American Benefits Council – March 3, 2016

Presented by

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Overview

- Shareholder Proposal Trends in 2015
- Proxy Advisor Policies for 2016
- Addressing the "New" SEC Rules?
  - CEO Pay Ratio
  - Compensation Clawbacks
  - Pay for Performance
- Focus on Performance Measures
- Post-Vest Holding Restrictions on Equity Awards
- 409A Issues
- Proxy Statement Drafting Tools and Tips
- Maximizing Say on Pay Support
- Avoiding Compensation Litigation Pitfalls

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1. Shareholder Proposal Trends in 2015

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Shareholder Proposal Trends

- There were 76 compensation-related stockholder proposals in the first half of 2015,* with the most common being:
  - Change CiC/Severance Equity Vesting Policies (n=29)
  - Adopt Share Retention or Holding Policy (n=14)
  - Adopt Clawback Policy (n=13)
- Average Support by Proposal, 2015*
  - Submit SERP to Shareholder Vote (37%)
  - Change CiC/Severance Equity Vesting Policies (34%)
  - Performance-Based Equity Awards (28%)
  - Adopt Clawback Policy (28%)
- Proxy Access
  - Designed to enable shareholders to use a company's proxy statement and proxy card to nominate director candidates of their own.
  - In 2015, 113 companies received proxy access proposals, 95 went to a vote and half garnered majority support.

*ISS United States 2015 Proxy Season Review – Compensation, September 25, 2015

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2. Proxy Advisor Policies for 2016

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ISS – Overview

- Proxy Voting Policies
  - Director Elections
  - Say on Pay (P4P review)
  - Equity Plan Proposals
- Equity Plan Scorecard and Equity Plan Data Verification
- Corporate Governance Ratings – QuickScore (new methodology)

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ISS Updates – Proxy Voting

- Proxy Voting Guidelines (selected topics)
  - Say on Pay Proposals - **Pay for Performance** and **Problematic Pay Practice** reviews
  - Equity Plan Scorecard – (slightly tweaked for 2016)
    - Plan Cost, Plan Features and Grant Practices to be weighed and balanced
    - List of "problematic" features of plans (see next slides)
    - Burn rate factor slightly modified
    - 2016 FAQs: http://www.issgovernance.com/file/policy/1_us-equity-compensation-plans-faq-dec-2015.pdf
- Equity Plan Data Verification (http://www.issgovernance.com/file/faq/equity-plan-data-verification.pdf)
  - Companies with a stock plan proposal may register for this (can't participate without registering)
  - Must file proxy statement at least 30 days prior to meeting to be eligible
  - Data verification window will open approximately 12 business days after filing of definitive proxy; companies will have a 2 business day window to verify the data

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ISS' Pay-for-Performance Methodology (general overview)*

Used to determine Say on Pay and director election vote recommendations

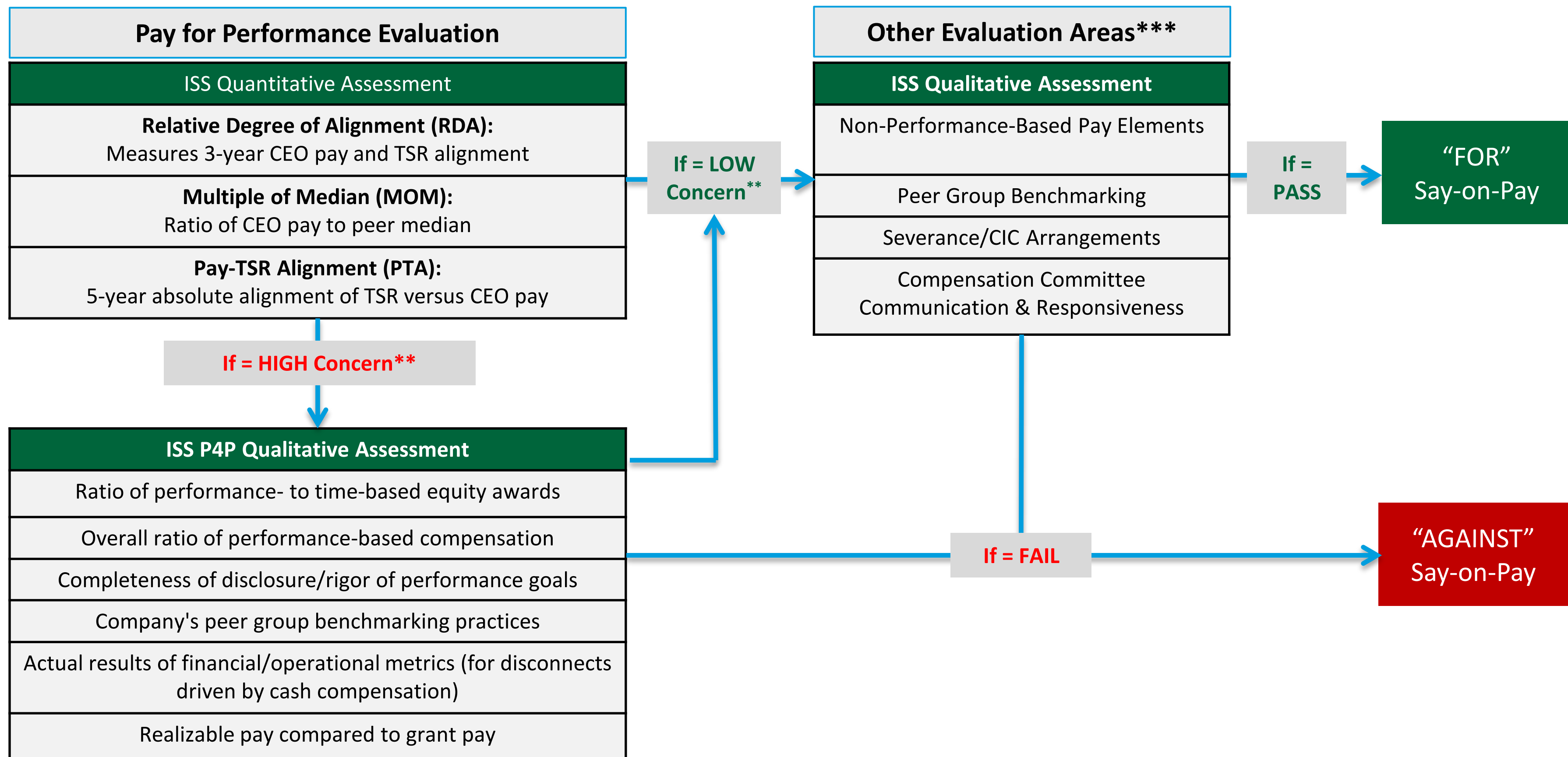

*Chart provided by **Pay Governance LLC**

**"MEDIUM" concern on the quantitative test may result in an ISS P4P qualitative review depending upon concerns raised in other evaluation areas

***ISS maintains a listing of "problematic" pay practices that may also trigger an against say-on-pay vote recommendation (e.g., excise tax gross-ups at a change-in-control)

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ISS – Problematic Pay Practices

- Egregious employment contracts:
  - Contracts containing multi-year guarantees for salary increases, non-performance based bonuses, or equity compensation.
- New CEO with overly generous new-hire package:
  - Excessive "make whole" provisions without sufficient rationale;
  - Any of the problematic pay practices listed in this policy.
- Abnormally large bonus payouts without justifiable performance linkage or proper disclosure:
  - Includes performance metrics that are changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance
- Egregious pension/SERP (supplemental executive retirement plan) payouts:
  - Inclusion of additional years of service not worked that result in significant benefits provided in new arrangements
  - Inclusion of performance-based equity or other long-term awards in the pension calculation
- Excessive Perquisites:
  - Perquisites for former and/or retired executives, such as lifetime benefits, car allowances, personal use of corporate aircraft, or other inappropriate arrangements
  - Extraordinary relocation benefits (including any home loss buyouts)
  - Excessive amounts of perquisites compensation
- Excessive severance and/or change in control provisions:
  - Change in control cash payments exceeding 3 times base salary plus target/average/last paid bonus;
  - New or materially amended arrangements that provide for change-in-control payments without loss of job or substantial diminution of job duties (single-triggered or modified single-triggered, where an executive may voluntarily leave for any reason and still receive the change-in-control severance package);
  - New or materially amended employment or severance agreements that provide for an excise tax gross-up. Modified gross-ups would be treated in the same manner as full gross-ups;
  - Excessive payments upon an executive's termination in connection with performance failure;
  - Liberal change in control definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring

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ISS – Problematic Pay Practices (cont.)

- Tax Reimbursements: Excessive reimbursement of income taxes on executive perquisites or other payments (e.g., related to personal use of corporate aircraft, executive life insurance, bonus, restricted stock vesting, secular trusts, etc; see also excise tax gross-ups above)
- Dividends or dividend equivalents paid on unvested performance shares or units.
- Internal pay disparity: Excessive differential between CEO total pay and that of next highest-paid named executive officer (NEO)
- Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts, option exchanges, and certain voluntary surrender of underwater options where shares surrendered may subsequently be re-granted).
- Other pay practices that may be deemed problematic in a given circumstance but are not covered in the above categories.

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Some Other ISS "Dealbreakers"

- Director Overboarding – ISS will recommend "AGAINST" director who is on more than 5 public company boards (phased in – cautionary language until Jan. 31, 2017, then negative recommendations thereafter); prior policy was 6 boards
- CEO Directorships – ISS will recommend "AGAINST" CEO sitting on more than 2 other boards (w/r/t outside board proxies)
- Director Attendance – "AGAINST" director not attending at least 75% of board and committee meetings, without valid excuse
- Board Responsiveness – case by case review of directors who fail to act on a shareholder proposal receiving majority support
- Director Independence – "AGAINST" director who is an "INSIDE DIRECTOR" or "AFFILIATED OUTSIDE DIRECTOR" and on a key board committee
- Problematic Takeover Defenses – "AGAINST" entire board with inherent board accountability or oversight issues (combination of board structure and SH rights)
- Problematic Audit-Related Practices – "AGAINST" audit committee members if there are excessive non-audit fees, if company receives adverse opinion from auditor, or committee entered into inappropriate indemnification agreement with auditor
- Unilateral Bylaw/Charter Amendments – "AGAINST" directors or the entire board if the bylaws or charter are amended without shareholder approval in a way that materially diminishes shareholder rights
- Problematic Pay Practices – "AGAINST" compensation committee members when problematic pay practices occur and "say on pay" is not on the ballot

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ISS Equity Plan Scorecard*

Maximum scores by EPSC Model and Pillars*

EPSC Model	Plan Cost	Plan Features	Grant Practices
S&P 500	45	20	35
Russell 3000 (excluding S&P 500)	45	20	35
Non-Russell 3000	45	30	25**
IPO/Bankruptcy	50 or 60	35 or 40	0 or 15

*Maximum total score of 100 (53 is passing score, subject to override for **problematic features*****)

**Non-Russell 3000 model only includes Burn Rate and Duration factors

***Problematic features include:

Liberal CIC definition;

Ability to re-price options w/o shareholder approval;

Plan is a vehicle for problematic pay practices;

Other plan features with significant negative impact on SH

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ISS Equity Plan Scorecard

General Factors in each pillar

Plan Cost (45 pts)	Plan Features (20/30 pts)	Grant Practices (35/25 pts)
SVT – new & available shares	Automatic CiC vesting	3-yr average burn rate
SVT – new & available shares & outstanding grants	Liberal share recycling (FV and/or options)	Estimated plan duration
	Board discretion to accelerate vesting	% CEO equity with performance conditions
	Minimum 1-yr vesting for one award type	CEO's most recent grant vesting period
		Clawback policy for equity awards
		Post vesting/exercise holding req.

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ISS Equity Plan Scorecard

- In 2015, 541 of the first 645 equity plans received a "FOR" vote recommendation from ISS*
- Of the 104 plans with "AGAINST" recommendations:*
  - 40 failed to meet the score threshold
  - 48 had excessive plan cost (which alone caused the plan to miss the score threshold)
  - 14 plans permitted repricing
  - 8 plans permitted cash buyouts
  - 8 plans had a liberal change in control risk
  - 4 had independence issues with the compensation committee
  - 2 had a pay-for-performance disconnect

* Source: ISS Research Reports for S&P 500 and Russell 3000 Companies, issued through October 5, 2015

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Glass Lewis 2016 Policy Updates*

- GL has stated that any transitional and one-off payments should have meaningful explanations (e.g., sign-on arrangements, “make-whole” payments, severance, etc.)
- GL is no longer stating that they will run twenty analyses to review LTI, but rather will analyze the plan’s cost and company’s pace of granting.
  - GL will use a number of analyses including the following qualitative factors: (i) difficulty in meeting performance metrics, (ii) changes to the plan, (iii) company’s size and operating environment, and (iv) executive compensation practices
- Any increase to the target and maximum STI should be clearly justified to shareholders
  - In 2015, just an increase to the maximum STI had to be justified
- Companies will have to disclose actual performance and vesting levels for previous LTI grants earned during the fiscal year.
  - No requirement in 2015

*Policy available at (http://www.glasslewis.com/wp-content/uploads/2016/01/2016_Guidelines_United_States.pdf)

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Glass Lewis – Say on Pay Red Flags

- Inappropriate peer group and/or benchmarking issues;
- Inadequate or no rationale for changes to peer groups;
- Egregious or excessive bonuses, equity awards or severance payments, including golden handshakes and golden parachutes;
- Problematic contractual payments, such as guaranteed bonuses;
- Targeting overall levels of compensation at higher than median without adequate justification;
- Performance targets not sufficiently challenging, and/or providing for high potential payouts;
- Performance targets lowered without justification;
- Discretionary bonuses paid when short- or long-term incentive plan targets were not met;
- Executive pay high relative to peers not justified by outstanding company performance; and
- The terms of the long-term incentive plans are inappropriate*

*Common elements of proper LTI program are: No re-testing or lowering of performance conditions; Performance metrics that cannot be easily manipulated by management; Two or more performance metrics; At least one relative performance metric that compares the company's performance to a relevant peer group or index; Performance periods of at least three years; Stretching metrics that incentivize executives to strive for outstanding performance while not encouraging excessive risk-taking; and Individual limits expressed as a percentage of base salary.

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Dodd-Frank Implementation Overview

Provision	Proposed	Final	Effective	Applicable To
CEO Pay Ratio	September 18, 2013	August 5, 2015	W/r/t compensation in fiscal years beginning on or after January 1, 2017 (reported in 2018 proxy statement). Transition for newly public companies	Reporting companies other than emerging growth companies, smaller reporting companies and foreign private issuers
Clawback	July 1, 2015	TBD	SEC – TBD; exchanges have 1 year to adopt rules following effectiveness of SEC rule; companies then have 60 days to adopt policy	All issuers listed on a national exchange. Covers compensation based on financial info for periods ending on and after SEC effectiveness
Pay for Performance Disclosure	April 29, 2015	TBD	TBD; phase-in for number of covered years in the new table	Reporting companies other than emerging growth companies and foreign private issuers.
Hedging Disclosure	February 9, 2015	TBD	TBD	Reporting companies other than foreign private issuers

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CEO Pay Ratio

- The Dodd-Frank Act requires the SEC to adopt rules requiring companies to disclose:
  A. The median of the annual total compensation of all employees of the company, excluding the CEO
  B. The annual total compensation of the CEO of the company
  C. The ratio of (A) to (B)
- In August 2015, the SEC issued final rules on the CEO pay ratio rules
- The new disclosure requirements do <u>not</u> apply to:
  - Smaller reporting companies
  - Foreign private issuers
  - Multijurisdictional filers
  - Emerging growth companies
  - Registered investment companies

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CEO Pay Ratio – Final Rule

- For calendar year companies, the pay ratio disclosure will not appear until the **2018** proxy statement (for the fiscal year ending in 2017)
- However, executives, board members, and the company's HR and legal functions should begin to study these rules
  - The information the company will be required to collect for compliance with the rules is extensive and the calculations are likely to be complicated. Most companies will require a combination of services from internal functions, such as HR and legal, and external providers, including counsel, compensation consultants, and accountants
  - Press coverage of the CEO pay ratio rules has been extensive. Some institutional investors and pension funds have expressed the desire to see this disclosure before 2018

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Calculating the Ratio: Suggested Action Steps

- Briefing the Board and/or Compensation Committee on the pending requirements of the final rules
- Organizing a team of internal professionals to comply with the rules
- Develop an action plan for compliance. Implementation of the new Rule will require certain decisions

1. Evaluate Alternative Methodologies for Identifying the Median Employee. Each company may select a methodology to identify its median employee based on the company's facts and circumstances, including total employee population, a statistical sampling of that population, or other reasonable methods. For example, a company could identify the median of its population or sample using any consistently applied compensation measure from compensation amounts reported in its payroll or tax records

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Action Steps

2. Consider Cost-of-Living Adjustments. The rules explicitly allow a company to apply a cost-of-living adjustment to the compensation measure it uses to identify the median employee
   a) SEC acknowledged that differences in the underlying economic conditions of certain countries in which companies operate would have an effect on the compensation paid to employees in those jurisdictions, resulting in a statistic that does not appropriately reflect the value of the compensation paid to individuals in those countries
   b) The rules give companies the option to adjust for these differences
   c) The rules allow a company to make cost-of-living adjustments to the compensation of its employees in jurisdictions other than that in which the CEO resides

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Action Steps

3. Determination of Total Compensation. Assess your ability to calculate precisely all items of compensation or whether *reasonable estimates* may be appropriate for some elements. Companies may use reasonable estimates when calculating any elements of the annual total compensation for employees other than the CEO (with disclosure)

4. Select a Testing Date. The rules allow a company to select a date *within the last three months of its last completed fiscal year* on which to determine the employee population for purposes of identifying the median employee
   - The company would not need to count any individual who is not employed on that date
   - Companies that employ temporary or seasonal workers should pay particular attention to this rule
   - The rules permit the company to identify its median employee *once every three years*

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Action Steps

5. Non-US Employees. The rules allow a company to exclude non-U.S. employees from the determination of its median employee in two circumstances:
    a) Non-U.S. employees that are employed in a jurisdiction with data privacy laws that make the company unable to comply with the rule without violating those laws. The rules require a company to obtain a legal opinion on this issue
    b) Up to 5% of the company's non-U.S. employees, including any non-U.S. employees excluded using the data privacy exemption. Under this exception, if a company excludes any non-U.S. employee in a particular jurisdiction, it must exclude all non-U.S. employees in that jurisdiction

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Action Steps

6. New Employees. The rules allow a company to exclude certain new employees from its calculation
   a) A company can exclude any employees obtained in a business combination or acquisition for the fiscal year in which the transaction becomes effective
   b) Companies may annualize the total compensation for a permanent employee who did not work for the entire year, such as a new hire or an employee on an unpaid leave of absence
   c) Companies may not annualize the compensation of part-time, temporary, or seasonal workers when calculating the required pay ratio

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Action Steps

7. Independent Contractors. Individuals employed by unaffiliated third parties or independent contractors would not be considered employees of the company. However, the rules do not appear to allow companies to exclude many of the individuals that other areas of the law would recognize as independent contractors
   - Companies should re-examine the workers they currently characterize as independent contractors
8. Other Benefits Provided to Employees. The rules allow a company to include personal benefits that aggregate less than $10,000 and compensation under non-discriminatory benefit plans such as health and retirement plans in calculating the annual total compensation of the median employee as long as these items are also included in calculating the CEO's annual total compensation

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Action Steps - Summary

Before the beginning of the 2017 fiscal year when rules become effective, a company should:

1. Evaluate favorable testing dates and even testing years
2. Determine whether any non-U.S. employees are employed in a jurisdiction with data privacy laws that make the company unable to comply with the rule without violating those laws
3. Consider which non-U.S. employees to exclude under the 5% exclusion allowance
4. Examine the relationship with and likely status of leased employees and others the company currently treats as independent contractors
5. Consider the feasibility (and benefit) of applying a cost-of-living adjustment in certain non-US jurisdictions

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Compensation Clawbacks - Overview

- In July 2015, as required by Dodd-Frank Act Section 954, the SEC approved proposed rules by a 3-2 vote requiring companies to develop, disclose, and implement a compensation clawback policy
- The Proposed Clawback Rules would require all executive officers (e.g., Section 16 Officers) to disgorge any excess "incentive-based compensation" received that was based upon the attainment of financial reporting measures that subsequently were required to be restated to correct a material error in an issuer's financial statements. The Clawback Rules apply to all such executive officers who served in such capacity during the applicable period (both current and former officers)
- The amount subject to being recovered from the executive officers would be the amount, calculated on a pre-tax basis, of the incentive-based compensation received that exceeded the amount that would have been due based upon the corrected financial reporting measures reflected in the accounting restatement
- There is strict liability for all executive officers; fault or knowledge of the basis for the accounting restatement is irrelevant
- The look back period under the Clawback Rules would be the three completed fiscal years immediately preceding the date that an accounting restatement is required

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Compensation Clawbacks – Overview (cont.)

- “Incentive-based compensation” consists of any compensation granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure. Financial reporting measures consist of all measures determined and presented in accordance with the accounting principles used to prepare the issuer’s financial statements (or other measures derived wholly or in part from these measures) plus stock price and total shareholder return.*
- Exchanges will be required to adopt and put into effect a rule requiring clawback recovery policies within one year from the adoption of final rules by the SEC.
- Each listed issuer will then be required to adopt a compliant clawback policy no later than 60 days after the exchanges’ rules are effective.
- Issuers would be required to recover excess incentive-based compensation based on financial information for any fiscal period ending on or after the effective date of the SEC’s final rules
- Under the proposed Clawback Rules, a company’s board of directors has little discretion in executing the policy – a board is unable to differentiate between individual executives or recover less than the full amount (with some exceptions if recovery is impracticable or in violation of home country laws)

*Financial reporting measures would generally not include metrics that are not derived from financial information (for example, opening a specified number of stores or obtaining regulatory approval of a product, etc.).

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Compensation Clawbacks – Key Issues

- What is "Incentive-Based Compensation Subject to Recovery"?

  Issue: What about where the company had used a plan-within-a-plan structure, created a huge bonus pool, and exercised negative discretion; could it argue that even after adjustment of financial metric, the smaller (but still significant) bonus pool would have allowed for payment? Or should Committee apply some form of proration?
- What companies are covered – and excluded?

  The proposed rules would apply to all companies, including foreign private issuers, smaller reporting companies, emerging growth companies, and companies with publicly traded debt, except for certain registered investment companies to the extent they do not provide incentive-based compensation to their employees
- Definition of "Executive Officers"

  Includes anyone who served in that role during the affected period. Also includes chief accounting officer or controller
- Use of estimates
- Recovery required on a pre-tax basis
- What about equity awards with time-based vesting only?

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Compensation Clawbacks – Key Issues

When is Recovery Impracticable?

- A company must recover erroneously awarded compensation in compliance with its recovery policy except to the extent that it would be impracticable to do so
- The company's Compensation Committee must make the determination that recovery would be impracticable
- Recovery would be impracticable "only if the direct expense paid to a third party to assist in enforcing the policy would exceed the amount to be recovered, or if recovery would violate home country law"
- The Compensation Committee must *document* its reasonable attempts to recover, and may be required to provide that documentation to its stock exchange
- The company must obtain an opinion of home country counsel, before it may conclude that it would be impracticable to recover any amount of erroneously awarded compensation based on violation of home country law
- Before concluding that it would be impracticable to recover any amount of erroneously awarded compensation based on expense of enforcement, the company must first make a reasonable attempt to recover that erroneously awarded compensation
- The proposed rules do not address what happens if state law forbids recovery

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Compensation Clawbacks – Key Issues

- Proxy disclosure of enforcement

  Technically, a company is not required to disclose or discuss its policy – only the enforcement and recovery during the covered fiscal year, if any. Would be filed as an exhibit to the 10-K

  Is there likely to be a short-swing profits violation too?

- What is date on which company required to do restatement?

  Problem here is that a company most likely will be required to enforce the clawback before it has been able to quantify the amount/extent of the financial error!

  NOTE: there already is a significant tension between executives and the auditors as to when a restatement is required. This is certain to make it worse

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Compensation Clawbacks – What to Do Now

1. Review *existing* clawback policies for changes likely to be required
2. Take inventory of all plans, programs and arrangements that provide for incentive compensation tied to financial metrics
3. Consider including clawback language to incorporate the final rules into any new plans, grants and agreements
4. Consider amending cash/stock-based incentive compensation plans to apply clawbacks to awards made before SEC's new rule effective date (but with performance periods ending after the effective date)
5. Review who within the company will be subject to the clawback policy (including officer determinations)
6. Draft clawback policies to expressly allow for clawbacks by reducing compensation that would be payable in a future year, to give the executive and the company the best possible argument for a "net tax reporting position"
7. Check indemnification and mandatory arbitration clauses and D&O policies for clawback litigation issues

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Disclosure of Pay Versus Performance

- Requires company to disclose in proxy statement:

  "Information that shows the relationship between executive compensation actually paid and the financial performance of the issuer"

- "Financial performance" includes any change in the value of the company's stock and dividends or other distributions
- April 2015, SEC proposed rules
- No effective date set. Unlikely to apply to calendar year filers before 2018 (for the 2017 fiscal year)
  - However, the retrospective reporting requirements suggest a need for advance preparation

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Reporting Pay vs. Performance

New Item 402(v) *Pay versus Performance*. (1) Provide the information specified in paragraph (v)(2) of this item for each of the company's last five* completed fiscal years in the following tabular format:

PAY VERSUS PERFORMANCE

Year (a)	Summary Compensation Table Total for PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for non-PEO Executive Officers Named (d)	Average Compensation Actually Paid to non-PEO NEOs (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)
2017						
2016						
2015						

*Like the stock performance graph required by Item 201(e)

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Reporting Pay vs. Performance (cont.)

Compensation actually paid is:

- Total compensation for the covered fiscal year for each NEO as provided in the SCT
- Minus, the aggregate change in the actuarial present value of the NEO's accumulated benefit under all defined benefit pension plans reported in the SCT
- Plus, the service cost under all such pension plans, calculated as the actuarial present value of each NEO's benefit under all plans for service rendered during the year, in accordance with FASB ASC Topic 715
- Substitute the fair value on the vesting date of all stock, option, and SAR awards for which all vesting conditions were satisfied during the covered fiscal year, grant date FMV figures reported in the SCT as to those awards

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Reporting Pay vs. Performance – Footnotes

- The "measurement period" is the period beginning at the "measurement point" established by the market close on the last trading day before the company's earliest fiscal year in the table, through and including the end of the company's last completed fiscal year
- Footnotes to the Table – Amounts Actually Paid
  - Disclose the exact amounts deducted and added in calculating compensation actually paid the CEO and the average amounts deducted and added for the other NEOs
  - Disclose any difference in the assumptions used to calculate the fair value on the vesting date of all stock, option, and SAR awards from the assumptions used to calculate grant date FMV figures

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Reporting Pay vs. Performance – Narrative

- Narrative disclosure: provide a clear description of the **relationship** between
  1. the compensation actually paid to the CEO (column (c)) and the average of the compensation actually paid to the other NEOs (column (e))
  2. the company's cumulative TSR (column (f)) for each of the last five completed fiscal years
- Include a comparison of the company's cumulative TSR (column (f)) and cumulative TSR of the company's peer group (column (g)) over the same period

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Reporting Pay vs. Performance – Other Important Points

- *Transitional relief*. Company may provide this disclosure for three years, instead of five years, in the first filing in which it provides this disclosure, and provide disclosure for an additional year in each of the two subsequent annual filings in which this disclosure is required
- *New/IPO Companies*. Only need report the last completed fiscal year
- *Smaller reporting companies*:
  - May provide the required information for three years, instead of five, only two fiscal years in the first filing in which it provides this disclosure, and are not required to provide the disclosure with respect to the TSR of its peer group
- Exempt from this reporting:
  - Emerging Growth Companies
  - Registered Investment Companies
  - Foreign Private Issuers

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Reporting Pay vs. Performance – *Peer Group*

- “Peer group” either (i) the same peer group used for purposes of Performance Graph required by Item 201(e) or, (ii) a peer group used in the CD&A for purposes of disclosing the company’s compensation benchmarking practices
  - If the peer group is not a published industry or line-of-business index, the company must disclose the identity of the companies comprising the group.
  - The returns of each component company of the group must be weighted according to the respective companies’ stock market capitalization at the beginning of each period for which a return is indicated

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Establishing and Disclosing Performance Goals for 2016

- FASB elimination of "extraordinary items"
- Rigor of performance goals (ISS review)
- SEC's Non-GAAP Guidance (Reg S-K C&DI 118.08 and 118.09)
- Focus on transparency of adjustments (ISS survey)
- Impact of P4P Rules

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Post-Vest Holding Restrictions on Equity Awards

- Mandatory post-vest holding requirements are a powerful corporate governance tool, which are increasing in prevalence for a variety of reasons
  - Promoting Greater Alignment with Shareholder and Proxy Advisor Policies
  - Defining a Clear Path to Meet Ownership Guidelines
  - Creating Practical Mechanisms to Recover Awards via Clawback Policies
  - Improving the Tax Deductibility of Time-Vested Restricted Stock and RSUs
  - Preserving Preferred Tax Treatment for ISOs and ESPPs
  - Reducing Compensation Expense under ASC Topic 718 and IFRS 2
    - Consider recent statements from SEC staff

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6. Code Section 409A Issues

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Code Section 409A Issues

- Restricted Stock Units (RSUs) and Retirement
- List of Specified Employees (six-month payment delay)
- Stock Option Valuation for Private Companies
- Employment Agreement Provisions
  - Release Deadlines

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Proxy Disclosure Tools and Tips

- **Do Your Homework**
  - Review Company's Performance and Model P4P Connection
  - Read Prior Year's Proxy Advisor Reports
- **User Friendly Format** (RR Donnelley Survey)
  - Most institutional investors skip to specific sections of proxy when reviewing it (CD&A executive summary and proxy statement summary, especially) and no one reviews a hard copy
  - Director independence, pay for performance alignment and disclosure of performance measures ranked as most important subject matters
- **Proxy Summaries** (in CD&A and Proxy Intro)
- **"Good Governance" Highlights and, if applicable, Shareholder Engagement Efforts**
  - Disclosure targeted to impact QuickScore and proxy advisory firm reports and recommendations
- **Telling Your Story Consistently, including "Pay for Performance"**
  - "Anticipate" P4P Disclosure Rules
  - But remember "non-GAAP" rules (Reg S-K C&DI 118.08 and 118.09)
- **Follow-through on Commitments Made in Prior Disclosure**
  - SEC Comment Letter Responses
  - Say on Pay Proposal Disclosure

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Common Missed Proxy Disclosures

- Connecting the dots in CD&A between policies and comp decisions
- Discussing all outstanding LTI awards in CD&A (granted, vesting and vested during the year)
- Disclosing incentive compensation award targets and explaining the connection between the targets and the payouts
- Table of expected awards ("New Plan Benefits") for incentive plan approvals
- Notice of internet availability legend
- Actions taken in response to prior say on pay vote
- Properly calculated deadline for shareholder proposals and floor proposals
- Disclosing shares that may be acquired in 60 days in beneficial ownership table
- Including all biographical information required by Item 401 (principal positions in prior 5 years, public boards in prior 5 years)
- Disclosing key governance features of interest to institutional investors
- Explain missed meetings or Section 16 filings

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Say on Pay Results* and Strategies

- Overall passage rate for Say on Pay remains high (avg. support of 91% in 2015)
- So far in 2015, 54 Russell 3000 companies failed to obtain majority approval of their Say on Pay proposals
- 77% of companies have passed with over 90% approval in 2015
- ISS recommended a vote AGAINST Say on Pay at approximately 12% of companies it reviewed in 2015
- ISS effect?
  - Average approval with ISS “for”: 95%
  - Average approval with ISS “against”: 63%

*Data from Semler Brossy September 28, 2015 Say on Pay Report

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Say on Pay Results and Strategies (cont.)

- Usual reasons for failed Say on Pay votes:
  - Pay and performance disconnect
  - Rigor of performance goals
  - Special awards or mega-grants
    - Solid TSR and financial performance don't insulate companies from scrutiny (*Chipotle*)
  - Non-performance-based equity
  - Problematic pay practices
  - Benchmarking practices
- Typical company changes in response to Say on Pay challenges*:
  - Improving proxy disclosure
  - Ensuring incentive plan goals are sufficiently challenging
  - Shifting pay mix to performance based
  - Changing severance plan
  - Increasing weight of performance shares

*NYSE Governance Services / Corporate Board Member / Pay Governance Fall 2013 Survey

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Say on Pay Results and Strategies (cont.)

- Ensure that required and "best practices" disclosure and procedures are included/followed
  - Supporting Statement for Say on Pay Proposal (include current frequency and when next vote will occur)
  - Proxy Statement and Proxy Card Language – SEC Guidance
  - CD&A disclosure re: consideration of Say on Pay result
  - Executive Summary in CD&A
  - Pay for Performance Emphasis in Disclosure
  - Proxy Summaries
  - "Good Governance" Highlights
  - User-Friendly Format
  - Telling Your Story

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Compensation Litigation Update

- Stock Plan Proposal Litigation – don't be a target
- Incentive Plan "Oops" Litigation – do your diligence
  - Are your 162(m) performance goals due for SH approval? (every 5 years)
  - Dust off the plan document to review plan and award limits
  - Review 162(m) disclosure in proxy statement
  - Corporate formalities
  - Monitor Form S-8 Share Usage in All Plans
- Section 16 – Review Filing Procedures, Approach and Disclosures
- Compensation Litigation and Directors
  - *Seinfeld v. Slager*, *Calma v. Templeton* [Citrix Systems]
  - *Espinoza v. Zuckerberg*; *Cambridge Retirement System v. Bosnjak* [Unilife Corporation]

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Annual Meeting Disclosure Litigation – Strategies

- Stock Plan Proposal – Disclosure Approach
  - Start with the SEC disclosure rules
  - Enhanced burn rate and overhang disclosure
  - Review peer disclosures
  - Supplemental disclosure – less is more?
- Stock Plan Drafting – Address Director Compensation Hot Buttons
  - Meaningful limits on stock awards and/or cash awards and total compensation to non-employee directors
  - Shareholder approval

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[Thank you]

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