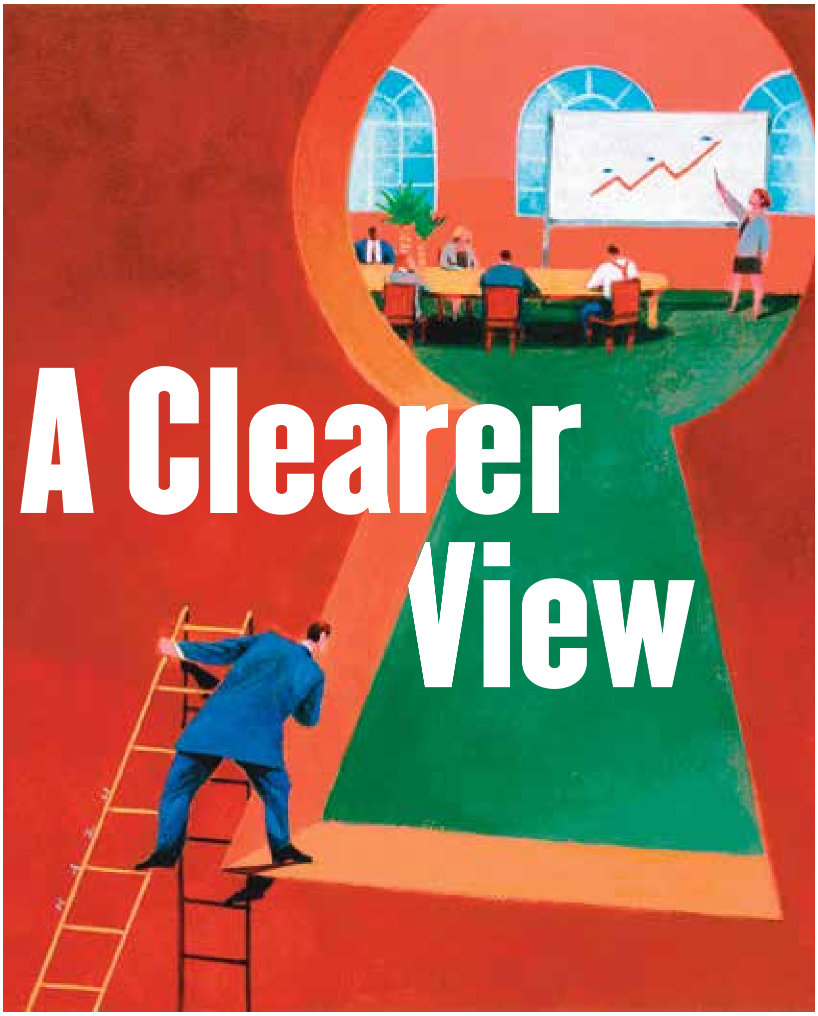
Much like a personal trainer who stresses the value of building one's core, the same is true for a board. If you boil down all of a board's responsibilities, there are three core areas that, when addressed prudently, can provide a board the core strength to be effective.

The first core responsibility is to recruit, reward, and retain the right CEO. Experts argue that this is the most important core duty, and it's hard to argue with that. CEO succession has repeatedly been identified by corporate directors as one of the two most challenging tasks a board faces.

The second core responsibility is overseeing enterprise risk management. This is the other most challenging board task identified by directors themselves. Let's face it, shareholders have invested in the company to grow their stake, so, at the least, directors should be protecting that value, if not growing it. Getting one's arms around all of the risk that companies face today, let alone the onslaught of cyber and big data security, is no small task. Good companies have a process to identify potential black swan events and risks within the business's operating plans, which mitigates surprises in operation and bottom-line performances—always a good thing.

The final core responsibility is confirming the organization has a good direction and plan for building value. Strategic planning and budgeting is the blocking and tackling of any good company. The board should play an oversight role in the situational analysis and goal-setting and then approve final plans and budgets. Effective boards are tapped by management for their expertise when appropriate, and most directors yearn to spend more time on strategy and less time on compliance and regulations. So far compliance is winning, but effective boards find a way to minimize board time on non-strategic issues.

In the end, there is no magic formula for ensuring that a group of qualified individuals can be an effective board. Leadership sometimes emerges from some unlikely places and even lack of leadership can sometimes be counterbalanced by a sharp CEO, who fills the void without conducting him or herself like an imperial chief executive. I believe you can increase your chances by building a good foundation of committed practices. Just remember: "You can't control the winds and tides, but you can adjust the sail and rudder to get to where you want to go!" CS



A Clearer View

The proxy as a window inside the board's compensation and governance practices

By Ron Schneider

RR DONNELLEY

Leading companies that started innovating with their proxies a decade ago did so primarily based on insights they gleaned from engagement with their larger institutional investors on corporate governance and compensation issues. This governance engagement—supplementing the traditional IR dialogue—informed companies of investors' informational needs and arguably launched proxies on their continuing march from dry compliance documents to more informative communications pieces.

Each year, RR Donnelley assists more than one-third of all listed U.S. companies with some aspect of the production and dissemination of their proxy statements, whether it's printing, SEC filing, mailing, web-hosting or, increasingly, strategy and design. This gives us a front-row seat to both witness and participate in the accelerating transformation of the proxy. The following sections detail a few key elements driving these changes.

Compensation Disclosure Drivers

The main question investors ask, which often is not succinctly articulated in proxies, is how pay supports corporate strategy. The CD&A requirement, which came into existence in 2009, along with Say on Pay votes commencing in 2011, made many public companies more proactive and turbo-charged engagement with investors. This led to clearer descriptions of executive compensation practices, decisions and awards, accompanied by design changes that gave the enhanced disclosures more impact. On the reactive side, poor votes in one year often lead to a reassessment of company practices and disclosures, also resulting in transformed documents the following year.

Board and Governance Disclosure Drivers

Over the past five years, while most proxy innovation was focused on compensation, we also began seeing increased innovation in how companies convey key attributes of their boards, including independence, diversity (such as gender, ethnicity, geographic background, age and tenure) and perhaps most importantly, skills and qualifications.

Reasons for these innovations include heightened levels of activism—whether about corporate governance, strategy or performance—and increasing focus by investors on board diversity, tenure, refreshment and whether boards contain the right mix of skills and qualifications given the evolving challenges facing companies today.

General Disclosure Drivers

Many companies, observing how their peer companies are enhancing the quality and clarity of their communications, are also following suit, not wishing to be perceived as relative communications laggards in the eyes of their investors. Concerns about proxy advisors and their influence is another reason companies are enhancing their efforts to effectively communicate their viewpoint directly to their investors.

Recent Research

This past year, RR Donnelley partnered with Equilar and Stanford University in our 2015 investor survey "Deconstructing Proxy Statements – What Matters to Investors."

According to the survey and as depicted in Graph 1, the top areas of investor interest with respect to compensation issues are pay for performance alignment, performance metrics and peer group benchmarking. In terms of corporate governance and board issues, the top areas of interest are director independence, nominee bio history, qualifications and skills, corporate governance profile/ shareholder rights and board oversight of risk.

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These results validate the energy and creativity companies are putting into more effectively "telling their positive story" on a range of issues.

However measured, company performance rises and declines, and investors understand that. Given uncertainty about short-term performance, effectively communicating your company's governance and compensation stories can help to gain you the understanding, confidence and support from a majority of your long-term, mainstream institutional investors. Specifically, strong communication can show that the company has the right leadership and strategies that are supported by appropriate compensation and corporate governance practices, and are overseen by a board that possesses the requisite independence, skills and qualifications to provide effective oversight.

The above foundation can help gain you additional leeway to permit your company to steer its own course through often-turbulent waters.

Issues with Expanded Disclosures

For many investors, the proxy is their primary window into the boardroom, and voluntary disclosures help them gain more understanding of and muster support for the board and the critical role it plays. That said, as companies increasingly add voluntary disclosures to the required disclosures, proxy statements unfortunately have grown in length. While this may discourage their use as "reading" documents, many investors report using them as "reference" documents, and this poses less of a problem.

Growing document length has led to innovations such as proxy summaries and CD&A executive summaries. The good news is that summaries are highly likely to be read. The bad news is that they typically contribute to some duplication and repetition and, yes, added page length. In our view, a little duplication is tolerable provided your key information is more likely to be read at least once.

Graph 1

Which of the following sections of the proxy does your firm read and rely on to make voting decisions?

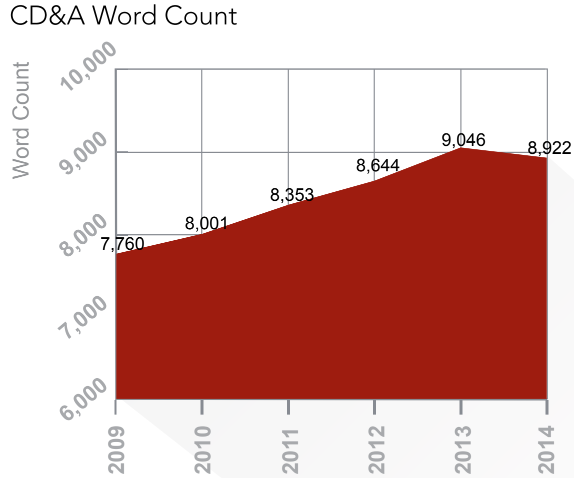
Another innovation is the use of charts, graphs, checklists, time lines, icons, shading, callout boxes and other visual elements. These do help draw the reader's eye to the content you consider critical. As with summaries, the downside—when such visual elements are used to supplement text—is that they also add to document length.

Recently, more companies are successfully using such visual and design elements to replace rather than supplement certain narrative disclosures. We believe that when this occurs, it is a win-win situation for companies and their investors alike.

As possible validation of this, we point to data from Equilar's most recently available CD&A trends analysis, which indicates that CD&As have grown on average by 300 words per year since their inception in 2009. In 2014, this steady increase declined by just 100 words from its peak in 2013. We look forward to upcoming Equilar data covering the balance of 2015 to see if this "peak" is truly a "trend." And if so, it may be attributable in part to companies replacing rather than supplementing text, in the process creating a more impactful and digestible document. Hmm … if only I hadn't written this last paragraph and simply let you absorb the image!! CS

Graph 2

CD&A Word Count



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To access the Investor Survey, visit ***info.rrd.com/2015_Investor_Survey****.*

To access the CD&A Trends analysis, visit ***info.rrd.com/LP=283****. Keep an eye out for this year's update, to be released on February 24, 2016.*

2016 Hot-Button Issues

JOHN J. CANNON, III
Partner
SHEARMAN & STERLING LLP

SHEARMAN & STERLING LLP

Mr. Cannon is a partner in the Compensation, Governance & ERISA Group and Chair of the firm's Corporate Governance Advisory Group. In his practice, he focuses on all aspects of compensation and benefits, including corporate, securities, bankruptcy, employment and tax laws and ERISA. He has extensive experience in executive compensation and corporate governance matters, Dodd-Frank and Sarbanes-Oxley, and the employee issues raised in the mergers and acquisitions context. Mr. Cannon joined the firm in 1985 and became a partner in 1994. He has been named an inaugural fellow of the American College of Governance Counsel.

A Transitional Year for Executive Compensation Disclosures

In many ways, the 2016 proxy will be a transitional one for executive compensation disclosure, with issuers awaiting the implementation of the remaining significant Dodd-Frank mandates.

In the meantime, what will be interesting to watch in 2016 is public companies' response to the plaintiff bar's recent challenges to director compensation at Citrix, Goldman Sachs, Facebook and other companies. The vulnerability of companies on this score arises from the fact that, in approving their own pay, including but not limited to equity awards, nonemployee directors are conflicted and therefore not protected by the business judgment rule under Delaware and other state laws. Accordingly, unless the relevant director compensation has been approved or ratified by shareholders, in any litigation attacking director pay the directors will have to prove the "entire fairness" of the challenged compensation. This may be difficult if the director pay at issue is outsized relative to peer and market practice.

For an asserted defense of shareholder approval or ratification of director compensation to be successful, the courts have held that the caps on per person awards in a plan must be "meaningful," which often is not the case in omnibus equity plans. As a consequence, many public companies are considering whether to ask shareholders to approve the inclusion of more restrictive limits on equity and/or cash compensation to directors in their compensation plans. To what extent issuers decide to submit amendments to shareholders solely for this purpose, or instead wait until they need to amend plans for other reasons, remains to be seen.

MARC R. ULLMAN
Partner
MERIDIAN COMPENSATION PARTNERS, LLC

Marc Ullman is a Partner and leader of Meridian Compensation Partners' New York office. With over 20 years of executive compensation consulting experience, Marc has established many long-standing client relationships as a trusted advisor to both boards and management teams. Marc consults with large and small, publicly-held and privately-owned organizations, and has experience in various industries, including consumer products, insurance, manufacturing, media, professional services, REITs, retail, technology software and hardware and telecommunications. Marc consults in the areas of shareholder engagement, share reserve requests, transaction-related compensation programs, such as in initial public offerings, M&A and spin-offs, and executive new hires and terminations, as well as in all phases of the annual executive compensation cycle.

Pay for Performance Alignment

Demonstrable pay for performance alignment will be a hot-button issue for 2016, as it has become the holy grail of CD&As. Notwithstanding the looming SEC pay for performance disclosures, shareholders are ahead of regulators in expecting companies to demonstrate how they align pay with performance.

One challenge is that compensation values in a given year are typically based on prior year performance, future performance, financial performance and share price performance, all over one, three and five years or longer. This inherent timing disconnect has spawned new approaches to valuing compensation (e.g., realizable compensation) and to illustrating pay for performance alignment ahead of required disclosures.

Based on proposed SEC rules, it is well understood that required disclosures alone will be insufficient, with supplementary disclosures likely needed. One way to supplement the pay for performance picture now is to clearly disclose a rigorous "front-end process" for selecting incentive plan performance measures and setting goals. Companies that do this well should clearly disclose the process, and, if possible, provide investors answers to the following questions:

- How do performance measures drive shareholder value?
- How do threshold, target and maximum performance goals compare to actual performance in prior years?
- What is the degree of difficulty and how likely is threshold, target and maximum performance?

When companies use a rigorous "front-end process" to select appropriate performance measures and set appropriate goals, pay and performance will be aligned over the long-term. And by disclosing this "front-end process," future pay for performance disclosures will be viewed in context and help secure Say on Pay votes.

JOAN CONLEY
Senior Vice-President and Corporate Secretary
NASDAQ

As Senior Vice President and Corporate Secretary of Nasdaq and its global subsidiary organizations, Joan is responsible for the Global Nasdaq Corporate Governance Program. She is also responsible for the Nasdaq Global Ethics and Compliance Program, is Managing Director of the Nasdaq Educational Foundation and is a member of the Nasdaq NLX Ltd. Board of Directors. Joan is a contributor to NACD publications including the NACD Blue Ribbon Commission reports on Talent Development: A Boardroom Imperative (2013) and Effective Lead Director (2011). In 2008, she received Corporate Secretary Magazine's award for "The Best Corporate Secretary in an M&A Transaction." Joan serves on the Board and Audit Committee of two non-profit organizations in Washington, D.C. and mentors several young women. In 2014, she was elected to the SIFMA (Securities Industry and Financial Markets Association) Foundation's board of directors.

CHARLES V. CALLAN
Senior Vice President, Regulatory Affairs
BROADRIDGE FINANCIAL SOLUTIONS

Mr. Callan joined Broadridge in 2003. His responsibilities include government relations, regulatory affairs and policy research and analysis. He is a recognized expert on investor communications processes. He has written about such topics as process costs, benefits and investor participation. His research and analyses are used by regulators, institutional investors, corporate issuers, mutual fund companies, the media and leading associations. Mr. Callan is a cum laude graduate of Columbia University (BA, economics). He earned an MBA with honors from Harvard University.

Shareholder Activism: The Need to Know Your Shareholders

There were record numbers of proxy contests in 2015, a surge in new bylaws enabling qualifying shareholders to nominate directors and more shareholder-to-shareholder communications campaigns than we've seen in years. While some observers suggest shareholder activism may decline in 2016 due to changing market conditions, the fact is the high performance expectations of directors and boards are here to stay.

By mid-year 2015, 10% of Say on Pay proposals and nearly 1,200 company directors failed to surpass the 70% support benchmark considered important to many companies and some proxy advisors, and that is likely to result in more pressure on votes in 2016. New rules on disclosing CEO pay ratios will add scrutiny to pay plans as they kick in beginning in 2017. Moreover, a recent SEC legal bulletin narrows the exclusions companies can use to limit shareholder proposals and, as a consequence, proposal activity is expected to remain robust in 2016. Shareholder interest in corporate governance shows no sign of abating even if the specific matters and issues change. There's simply more at stake now for shareholders, management and directors.

Given this, many managers and directors are looking to better understand the views of all of their shareholders, to better know them and to engage with them more regularly throughout the year. This includes retail shareholders, who as a group owned more than 30% of the shares of U.S. companies in 2015. It goes without saying that the participation of individual investors as buyers and sellers makes a difference to share ownership levels at many companies. And although their participation in proxy voting has generally waned in recent years, it logically follows that retail shareholders can also make a difference in voting outcomes. More data and technology are being made available for these purposes including, for example, aggregated analyses of shareholder ownership and voting patterns, virtual shareholder meetings and the use of popular digital mail sites for regulatory and other communications.

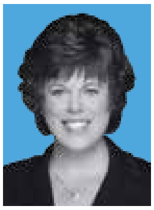
Active and ongoing engagement between directors and shareholders is becoming the norm. Even if the number of actual battles for control moderates a bit in some areas in 2016, shareholder interest in corporate governance continues to expand. With these developments, it is essential for companies to know all of their shareholders for effective governance.

Corporate Use of Capital

Corporate use of capital is likely to be a "hot-button" issue for the 2016 proxy season. It is notable in this regard that stock buybacks have attracted attention from stakeholders, including the public at large.

Media attention on this subject has been significant, and the statistics are interesting. For example, FactSet reported on September 21, 2015, that "on a trailing twelve-month basis (TTM), dollar-value share repurchases totaled $555.5 billion;" and that "the aggregate BuyBack to [free cash flow] FCF ratio for the S&P 500 exceeded 100% for the first time since October 2009."

C-suite executives, in modeling their capital structure and how it can be optimized in their own corporate circumstances, must balance the benefits of capital investment with other uses of capital, including dividends and stock buybacks. As a matter of strategy and risk management, boards have an oversight role to make sure the policies remain appropriate—in particular, that they contribute as intended to strategy and are in step with the corporate risk appetite. This balance is a key issue for institutional investors and one might therefore expect it to be a front-of-mind issue for them, and a prime candidate for focus in 2016. In the event this issue does arise, you'll be in a great position having ensured your C-suite is coordinated and has engaged in proactive dialogue with major shareholders, including with the portfolio managers and the governance teams. Such dialogue is especially helpful if it is educational and informed—the key is to tell the story and be transparent.



JANE EDISON STEVENSON
Vice Chairman, Board & CEO Services
KORN FERRY

Jane Stevenson is Vice Chairman, Board & CEO Services at Korn Ferry. She leads the firm's Global CEO Succession Practice. Jane co-authored the best-selling business book, *Breaking Away: How Great Leaders Create Innovation that Drives Sustainable Growth—And Why Others Fail* (McGraw Hill 2011). She is a recent recipient of the prestigious Maurice Holland Award for her writing on innovation.

Succession Planning: Resolve to Make a Difference in 2016

With the 2016 proxy season under way, if "succession fitness" isn't at the top of your board's to-do list, it should be. And as with any fitness regimen, be prepared to persevere so it doesn't follow the usual fate of New Year's resolutions.

"Succession fitness" is best viewed in broader terms, as part of a rigorous, evergreen succession planning process. Given the intense scrutiny of boards and their increased level of accountability, boards can have significant impact in this area in 2016 as they manage risk and seek to provide long-term value.

But succession fitness doesn't happen overnight. It requires ongoing commitment and discipline to build succession muscle—i.e., ongoing leadership development linked to strategic business priorities—to reap the benefits for years to come.

The most daunting aspect of implementing and maintaining a results-driven succession fitness process is getting started. Step one is an annual team exercise for the board, beginning with a few fundamental questions:

1. Are we aligned around the board's strategic priorities for the next two years? For five years and beyond?
2. How do these strategic priorities line up with our leadership bench capabilities and where do the gaps lie?

Beyond identifying immediate CEO successors, we advise board clients to "go deep." Organizations at "peak performance" use succession planning to look three generations out when identifying promising leadership talent and set development goals to build skills that support strategic imperatives for the business.

This ongoing work requires a shared understanding by directors that the ultimate responsibility for effective succession fitness rests squarely with the board. Don't wait to act. While your board is in 2016 resolution mode, commit to implementing a succession fitness process with the framework, support and actionable steps that will result in visible, measurable progress—in the coming year and beyond.

A New Generation of Governance

An interview with Catherine A. Allen, Chairman and CEO at The Santa Fe Group

SHARED ASSESSMENTS

Catherine A. Allen is Chairman and CEO of The Santa Fe Group, the strategic advisory services company with expertise in cybersecurity, emerging technologies, and project and risk management. The Santa Fe Group provides management for strategic industry and institutional projects, including the Shared Assessments Program, focused on third party risk management.

From 1997 to 2007, Catherine was the founding CEO of the financial services industry consortium, BITS. Earlier in her career, Catherine served in several senior executive positions at Citicorp and Dun & Bradstreet. She represented Citibank as founding Chair and President of the multi-industry Smart Card Forum.

Catherine currently serves as a board member of Synovus Financial Corporation, El Paso Electric Company, and Analytics Pros and is a member of the Risk, Energy and Natural Resources, External Affairs and Nominating and Governance Committees. She also serves as the Chair of the Security Committee for El Paso Electric. She sits on the Advisory Committee for Houlihan Lokey.

We sat down with Catherine Allen—Chair and CEO of The Santa Fe Group and a member of multiple corporate boards—to discuss how directors are approaching issues facing the companies they serve, as well as their own boards' structure and succession. Each of these issues came back to a central theme: The future is here, and boards that aren't able to adapt to changes as we embark on a new generation will face significant challenges in the years ahead.

What have been the most prominent changes affecting boardroom management in the past five years, particularly in relation to financial challenges and technology advancements?

Catherine Allen: Six main things have changed in the past five years that are affecting corporate boards: The financial crisis, globalization, shareholder activism, revenue generation and innovation, technology directors and board education. Each of these factors plays a critical role in how boards approach their duties as directors.

Financial Crisis. The financial crisis impacted every board I was on as well as all of corporate America. In one sense, the event helped boards understand there could be a crisis over which they had no control—it just happened and happened to you. In addition, it was a stark reminder that you have to be thoughtful about risk and regulatory compliance. As a result, we've seen huge moves to be more conservative about financial bubbles. That's been a prudent thing.

Globalization. Even if you're a company that is only focused on the U.S. market or even a region, boards are realizing, whether it's talent or competition on specific services or goods, or technology changes, the market is more diverse and firms need to understand how customers around the world are different.

Shareholder Activists. A majority of companies have had some kind of shareholder activist activity, and there are often good reasons for it. But I've seen a number of bad ones where short-termism and egos of people who want to make a mark on Wall Street pump up the stock for their own purposes before exiting and leaving the company in a tough position. Even if you aren't

> The new normal is constant change, and the new attribute is someone who can live with ambiguity. It's only going to get more complex.

approached, you have to understand shareholders' most pressing concerns.

Revenue Generation and Innovation. During the mortgage and derivative bubble the financial industry took on new risks around mortgages and a lot of revenue came from that. But now it's harder to find that revenue, so leadership has to be strategic in creating new revenue streams. And that takes innovation. It's not just with financial companies. Where do those innovations and revenue streams come from, and how do you leverage them?

Directors of Technology. Boards now need a director to understand how dramatically technology is changing business models and disrupting business as usual. And that person must be able to speak eloquently to the rest of the board about that, whether it is someone who can see where mobile is going, or understand cybersecurity, or the difference in demographic groups' usage of technology.

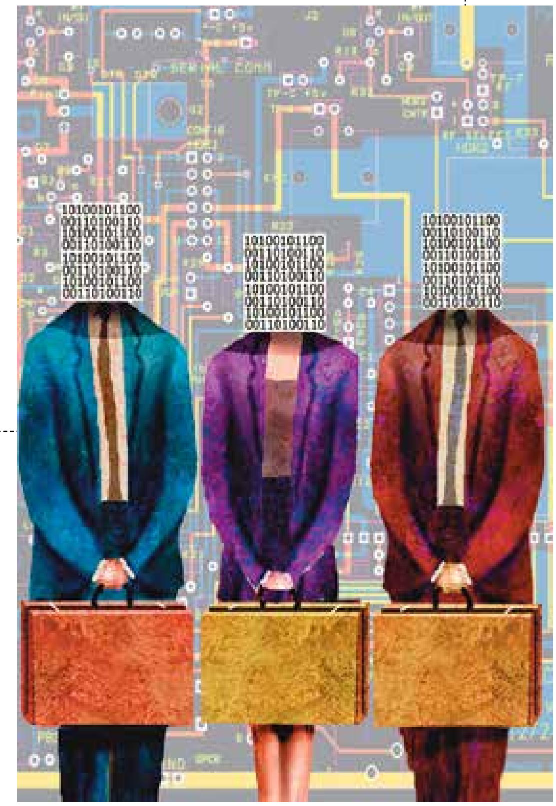
Board Education. Even though it's not required, more board members are getting educated by bringing in outside speakers, going to conferences, or reading to stay up to speed, and they need to stay up to speed. That education component is huge, and it's part of the reason you need diversity on boards. Boards need to stay fresh or be refreshed with new members.

As the average age and tenure of directors continues to increase at a broad level, and as a large generation of executives and directors reaches retirement age, how are boards engaging in re-assessment and succession planning? What challenges does this cause boards in the present?

Allen: Personally, I am a big believer in board and personal assessments and in having a certain age limit, although I would argue if you have an age limit you should have exceptions for skill sets. You have some 75-year-olds who are savvy and can stay up on anything,

But then you have other directors who are complacent—and that's not limited to age. I'm also concerned about tenure over 15 years. Is that person who's been on the board 20 years really independent? Also, most boards in the past were former CEOs or sitting CEOs or COOs or a legal person who knew how to run a business in a traditional way. Now you need people who are very strategic, and also open to change. The new normal is constant change, and the new attribute is someone who can live with ambiguity. It's only going to get more complex.

> “Boards need to be educated about [technology] and have at least a couple directors who can explain it in plain English and business terms.”



Speaking on age, you recently co-authored a book called “The Retirement Boom,” which is about the baby boomers and how they really aren't retiring but in fact are reinventing themselves. How does the generation gap complicate the issue of board assessment and succession?

Allen: Whether they are your employees or customers of your customer, you need to understand the Millennial demographic to understand what the world is going to be like. There are 77 million Boomers, 40 million Gen Xers, and 80 million Millennials in the U.S. alone. Millennials around the world are more alike than any other generation because of technology. You have to understand what they're doing to manage your workforce, to attract, train and retain them, and also to get them to buy your products and services and interact with you.

Many boards are not there yet. Managing a multigenerational workforce and leveraging the best of the generations is not easy. For the Millennials, technology is a given, and they use it in all forms. They want to text, they don't want person-to-person meetings, and they can multi-task. They are interested in personal development. They want to be promoted or go somewhere else. They don't have the same loyalty as other generations.

For one company I advise, I helped bring in a Boomer CEO. The Millennials who started the company were innovators and brilliant, but didn't know how to run a business. It's an opportunity for the Boomers to reinvent themselves working for Millennial companies. The founders are open to advice because they want to sell or go public. On the other hand, Xers tend to want to do it on their own. Interestingly, the Xers and Millennials don't get along very well.

You've mentioned diversity a couple times, which is a hot topic. In what ways has diversity—not only gender and ethnicity, but also skills and expertise—become a factor in board evaluation?

Allen: There is talk about it, but chairs of the board or nomination and governance committees tend to be more traditional. They say they want change, but it's not happening very quickly. When there are three or more women on a board there is substantial difference in positive financial performance and stakeholder perspective, but there isn't a huge amount of change yet. Women still make up only 17% of corporate boards.

You have to ask what do our stakeholders and customers look like, and does the board reflect that? If 30% of your customer base is African-American and 70% women, are you understanding what your customers or workforce or stakeholders really want and need? There will be more and more pressure on boards for diversity from Millennials as well, who are not yet into investment mode—right now it is mostly large institutions and activists asking these questions.

Another issue is how boards find new candidates. We keep hearing people say there's no pipeline of women. But what they mean is that there aren't enough women who are already on boards. If you're not on your first board, it's really hard to be considered, and you're dubbed "inexperienced." The pool of women who are on boards is much smaller, so to see change we'll need to look for the talent among those who are not on boards but have the skill sets and experience that is needed in today's boardroom, such as technology, public policy and communications.

To see change we'll need to look for the talent among those who are not on boards but have the skill sets and experience that is needed in today's boardroom, such as technology, public policy and communications.

You mentioned something else from a technology perspective—mobile and digital and consumer trends around these things. How is digital technology affecting all companies, not only those who are directly consumer facing?

Allen: This comes back to the generational shift. The board needs to understand digital technology to attract the new generation. If they're going to work for you or buy something from you they are going to go your website first to find out how tech-savvy you are, what is your mission, can they reach you on an app, etc. We really have to ramp up what we're doing online and in the mobile app environment. That means boards need to be educated about this and have at least a couple directors who can explain it in plain English and business terms. Understanding disruptive technologies and business models will be key.

As a risk consultant, you have unique perspective into the challenges companies are facing. What are some other examples of new or evolving risks boards are seeing today?

Allen Third-party risk is a hot topic. I've hired seven people in the last year because it is front and center for many boards as well as companies in general. The explosion of cyber attacks like Target and Home Depot and others were through a vendor or another third party. As a result the CEO was gone and people were calling for resignation of the board risk committee. You may have great privacy and security policies and practices in place, but that vendor or vendor's vendor who doesn't could cause the problem.

Third-party risk is the weakest link in protecting company assets, and we're only going to see an escalation of breaches. We need to evaluate vendors on a regular basis. Third-party risk is not only a management, procurement and sourcing issue, but also a reputational and operational risk.

What key factors should boards look at going forward to the future?

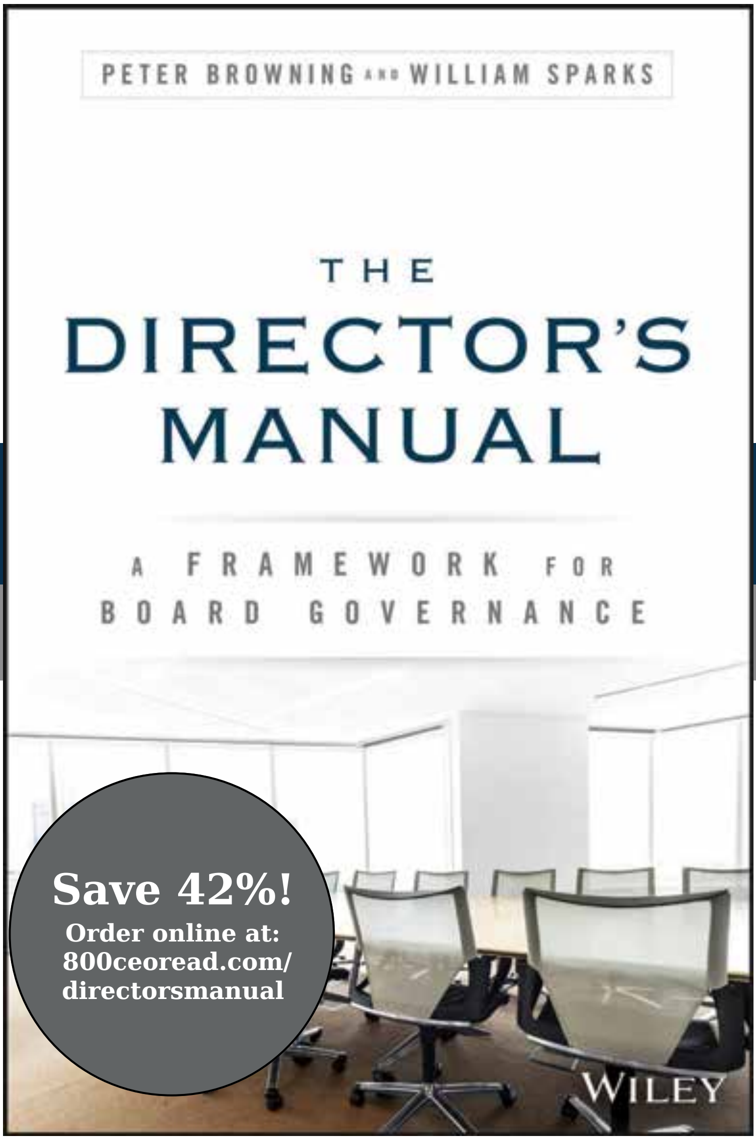
Allen: As I mentioned, demographic issues will cause challenges as we face the combination of Boomers leaving boards and the workforce and Millennials coming into the workforce. And then we have a much smaller number of Gen Xers to fill the gaps. I can't reiterate enough how important it is to understand disruptive technologies and business models.

And finally, shareholder activism has ignited the debate between short-termism and longer-term views. The question is how you satisfy Wall Street but take the time to do the R&D and create innovations to make a long-term strategy successful. When you do a strategic plan, three years is now "long-term," and that makes it a more complex environment. CS

Improve Board Performance

by Peter Browning

and William Sparks



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The Director's Manual: A Framework for Board Governance offers current and aspiring board members essential up-to-date governance guidance that blends rigorous research-based information with the wisdom found only through practical, direct experience. The book's flexible approach to solving governance issues reflects the authors' belief that no two boards and the cultural dynamics that drive them are the same. As such, the advice offered reflects recognizable leadership dynamics and real world, relevant organizational situations.

The book's two authors, Peter C. Browning, an experienced CEO and member of numerous boards and William L. Sparks, a respected organizational researcher, combine their individual experiences and talents to create a book that is both innovative and applicable to directors in any industry sector. Specific best practice guidance is designed to help board members and their directors understand the unique strengths and challenges of their own board while at the same time provide targeted information that drives needed improvements in board performance and efficiency. Specifically, this book will help board members:

- Explore practical advice on key issues, including selection, meeting schedules, and director succession
- Consider board performance from multiple perspectives, including cultural and group dynamics
- Discover how to effectively manage classic problems that arise when making decisions as a group
- Access a comprehensive set of assessment questions to test and reinforce your knowledge

The Director's Manual: A Framework for Board Governance offers practical advice to guide you as you lead your organization's board.organization.

PETER BROWNING with experience on the boards of 13 public companies, two as CEO, is founder and managing director of Peter Browning Partners, LLC, a board advisory service that helps directors answer tough questions in the areas of board governance, board performance and dynamics, and leadership transition and succession planning.

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Engaging Proxy Advisors for 2016

An interview with Robert McCormick, Chief Policy Officer, and Kevin Liu, Director of the North American Executive Compensation Research Team at Glass Lewis

GLASS LEWIS

Robert McCormick is the Chief Policy Officer at Glass Lewis, overseeing policy development and analysis of over 20,000 research reports at companies in 100+ countries. He is on the board of the NACD's Northern California Chapter and the advisory board of the Weinberg Center on Corporate Governance. Bob was named one of the 100 most influential people on corporate governance by *Directorship* magazine in 2015.

Kevin Liu is director of the North American executive compensation research team, which analyzes compensation practices of more than 3,500 U.S. and Canadian companies. Kevin also directs analysis of all equity-based compensation plans for North American companies. He is the final editor/lead analyst for a broad selection of publicly traded U.S. companies, and leads compensation-related engagements with hundreds of public company issuers, discussing Glass Lewis' compensation policy and approach to analyzing compensation, as well as general executive compensation practices and trends.

As another proxy season looms, issuers nationwide are engaging shareholders in order to communicate the most crucial information impacting their companies. But there's also another type of engagement in session—with proxy advisors. These influential firms are often the lifeline from issuers to investors, so it's crucial for governance professionals to be up-to-date on the latest practices. With that backdrop, *C-Suite* sat down with Robert McCormick and Kevin Liu of Glass Lewis to hear more about how the proxy advisory firm approaches engagement, analyzes executive compensation, assesses boards of directors, and considers the impact of environmental, social and governance issues on shareholder value.

As we all know, we're in engagement season right now, and we're getting a lot of questions from our clients about how to engage with proxy firms, and specifically with Glass Lewis. Starting off, can you give us a background on the scope of how Glass Lewis evaluates companies?

Robert McCormick: Glass Lewis covers over 20,000 company meetings each year. We look at each company on a case-by-case basis within the context of specific circumstances, varying based on the type of company, its complexity, its maturity and how large it is, etc. The team is multidisciplinary so we typically have several different analysts working on the same report at the same time based on their expertise.

I think it's fair to say we've engaged with many more companies in the last couple years than we have in the past. We engage with companies outside the proxy solicitation period, and then we'll compile information we learn in the engagements, which we consider when we go to actually write the reports. Issuer engagement ultimately provides us with the ability to empower our investor clients with more and better information about particular issues.

How many engagement meetings did you conduct in 2014, and how does it compare to the previous year?

McCormick: We're still compiling the numbers, but I can certainly say it's well above 1,000 across our various global offices. Prior to Say on Pay, the engagements were probably in the 100 to 150 range. But I think the advent of Say on Pay, particularly in the U.S., but also in a number of growing markets, encourages more engagement. Engagement meetings often start with conversation on compensation but often lead to discussion of other governance features of a company.

When it comes to engagement strategies and our experience, we have found the effectiveness of the engagements depends on the issue and who represents the company. It's always helpful to know ahead of time what the issues are going to be. We really leave it up to the company, though I will say if it's a conversation about CEO compensation and the CEO is across the table from you, it's probably not the most constructive dialogue. So discussions regarding executive compensation, particularly CEO compensation, are most productive when led by a compensation committee member or in some cases, a lead independent director.

I've heard major asset managers talking about 20% of their engagement meetings involving a board member. Is there an order of magnitude for the different participants?

McCormick: Yes, I think it has evolved. Over the years we've seen more directors participate. I wouldn't say it's more than 10% of the time the director participates. It's usually more likely when a company has lost its Say on Pay or it's a substantial board-related issue.

In general, the corporate secretary has taken the lead role. As I've seen it evolve, I think there's been a greater coordination between the corporate secretary's office and the investor relations functions, which I think can be healthy, particularly when engaging with institutional investors. I think it's probably more a generational factor, where directors newer to boards are more inclined to engage with shareholders on governance issues and directors who have been on a board for a longer period of time may be less inclined to engage, but that's just something anecdotally I've observed.

What does your engagement look like around board assessment and succession, which has been a big topic lately?

McCormick: The board sets the tone for everything in a company, so we do spend quite a bit of time engaging about board membership, board experience and makeup. And I think for the most part, boards have addressed the directors who have board attendance issues or were over-boarded or didn't really have relevant experience. So now the discussion is really around board diversity, and I mean that broadly. Overall background, experience, age, passport diversity—all that is reflected in discussions of refreshment and tenure.

Glass Lewis does not have a specific policy on age or tenure limits, but we do think generally a board with a diversity of skills, experience and tenure can be more effective. The question is have you added new board members recently, and what's the overall tenure of the board? If there is a greater percentage of directors who have been serving for 10-plus years, maybe that's a potential risk factor if the board at a company that has changes in its strategies or is in a fast-moving industry— maybe there's opportunity missed for a fresh perspective.

What are some of the specific factors you examine?

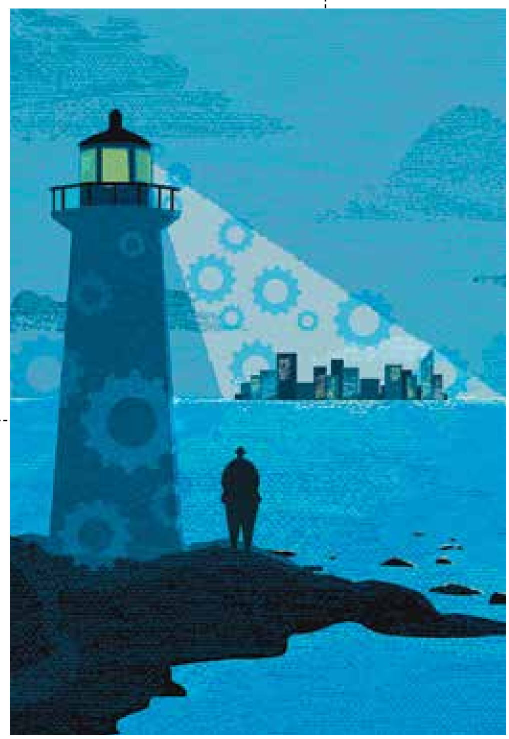
McCormick: We spend quite a bit of time on director independence. Glass Lewis has a slightly stricter independence definition than NYSE or Nasdaq, so we try to get a sense of whether directors' related party transactions negatively affects their independence. And it could be various aspects such as a director sitting on a board of a utility where the company gets its electricity versus a company who has a director that is outside counsel and could get legal advice from many different law firms. That may raise conflict concerns about information they provide in his or her role as attorney. In general, what we found is in some cases companies have provided significantly enhanced disclosures, which allows us and shareholders to evaluate that director in a better context.

> We think generally a board with a diversity of skills, experience and tenure can be more effective. The question is have you added new board members recently, and what's the overall tenure of the board?

We also spend some time looking at board commitments and attendance. I think attendance is probably less of an issue than board commitments. Directors are serving on fewer boards as a result of more responsibility for each director and the more time commitment in each directorship. For us, our board commitment test is three directorships for an executive—his or her own board and then two others. For a non-executive it's up to six. Except for small companies, it's rare that we see that as an issue. And then sometimes we may talk about director performance particularly as it concerns a director's background at a company that may have had some financial or other performance problems.

We spend a fair amount of time talking about board leadership. Glass Lewis has generally favored the separation of roles of CEO and chairman in favor of the appointment of independent chairman, although we do recognize

> "We're focused on the risk to the companies from their operations and whether they have identified the risk and monitored it, and disclosed so shareholders can understand."



more and more companies are moving toward a lead independent director role, evolving from a presiding director. So we try to be aware of those developments and have discussions about the leadership model. It's often very helpful to meet the lead independent director because I think that more than anything allows us to learn about who is setting the tone of board leadership.

Thanks for that insight, Bob. Now that we've talked a lot about board leadership, what about compensation?

Kevin Liu: We assess compensation from both the quantitative side, looking at how the company pays compared to its performance relative to its peers, and also on a qualitative basis—how the company is structured, what are the company's granting practices, and are there any unique or unusual circumstances that we should be taking into account. So when we engage with companies, this information can help us formulate and in some cases even change our analytical approach, both on the quantitative side and on the qualitative side. We recognize that each company is unique in one way or another, so engagement meetings are our chance outside of the regulatory filings to gain a better understanding of the company's compensation practices and how they align with its strategy.

With global warming becoming a bigger issue at the corporate level, what are you hearing from companies with respect to how they approach environment and social impact?

McCormick: There is definitely more interest in environmental and social impact, which we believe should be considered as a part of the overall risk profile rather than treated as a silo issue. In particular, when it comes to environmental and social issues, we spend quite a bit of time discussing companies' current disclosures, what actions have they taken to address some of these issues, whether they are engaging with shareholders and how they reacted. Ultimately, we're focused on the risk to the companies from their operations and whether they have identified the risk and monitored it, and disclosed so shareholders can understand.

What about governance and shareholders' rights?

McCormick: When it comes to governance and shareholders' rights, much of the focus is not necessarily on new issues. Proxy access in particular in 2015 got a huge amount of attention given the number of proposals and the circumstances leading to the SEC's decision not to opine on the applicability of rule 14a-8(i)(9), which was recently revised. Companies were caught scrambling, so there's quite a bit of engagement around the applicability of the omission rule, which allows conflicting proposals to be admitted. I think shareholder proposals to allow for shareholders to call special meetings are more of a perennial issue. On majority voting for directors, I think it's probably harder for companies to really push back on a lot—frankly it's probably more of an issue that smaller companies face since most large companies have adopted some form of majority voting. We occasionally discuss cumulative voting—but it hasn't really gotten huge traction over the years. So it's an issue we may see in the discussions, but it's not an issue that's extremely prominent.

As a closing comment, what can you tell us about when engagements take place, and when is the best time for a company to reach out?

McCormick: We have found that engagements in the midsummer through early winter range are probably the most effective. We don't think we're in a position to say "every company must do this," or "they shouldn't do that," but we push for more information and more disclosure, sometimes more rationale. So this is information we often learn in such engagements, and we definitely value it and encourage companies to learn more about how we do our engagements and how to request one. CS

Dissecting Director Sentiment

An interview with Paula Loop, Leader, PwC's Center for Board Governance & Investor Resource Institute

pwc

PwC's Center for Board Governance and Investor Resource Institute aims to strengthen investor confidence and provide resources for directors and investors addressing new and traditional challenges. With more than 20 years of experience at PwC, Paula Loop brings extensive knowledge in governance, technical accounting and SEC and financial reporting matters. With a passion for giving back to the community, Paula currently serves on the board of the PwC Charitable Foundation. Paula is a Certified Public Accountant, licensed in New York and is a graduate of the University of California at Berkeley with a bachelor's degree in business administration.

For more information on PwC's annual Director Sentiment survey, please visit pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/downloads.html.

With changes continuing to occur across the corporate landscape and many more on the horizon in the coming years, board members are constantly reassessing their companies' position in the marketplace, and their own composition as boards. Each year, PwC U.S. (PricewaterhouseCoopers) conducts a corporate directors survey, with this year's responses focused on governing for the long term, and how boards are adapting to change and reorienting their approach. *C-Suite* dug into the details of the data on director sentiment and what we can expect to see going into 2016.

What are the most notable changes you've seen in director sentiment over the past few years? Going into 2016, what are the top issues on directors' minds, and what are they doing to resolve them?

Paula Loop: Directors are holding fast to taking a long-term view. They've always done that, and trying to do so still, but there are disruptors in place causing them to be responsive to short-term questions and issues while trying to keep an eye on the long term.

Shareholder engagement is becoming a huge issue in the boardroom. Your survey showed an increase in directors' sentiments toward directly communicating with investors, which is consistent with the research we've conducted at Equilar. What's behind this shift?

Loop: More directors are realizing that engagement by the company and at least some individual board members is becoming more the norm than in the past. Most of the ones we surveyed are looking at protocols for who will have conversations with the investors, how often, where, when, etc.

> When activists or investors engage with directors, they want insight into strategic plans and capital allocation and any significant risks associated with that.

> More than 80% of directors at least "somewhat" believe diversity enhances board effectiveness and company performance, but only 22% say they "very much" believe there are enough qualified diverse candidates available.

Figures are from PwC's Annual Corporate Director's Survey.

Directors say it's important to embrace diversity in board composition, but we haven't seen the numbers shift significantly yet. What will it take to move the needle, and what trends are already occurring that point to a potentially more diverse director population?

Loop: I think the nominating and governance committees are tasked with more responsibility around boardroom succession than ever, and activists are putting pressure to make sure they do that. Boards are focused on composition because there are more skills needed in the boardroom today than they may have currently—particularly around technology, which is driving so many changes and disruption in business now. And when I say technology, I mean not only around cybersecurity but also things like digital marketing.

Gender is also a strong piece of the diversity initiative. As just one example, women control 80% of consumer spending in the U.S. So any company involved in consumer spending or services should be sure they have the voice of that gender on their board.

Some boards look at gender diversity as 'let's find a female CEO to join our board.' And they look and there aren't any available, so they assume there aren't any qualified female board directors. If that's the criteria, an increase in gender diversity is not going to happen quickly. On the other hand, some boards are broadening their horizons and looking at women who've run really large divisions, who are CMOs or human capital leaders, and who have broader skills that can apply to the boardroom beyond CEO or CFO experience. And that diversity of skills is a good thing for the board.

The mental image of nearly two in five directors sitting around the boardroom thinking at least one of their directors doesn't belong on the board is humorous at face value, but it actually raises a serious issue. What are some ways boards are actively approaching succession planning, and why is that important?

Loop: Again, I'll point to activists who have raised the bar by pressuring boards to deliver. So boards are looking around the room and making sure they have the right skills to bring their "A" game.

However, very few boards have term limits, and mandatory retirement age is upwards of 72 and beyond, so there's not an easy way to move off of boards. It's beholden on a strong chair to address these issues. Interestingly, the figure actually increased from 2012, and 39% of directors said they thought at least one director shouldn't be on the board, up from 31% three years ago. In other words, we must not have dealt with this problem in the past since the percentage seems to be growing.

The fact that 54% of CEOs plan to complete an acquisition this coming year stood out to me. What challenges do mergers and acquisitions bring to the boardroom?

Loop: I think investors are very clearly looking to directors for oversight on what management is doing. When activists or investors engage with directors, they want insight into strategic plans and capital allocation and any significant risks associated with that. And M&A is a significant part of that.

We are expecting deal activity to continue, and there already has been quite a bit this past year. For a director, M&A gets back to assessing the best use of corporate assets. They need to step back and make sure their decisions line up with their strategic plan that they've shared with the investor community and that they will ultimately drive value. This is a situation where directors are in a prime position to fulfill their fiduciary responsibility.

As you know, activist investors drive significant M&A activity. When activists come in, they often want to know what companies are doing with excess cash balances (are they considering dividends and buybacks?), and they'll consider whether the company should stay together or whether it makes more sense to sell off some pieces. We're also seeing activists scrutinize acquisitions or divestitures from the perspective of whether companies are getting the right value.

Nearly half of all directors said they are unprepared for CEO succession. What are the challenges from the board's perspective to appropriately planning for CEO succession in the case of both foreseen and unforeseen circumstances?

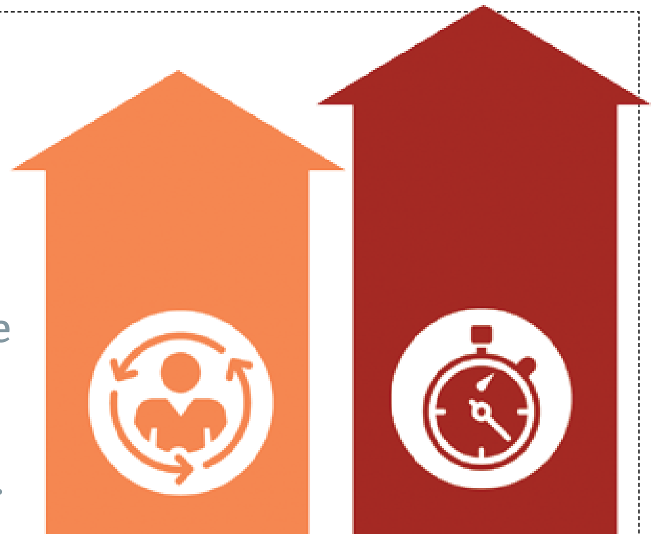
Loop: Really what our survey is telling us is that the directors would love to spend more time on this topic, recognizing that it is significant. CEO succession is something they should think about daily, but it's a challenging concept. It depends where your CEO is in their tenure. If you just got a new one, you're probably not spending too much time on it versus if you have an aging or ready-to-retire CEO. At the same time, some fairly high-profile CEOs have stepped down, and boards have had to scramble.

Was there anything else new or surprising in this year's survey?

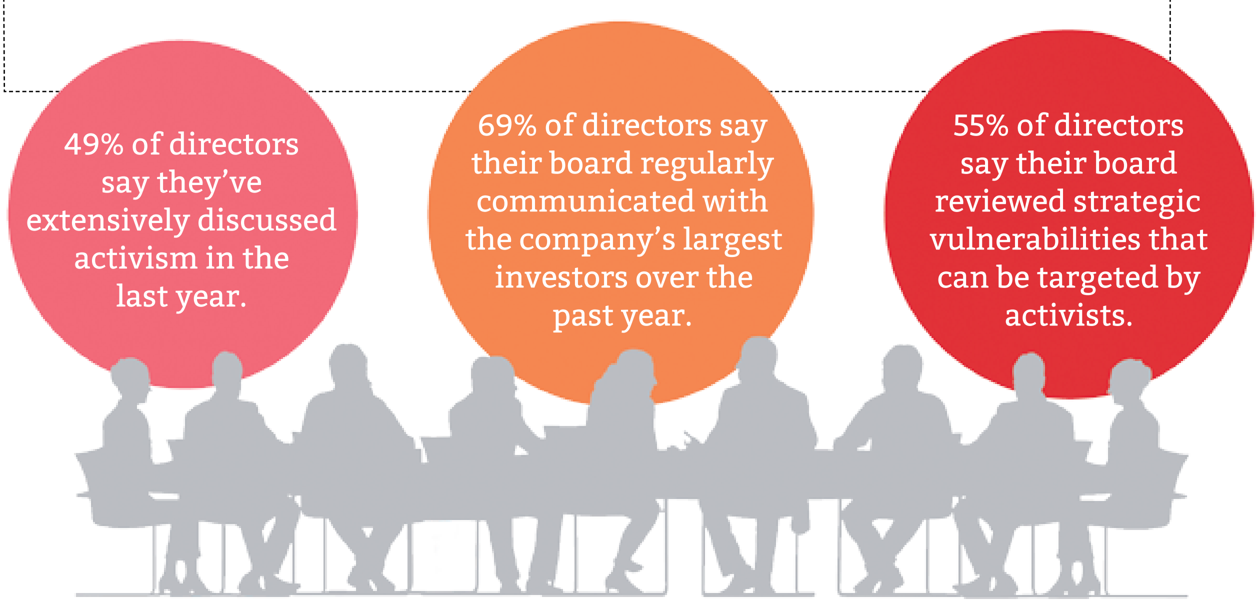
Loop: One of the other things that surprised me was when you look at skill sets on the board, IT background was fairly far down the chain. In our annual CEO survey, 86% said IT was going to change their business over next five years. So directors know it is a significant driver, but only 37% said that skill was critical expertise.

And one more highlight: 27% of directors that we surveyed related to proxy access felt that it was never appropriate. That sentiment will absolutely be challenged over the next year or two, since proxy access has significant momentum. It'll be a very significant topic in the upcoming proxy season, and directors may have to think differently. CS

39% of directors believe someone on their board should be replaced; but only 44% say they "very much" believe they're spending sufficient time on director succession.



Boards are navigating an aggressive activist environment.



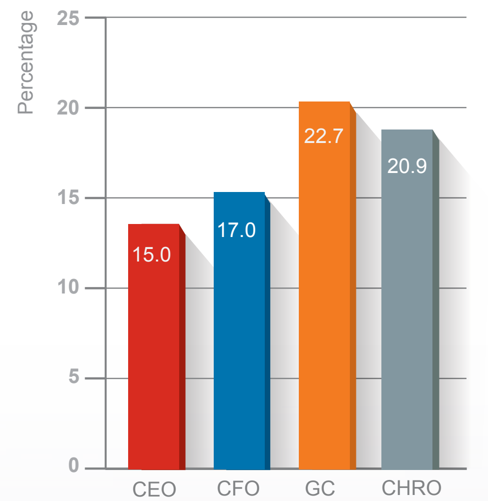
Rising Tide of Executive Pay

CEO pay gets most of the attention when it comes to executive compensation, and with good reason. Chief Executives are by far the highest-paid individuals at almost every company, with median CEO pay totaling $9.2 million* for S&P 500 companies in 2014.

With the CEO-to-median employee pay ratio becoming a required disclosure in public filings by 2018, more and more companies are likely to communicate this information starting next year ahead of the official deadline to report. Where we stand now, however, very few have come out with a figure defining median employee pay, and thus the CEO pay ratio will remain a topic of heated discussion and speculation over the coming months and years.

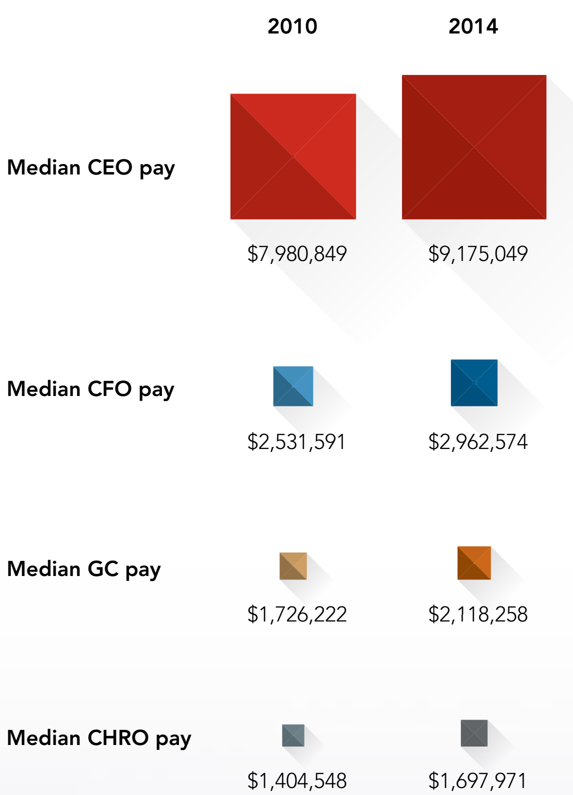
In the meantime, there's plenty more to analyze when it comes to CEO pay in relation to other employees. Equilar recently crunched the numbers on several other key executive positions at S&P 500 companies and assigned a pay ratio. Though CEO pay continues to rise, we're seeing compensation for other executive roles increase even more quickly, and the gap is closing between the top CEOs and their right-hand executives.

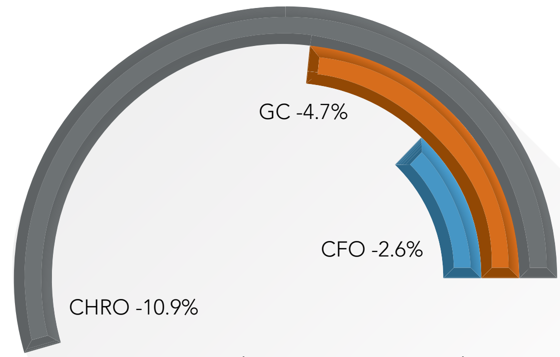
Percentage increase in median pay between 2010 and 2014 for Named Executive Officers



*To account for a like comparison between executive roles, we excluded "special awards" from pay packages when calculating these figures.

Median pay between 2010 and 2014 for Named Executive Officers





Percent change in pay ratio between 2010 and 2014, compared to CEO

CEO-to-Named Executive Officer pay ratios between 2010 and 2014

	2010	2014
CEO - CFO Pay Ratio	3.04 : 1	2.97 : 1
CEO - GC pay ratio	4.52 : 1	4.31 : 1
CEO - CHRO pay ratio	6.19 : 1	5.46 : 1

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For more details on executive pay and other Equilar research reports, check out ***equilar.com/reports.html****.*

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