All on Board
Companies move forward in recruiting diverse directors

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By Dan Marcec

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Board Leadership Forum
February 2, 2017 | San Francisco, CA
May 16, 2017 | Dallas, TX
September 12, 2017 | New York, NY
Co-hosted by Equilar and Nasdaq, this event will address investors’ increased expectations for transparency around board refreshment and diversity and how they are voting on boards. Developed for public company board members and executives, this forum will look at how innovative boards are driving results and will empower participants to build higher performing boards through better evaluation and recruitment processes.

Compensation Committee Forum
April 19, 2017 | New York, NY
November 9, 2017 | San Francisco, CA
Co-hosted by Equilar and Nasdaq, this forum will arm public company compensation committee members and senior-level HR and compensation executives with the necessary knowledge to make the right pay decisions for their businesses. Attendees will obtain independent viewpoints and noteworthy takeaways to drive long-term compensation strategies that will increase shareholder value.

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June 12-14, 2017 | Chicago, IL
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Fundamentals for New Public Companies
December 2017 | Palo Alto, CA
Co-hosted by Equilar and Nasdaq, this one-day program is developed for executives and board members of companies that have gone public in the last four years or are planning to go public in the next 12 months. Participants will obtain valuable advice to address critical executive compensation, board structure, growth, and shareholder engagement issues in the post-IPO world.

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Corporate governance leaders have made it clear that regular director evaluation and assessment is now an issue of corporate risk. As you flip through this issue of C-Suite, you’ll see a common theme around board refreshment.

Our cover story focuses on calls from investors and other stakeholders for more diversity in the boardroom. We continue to see this theme of refreshment in The Changing Face of America’s Boardrooms, which highlights the contributions of first-time directors. Cindie Jamison—chairman of the board at Tractor Supply and a director on three other boards—details her experience in an exclusive C-Suite interview of being elected to not one but two activist slates. Meanwhile, directors and investors discussed the need for regular board evaluations and new ways of thinking at events such as the Equilar and Nasdaq Board Leadership Forum and TK Kerstetter’s Investor Board Performance Review.

Despite calls to action from investors and other stakeholders, the old ways of doing business are slow to change. The closed-network approach of adding board members based on “who you know” has maintained the status quo. Advocates for change don’t feel like enough is being done. And quite simply, the excuse that there are not enough qualified candidates to create diverse boards is just not true.

That’s why we’ve developed Equilar BoardEdge and the new Equilar Diversity Network (affectionately referred to as “EDN” and pronounced as “Eden”). It’s not unreasonable that directors with decades of professional experience won’t remember everyone they worked with over the years. So we want to help cure “board amnesia” and connect them with qualified potential board members who may not be on their immediate radar. Our technology leverages big data and social networking concepts to connect boards with their larger, extended networks and beyond to tap a much broader candidate pool.

It’s amazing that technology has been applied everywhere across the business world but isn’t as quickly adopted in the boardroom. By expanding their horizons, boards will be better equipped to face the challenges of today’s evolving corporate landscape, meet shareholder demand and drive company value.

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

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Companies move forward in recruiting diverse directors

By Dan Marcec
The market is calling for more diversity on public company boards of directors, but even the largest companies on the leading edge have not yet heeded the call.

In the past several years, corporate governance stakeholders have become more attuned to board composition in terms of gender, racial and ethnic diversity. Proponents and advocates for a wider range of demographic backgrounds not only champion the value of various experiential perspectives, but also as a practical matter, they recognize that diverse boards are more representative of the increasing diversity of these companies’ employees, investors and customers.

“Throughout our society there’s been an increase in awareness and focus on diversity in general, and that’s clearly the case in most businesses as well,” said Steve Odland, President & CEO of the Committee for Economic Development (CED). “In the business world, companies are placing immense emphasis on making sure that the makeup of their employee base reflects their communities and their customers—we see more and more boards following suit.”

Though the commitment to diversity is there in word, in deed there has been slow progress. For example, women accounted for 21.3% of S&P 500 board seats in 2016, according to a recent report from Equilar. That represents an increase of fewer than five percentage points since 2012, when approximately one-sixth of all director seats were occupied by females (Graph 1).

“Companies around the world are paying more attention to board diversity, and when so much activity is happening, it leads us to ask how do we stack up,” said Brande Stellings, Vice President, Corporate Board Services at Catalyst. “Other countries are pulling ahead, and the mantra for decades was to give it time—women are graduating from college in higher numbers and the cream would rise to the top so there’s no need to be proactive. Time has not been sufficient, so there’s impatience.”

There’s more than meets the eye in terms of gender diversity as well. The overall numbers are up, but leadership positions are still low. Just 7.6% of all S&P 500 board leadership positions—CEO-Chair, non-executive chair or lead director—were filled by females in 2016. That is an increase from 5.6% in 2012, but it still falls well behind the overall percentage of women on boards, and of course, far beneath levels of parity.

“The first step was getting women on boards, and now that women are on boards in larger numbers, there should naturally be more opportunities for them to serve as non-executive chairs or lead directors,” said Blair Jones, Managing Director of Semler Brossy, who contributed independent commentary for the recent Equilar report, Board Composition and Recruiting Trends 2016. “Barriers can exist where there is not a natural rotation that opens up chair slots, or tenure dictates chair or lead director designations ahead of skill sets.”

**Evaluating the Team**

While the SEC has recently considered proposals that would require disclosure of various diversity attributes for public company boards, this chatter remains idle and has not gained momentum that would point to expectations of a forthcoming rule yet. As a result, information about ethnicity and race among directors is limited to what companies voluntarily disclose in their annual proxy statements.

According to Equilar data, a majority of S&P 500 companies—or 61.0%—disclosed that they “consider ethnic or racial diversity” when assessing the board or director candidates. However, disclosures of that type are often limited to boilerplate language inclusive of little more than an acknowledgment. A much smaller number of S&P 500 companies disclosed the
actual composition of their current board in terms of ethnicity or race—a total of 12.8%, or 64 companies (Graph 2).

Furthermore, as the corporate landscape continues to evolve, so have the skills required on the board of directors. Most companies expect directors to have at least some level of executive and/or financial experience in their past, but as new considerations create greater risks, boards are cultivating an array of experience from a diverse set of directors to engender more comprehensive oversight. Moreover, they are also disclosing this information more readily in order to show their investors and other stakeholders they are taking these new risks seriously.

“Investors’ call for board refreshment and interest in board diversity have placed this issue front and center for most companies, and best practice among nominating and governance committees is to conduct a skills audit to understand the skills possessed by current directors and skills that are not yet addressed, with the objective of keeping the portfolio of board skills contemporary and relevant,” said Jones. “Frequently the gaps are gender- or race-based, but the gaps also may reflect industry expertise, financial expertise, marketing expertise, or increasingly, technology—particularly cybersecurity.”

A case in point, the number of companies that include a board skills matrix in their proxy statements has nearly doubled in the past year from just 32 companies in the S&P 500 in 2015 to 63 in 2016—or 12.6% of the total. The skills matrix typically manifests as a visual representation of experience and qualifications for the directors up for nomination at the upcoming annual meeting. While a director biography includes an individual’s qualifications, skills matrices framing the skillsets represented on the board as a whole are becoming more common, and make assessing boards as a whole a simpler exercise.

Examining the Roster
Up until now, many boards that have fallen behind the diversity curve point to the fact that there are not enough qualified candidates available. An Equilar analysis conducted earlier this year in partnership with The U.S. 30% Club, found evidence to the contrary—approximately four in five females currently serving as public company executives had never served on a board.

“Many boards are committed to increasing diversity, but they cite difficulty in finding qualified candidates,” said S.K. Gupta, Managing Director and Co-Founder of Ascend Pinnacle, an initiative to increase the number of Pan-Asian corporate directors on public and large private company boards.

“If board members require experience as a Fortune 500 CEO to be on the board, then sure, there is a limited number,” said Odland. “We suggest that they broaden the criteria to include private board members, retiring audit professionals, legal experts, small business owners, and other senior C-suite members. If you broaden the scope even by a bit, the supply issue evaporates.”

Expanding the Network
Over the years, companies have looked for correlations to company performance as proof they need to seek board diversity. According to a Catalyst report “Why Diversity Matters,” there are 70 different citations showing that diverse teams, including boards, perform better. Although there has been over a decade of solid research to support the business case for gender diversity on boards, Stellings said, it has not proven sufficient to drive behavior change.

“Boards have control over the company’s strategic direction, and corporations are very important to everyday lives, so we think it’s important to see at least half of the population represented on the board,” she added.

Odland also noted that diversity is bigger than a performance issue, it’s a human capital issue. For example, women have a majority of advanced degrees and control a considerable portion of consumer spending. They’re very involved in investment decisions and have high net worth. Just under half the workforce is female. Yet, only less than 10% of top management and about 5% of Fortune 500 CEOs are women. They’re a majority, or close to one, of customers, employees and stockholders—every constituency except those making company decisions.

“Amid growing global competition, many boards are moving beyond the compliance role to emphasizing strategic planning for long-term innovation and growth,” added Odland. “More than ever before, boards comprised of broad diversity and thought will help companies to avert tunnel vision and be positioned for success.”

There may still be a long road ahead before reaching a tipping point. While there has been an increased commitment to mandatory retirement ages, and to a lesser degree, board term limits, a one-size-fits-all solution like that often precludes directors who should be on the board to stay on the board. Equilar data shows that less than 10% of S&P 500 directors were new to the board in 2016. That means about 500 seats opened in the past year—about one per company—and though 25% of those were occupied by women, it takes a while to make change.

“We’ll often see reproduction of what the system already looks like,” said Stellings. “It’s not really a bias against women, but it’s a bias in favor of who you know. It’s about the network, and you have to work to get in—it’s not like you just apply and you can get on there.”

Source: Equilar
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Independent Advice. Effective Solutions.
HR departments must consider employee perception ahead of the CEO pay ratio

By Dan Marcev
S

ince the SEC ruled one year ago that companies would be required to report the ratio of CEO pay to that of a median employee starting in 2018, this issue has become a lightning rod for discussion around executive pay.

The pay ratio is controversial for different reasons to different constituents. In the corporate governance universe, executive compensation professionals and the shareholders who vote on executive pay have debated the ratio’s usefulness as a means to help them evaluate CEO pay. Companies are concerned about the costs involved—by some estimates, it will cost public companies a collective $1.3 billion to comply with the rule in its first year, and about half that amount every year thereafter. Meanwhile, opponents of what they describe as exorbitant CEO pay have said they would use the ratio to shame companies publicly.

Caught in the middle, HR departments will be assigned the daunting task of communicating this delicate information to company employees, and handling the influx of inevitable questions about what job is the median, how that compares across departments, and quite possibly, why the CEO gets paid so much. Undoubtedly they are asking how can they best communicate their own company’s ratio and educate employees on what it means.

**Determining the CEO Pay Ratio**

There are many alternative ways to calculate the ratio, and various sources show vastly different figures. For example, the AFL-CIO Executive Pay Watch shows a ratio of 335-to-1, accounting for the average reported total compensation for S&P 500 CEOs versus the average for nonsupervisory workers in the U.S.

On the flip side, PayScale, which provides on-demand compensation data and software, compared median cash compensation for 168 of the highest-paid CEOs in the annual Equilar 200 study to cash compensation of the median employee for those companies. This included all employee levels from individual contributor to executive level. Under this methodology, PayScale’s median ratio came out to 71-to-1.

These differences reflect the fact that while companies will be required to provide disclosure of their CEO pay ratios beginning in 2018 public filings, there is some flexibility in the SEC rule that allows a company to select its methodology for identifying its median employee and that employee’s compensation.

The question remains how the ratio should be calculated to create the most direct comparison between how CEOs and employees are paid.

**Executive vs. Employee Pay Strategies**

It’s difficult to draw a direct comparison from executive to employee pay for several reasons. The AFL-CIO Executive Pay Watch included all reported CEO pay, which factors in equity compensation such as stock and options awards, while PayScale’s employee survey exclusively tracks salary information and thus compares more directly to the cash components of CEO pay in the form of salary and annual bonus.

On paper and in practice, stock and options make up a vast majority of CEO pay. Equity accounted for 68% of the reported compensation for the CEOs included in the Equilar 200 study used for the PayScale comparison. In other words, on average, less than one-third of these CEOs’ compensation was earned in cash. At the same time, CEO compensation reported in annual proxy statements often includes dollar values that are not paid in that year, because a significant portion of CEO pay is contingent on future performance. The ultimate value of those awards may be less or more than the reported numbers had indicated.

Meanwhile, non-executive employees may or may not receive company equity as part of their compensation.

HR departments will have to come up with detailed communications plans to address how the median employee was determined and why the ratio is what it is.

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For more information on PayScale’s employee survey, please visit payscale.com/data-packages/ceo-pay.
Even if employees do receive stock or options, they are less likely to be certain about the present value of their equity, and thus self-reported data may not fully capture the amount they ultimately realize as something tangible—even if it were accounted for in the pay ratio. As a result, survey data better reflects cash compensation, and an apples-to-apples comparison measuring the gap between CEO pay and their employees can help to normalize some of these discrepancies.

The highest-paid CEO on the Equilar 200 list—Dara Khosrowshahi of Expedia—provides a useful example of the differences between how pay is structured for CEOs versus most employees, and moreover, how that compensation is reported to the SEC.

In 2015, Khosrowshahi received stock options valued at more than $90 million on the day the award was granted. However, he will only realize that value if he hits aggressive performance goals. On top of that, the company has said it will not award him any more equity compensation until 2020. According to PayScale’s survey, the ratio of CEO pay—including equity—to the median employee would be nearly 1,000-to-1 at Expedia in 2015. In any other year, it would likely fall far closer to the 39-to-1 ratio shown in PayScale’s study, which represents the amount of cash Khosrowshahi took home in 2015.

Employee Perception of Executive Pay

The alternative ways to calculate the CEO pay ratio reflect another reality: While the figure may appear similarly across companies to the public, it will be calculated differently at every company. A new piece of information, never before disclosed by a majority of companies, will become publicly available—the median employee’s pay—and inevitably half of the company will fall below that mark.

So whether a particular company’s ratio is 335:1 or 71:1, HR departments will have to come up with detailed communications plans to address how the median employee was determined and why the ratio is what it is, especially if the figure may appear out of step compared to industry competitors.

To appraise employee sentiment on CEO pay, PayScale conducted a survey soliciting more than 22,000 responses on whether employees knew what their CEO’s compensation was, and if so, the degree to which they thought it was fair.

Overall, the findings showed more than half of employees were not aware of their CEO’s compensation (55%), and among those that did, nearly 80% believed it was appropriate. Meanwhile, more than half of respondents who felt that their CEO is overcompensated also reported that it negatively affects their view of the company (57%).

Unsurprisingly, employees at higher levels in their companies have more knowledge about and more readily approve of CEO compensation than employees at lower levels. In other words, the perception of the CEO’s compensation and its impact on the respondent’s opinion of the company is often related to their job level, according to the survey.

“The report raises questions about what would happen if everyone knew their CEO’s compensation,” said Katie Bardaro, Vice President of Data Analytics and Lead Economist, PayScale. “As people move out of the ‘don’t know’ category, are they more likely to move into ‘approve’ or ‘disapprove’?”

Though these responses may not be unexpected, they underscore the value of transparency in setting expectations about the forthcoming ratio and its influence on employee morale. If employees are surprised by revelations in the news or coming from a union advocate, they’re likely to be less informed than if it comes straight from the source.

Ultimately, CEOs are paid very differently than employees, and the data suggests that workers who understand the nuances are more receptive to learning more about why. HR departments and other internal communicators have the opportunity to gather information and data now so they can accurately tell their company’s story and dampen the noise from external parties that may try to tell that story for them.
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A Chief Executive Officer (CEO) is both the managerial leader and the figurehead of his or her company, representing it to its employees, shareholders and the general public. In times of growth and success, but also in turmoil and failure, a company’s CEO must persevere and plan their next course. Consequently, CEOs take on incredible responsibilities, and companies seek to pay them in line with those risks and opportunities.

Due to these factors, investors, advisors, the media and the general public closely scrutinize CEO pay, and this tenor has increased in pitch in the wake of Dodd-Frank and Say on Pay. Under these pressures, executive compensation—especially CEO pay—has been shifting toward long-term value generation and retention through stock awards, while salary and bonus levels have begun to stagnate. Equilar’s recent CEO Pay Trends 2016 report, which featured independent commentary from Meridian Compensation Partners, analyzed CEO pay trends in the S&P 500 over the last five years, examining pay structures, elements and values in the face of this changing corporate landscape.

Rising CEO pay often catches media attention as unnecessarily large, or “exorbitant,” especially compared to stagnating workers’ wages, but criticisms must be taken with a grain of salt. While groups like AFL-CIO criticize income inequality—calculating the average CEO-to-worker pay ratio at 335-to-1 according to its Executive Pay Watch—broad ratios often don’t tell the whole story, generalizing workers and not accounting for variable pay elements or wage growth. In fact, while median reported CEO compensation increased 1.6% from 2014 to 2015, the Economic Policy Institute’s Nominal Wage Tracker found that private employees’ actual year-over-year wage growth was 2.6%.

**Rising Total Compensation: More Than Meets the Eye**

S&P 500 companies have steadily increased CEO compensation over the past five years. Median reported CEO total compensation rose 16.9% from $8.9 million in 2011 to $10.4 million in 2015. This...
There’s a mismatch in the way that the SEC requires companies to report pay, and therefore practitioners take special care to evaluate these figures in a larger context.

growth generally occurred incrementally, only rising more than 3.5% in any given year in 2013 where CEO pay increased 10.5%, or nearly $1.0 million ($970,042).

“When looking at CEO compensation, there are two ways to frame it. You can view CEO compensation in terms of actual payouts or in terms of structure/target opportunity,” said Gerard Leider, a partner with Meridian Compensation Partners. “The proxy summary compensation table disclosure is a mixed comparison of both actual and target accounting value.”

“The number of different definitions companies have to tell their story is not to confuse the reader, but to add clarity across appropriate components of pay,” added Donald Kalfen, Partner and Technical Lead at Meridian Compensation Partners.

In other words, there’s a mismatch in the way that the SEC requires companies to report pay, and therefore practitioners take special care to evaluate these figures in a larger context. There’s no denying the size of CEO pay in the S&P 500, but recent scrutiny has drastically affected how it has changed, refocusing on equity-based compensation with major increases appearing in largely growing sectors like healthcare and technology largely due to grants of non-cash compensation.

One Size Does Not Fit All
Market performance relies on external factors that affect each sector differently—consequently, CEO pay did not rise equally across every sector. Reported total compensation increased modestly in the consumer goods sectors, and dipped slightly in the industrial goods and services sectors in 2015. Meanwhile, healthcare and utilities continued a steady growth while technology rose after a 2014 dip (Graph 1). The basic materials sector was down 10.2%, while the financial sector saw a 15.5% increase at the median over 2014.

These changes reflect the aforementioned CEO pay package design changes that emphasize equity compensation. Equity compensation in the form of stock and options made up 65.3%, 63.1% and 65.5% of their CEOs’ pay mix in the healthcare, utilities and technology sectors respectively.

In fact, across all sectors, stock awards were the only pay component to show meaningful growth. Median reported salary has increased incrementally, while bonuses and options awards decreased in the past five years. Meanwhile, median stock awards surged, increasing by over $1.8 million at the median (Graph 2).

“I would argue governance factors are more
significant in driving pay structure than just the proxy-disclosed pay data,” explained Leider. “[Shareholders] are looking for better pay for performance in executive pay, greater transparency around pay programs and enhanced governance policies and oversight of CEO pay by boards and committees.”

**Pay for Performance Drives CEO Comp Design**

Companies award equity as either stock options or full-value shares of restricted stock, doing so in two primary formats: time-based and performance-based. Dodd-Frank and its financial reforms led the transition from the former to the latter, leading to and popularizing more deliberate and transparent pay for performance strategies. In 2012, the number of S&P 500 companies granting performance awards surpassed those giving time-based options awards, and this trend continued through 2015, with the prevalence of companies offering performance awards peaking at 80.5% versus just over half of still paying CEOs with time-based options.

Performance-based equity has also increased and surpassed time-based equity in S&P 500 companies’ median equity mixes, balancing the scales between fixed and variable, or “at-risk,” pay components. While in 2011 performance-based equity made up only 31.5% of median equity mixes, with time-based equity filling the remaining 68.5%, these values shifted dramatically in 2012 where they met at 50.0% each. This trend fluctuated year-over-year, but most recently performance-based equity accounted for a slight majority, representing 51.6% of equity compensation, compared to time-based equity making up 48.4% (Graph 3).

**Graph 3**

S&P 500 Median Time- vs. Performance-Based Equity Mix

“Time-vested and performance-vested stock awards both have grown in prevalence for different reasons,” said Leider. “Time-vested equity takes on a primary goal of talent retention given the lack of performance required to earn the grant, even in a declining market, while in contrast, performance equity, otherwise defined as performance shares or units, only vests when certain goals are achieved over the measurement period, requiring goals to be set and achieved before payout.”

Furthermore, performance awards amplify stock as an innate performance award because its payout value relies on company performance, in addition to company valuation—the amount of stock they receive relies on how well the CEO performs, beyond simply relying on how well the stock performs. Equity incentives clarify and connect executive compensation to actual company metrics, demonstrating and clearly linking CEO pay and company growth to shareholders.

While companies design CEO awards to motivate growth and generate shareholder value, certain performance metrics can lead to the pursuit of short-term strategies to meet performance targets over long-term growth. Some studies have found that executive compensation reliant on earnings per share and granting stock options often correlates with increased share buybacks. Critics oppose these repurchases because they often take the place of long-term investments in company growth and development. While connecting pay and performance clarifies components that compose CEO pay, careful design becomes important to ensure that the goals promote strategic decisions and shareholder value. [5]

Dodd-Frank and its financial reforms led to the popularization of more deliberate and transparent pay for performance strategies.
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Peer to Peer

Companies calculate the best ways to pay vs. comparators

By Ryan Villard

Peer group benchmarking has increasingly become a vital component to executive compensation design because it contextualizes companies’ pay decisions, clarifying why executives are earning what they’re earning. Shareholders often look for detailed pay disclosure that justify and explain pay decisions beyond motivating and retaining key talent. In the last five years, the number of S&P 500 companies disclosing a compensation benchmarking group has increased from 91.2% to 95.4%, evidence that this has become a best practice.

Executive compensation peer groups include companies who compete in a similar corporate landscape, matching in size and focus, and, in turn, attracting similar executives. In order to retain top talent, boards benchmark their executives’ pay packages to these peers so that their pay is competitive and appropriately drives company performance.

Pooling the Right Peers

Equilar examined S&P 500 companies’ peer groups in their 2016 Peer Group Composition and Benchmarking report, which featured independent commentary from Pay Governance, covering how leading companies design and use their executive compensation peer groups.

Peer group construction revolves around finding a balance between including relevant companies that match in size and focus, and enough companies to make comparisons meaningful. More than two-thirds of S&P 500 companies have peer groups inclusive of 11 to 20 companies, though there is extensive variation with peer group sizes ranging from 2 to 132. These large peer groups often compete in fragmented industries and take a broad industry overview when benchmarking executive compensation.

Besides variations in size, some companies use multiple peer groups when benchmarking different components of their pay packages. These companies often belong to multiple industries or have executives working abroad and they use separate benchmarking groups to address these differences. While this practice is rare—with only 9.9% of companies using two peer groups and 1.1% using three or four—it remains an important practice for addressing complicated
Peer group construction revolves around finding a balance between including relevant companies that match in size and focus, and enough companies to make comparisons meaningful.

benchmarking situations where a single peer group falls short.

“While a minority practice, companies use multiple peer groups for many reasons. For companies with much larger competitors, they may benchmark against those larger companies to assess non-pay related items such as incentive designs,” wrote Patrick Haggerty and Joe Mallin, both partners with Pay Governance. “Another example is for companies that recruit for talent in diverse industries. Since pay models and levels can be very different across industries, it is important to have benchmarking data to support pay decisions.”

Choosing Compensation Benchmarks

While many factors influence peer group selection, companies typically disclose specific criteria that play defining roles in their decisions. Out of the entire study, industry was the most cited criteria for influencing peer group construction, appearing as a factor for 441 S&P 500 companies.

Besides industry, financial comparisons like revenue and market cap were frequently cited criteria, appearing 363 and 308 times respectively. Companies also often chose their peer groups based on companies that compete with them for executive talent, with 328 companies citing this criterion. Selecting criteria reflects what factors companies consider important when determining how they will benchmark their executive pay and these differences may be more pronounced in different industries.

For example, companies who hire management with universal skillsets may be more likely to specify competition for talent as a criterion because they know that these executives could easily transition to a new company.

Graph 1

Percentage of S&P 500 Companies by Peer Group Size

Many S&P 500 companies look to non-U.S. based competitors when determining executive pay. A majority (52.1%) included only U.S.-based companies in their peer group, while 42.3% of companies named peer groups comprising up to 25% companies based outside the U.S. Just 0.6% of the S&P 500 had a peer group made up of a majority non-U.S. companies.

Low corporate tax rates make Ireland a desirable place for U.S. companies to relocate headquarters—often through inversion mergers—and many of the 183 named S&P 500 peers in Ireland are likely predominantly U.S.-operating outfits. Meanwhile, Great Britain, Canada and Switzerland hosted the next-largest concentrations of S&P 500 peer companies with 136, 86 and 77 references respectively.

“Over the past few years, proxy advisors have played a role in influencing peer group creation and CEO pay comparisons,” noted Haggerty and Mallin. “In evaluating pay for performance alignment, some proxy

Table 1

S&P 500 Peer Group Selection Criteria

<table>
<thead>
<tr>
<th>CRITERION</th>
<th>NUMBER OF COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>441</td>
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<tr>
<td>Revenue</td>
<td>363</td>
</tr>
<tr>
<td>Talent</td>
<td>328</td>
</tr>
<tr>
<td>Market Cap</td>
<td>308</td>
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<tr>
<td>Business Model</td>
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<td>Competitors</td>
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<tr>
<td>Geography</td>
<td>119</td>
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<tr>
<td>Assets</td>
<td>84</td>
</tr>
<tr>
<td>Employees</td>
<td>46</td>
</tr>
<tr>
<td>Profitability</td>
<td>39</td>
</tr>
</tbody>
</table>

Source: Equilar

Ryan Villard is a research analyst with Equilar. For more information on Equilar’s Peer Group Composition and Benchmarking 2016, featuring commentary from Pay Governance, please visit www.equilar.com/reports.
advisors establish their own peer groups to compare a company’s relative CEO pay and total shareholder return. Since these proxy advisor reports are typically shared with compensation committee members, many companies have adjusted their peer group development approach to be more aligned with proxy advisors."

**Comparing CEO Compensation**

To identify how reported pay correlates to peer group construction Equilar juxtaposed the CEO total direct compensation (TDC) of the S&P 500 disclosed proxy peers and found that 53.5% of companies’ TDC fell within the 25th to 74th percentiles of their peer groups. Ultimately, this can mean a lot of things—there may be a very small range within a peer group, for one—but it shows that while targeting the median is a common strategy and a best practice, outcomes can vary and for investors and other stakeholders evaluating CEO pay, there is more to consider than just the raw numbers.

This difference demonstrates variable pay as an important component of executive compensation. Companies will set award targets for their executives that depend on meeting performance goals—exceeding or falling short of these goals is likely to result in a payout above or below peer group median. These “at risk” elements are another explanation for the relatively even distribution of CEO TDC aligning with proxy peers’ compensation (Figure 3). A perfectly targeted and achieved award system would likely result in CEO TDC closer to median levels.

**Graph 2**

S&P 500 Companies Reported Pay in Comparison to Peers

<table>
<thead>
<tr>
<th>Percentile Rank</th>
<th>Percent of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
<td>2.6</td>
</tr>
<tr>
<td>1-24</td>
<td>19.4</td>
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<td>25-49</td>
<td>27.8</td>
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<td>50-74</td>
<td>26.7</td>
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<tr>
<td>75-99</td>
<td>19.4</td>
</tr>
<tr>
<td>Maximum</td>
<td>4.9</td>
</tr>
</tbody>
</table>

Source: Equilar

"There are several situations that often result in below-median pay for CEOs versus peer companies,” said Haggerty and Mallin. “We typically find that newly promoted CEOs, who have not been CEOs before, are often paid below well below median with the expectation that they will get to median over a period of years (usually two to five years) depending on performance during that time frame. We believe most companies prefer promoting CEOs from the inside because of the risks often associated with hiring CEOs from the outside and because outside hiring often results in above-median pay programs.”

However, this system is not fool-proof. Opponents of growing executive pay see peer groups as a type of “ratchet” that inflates executive pay package size as pay is compared and increased year after year. For example, a recent study from MSCI, entitled *Are CEOs Paid For Performance*, found that CEOs in the last 10 years have been compensated above their sector median while delivering below the sector median in total shareholder return. This analysis suggests that companies are increasing pay without necessarily considering executive performance compared to their entire sector, or choosing unnecessarily large peer groups.

**Contributors**

Patrick Haggerty  
Partner, Pay  
Governance

Joe Mallin  
Partner, Pay  
Governance
This program will give participants the kind of insights, experience and knowledge that would take 3-5 years of on-the-job training ... and they get it all in a 5-week program.

Brit Wittman, CCP, CECP, Director, Executive Compensation and Corporate Compensation Design, Intel Corp.

2017 Programs Announced.

<table>
<thead>
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<th>Month</th>
<th>City</th>
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<tbody>
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<td>April</td>
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<tr>
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<tr>
<td>September</td>
<td>Phoenix</td>
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</tbody>
</table>

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Effective board oversight of cybersecurity risk begins with asking the right questions. While the issue is complex, the board’s mission is straightforward: To confirm that the essential elements of a risk management program are in place. This article describes what to probe in order to protect your organization and discharge your duties, presented by a seasoned lawyer and executive who has worked with boards, management and security professionals on these issues for two decades.

1. Do you know your risks?
As with any major challenge, the first step is to define the problem. Every company faces a different set of cybersecurity threats shaped by its position in the market, its geographic footprint and its reliance on technology. Boards should confirm that management has taken steps to understand the organization’s posture in this respect and in the process educate themselves about the threats facing their company now and the threats on the horizon. Some cybersecurity threats are to data, like the well-known payment card breaches affecting retailers. Other threats are to access, like the distributed denial of service attacks on online sharing platform GitHub in 2015, which blocked consumers from the site for nearly six days. And still other threats might target a company’s operations or reputation. What kinds of cyber actors target your sector? Are you susceptible to cause-related attacks? Which nation-states may take an interest

Key Questions

1. Has management identified known cybersecurity risks to the company?
2. Has management developed appropriate safeguards to protect systems and data?
3. Has management implemented methods to detect cybersecurity incidents?
4. Has management developed a process by which to handle a cybersecurity incident?
5. Has management developed a plan to recover and restore the company’s operations that were impaired as a result of a cybersecurity incident?
in your activities? What are your biggest vulnerabilities and regulatory obligations, in terms of IT systems, data and people? And what about your third party vendors and relationships—what threats do their systems and activities face that could affect yours? If the board lacks an appropriately experienced member to take the lead on these and related inquiries, consider consulting with a specialist to assist.

Understanding your cybersecurity risk also requires understanding what you must want to protect. Confirm that management has taken steps to identify which data and systems are the company’s “crown jewels” or mission-critical assets and has prioritized their defenses accordingly. There may be some kinds of data that require special care because of regulatory or contractual obligations, like personal health information or employee social security numbers. Other kinds of data, like key intellectual property assets, may be vital to the business plan. Knowing what most needs protecting, for both legal and broader business reasons, will help you confirm whether management is appropriately allocating limited cybersecurity resources.

2. Do you have and understand your organization’s plan to addressing risk?
Once you know what is key to protect, the next set of questions aims to confirm that your organization has implemented appropriate safeguards. Starting with the Cybersecurity Framework issued by the National Institute for Standards and Technology and the ISO 27001 management standard, there are multiple industry-level standards for cybersecurity that can help identify a baseline of safeguards. How does your current program compare to those standards? Depending on the nature of the business, management may not need to implement every possible safeguard, but you will want to know why there are deviations from industry norms. A factor in investing in safeguards may be how much the company has transferred risk via cybersecurity insurance coverage. Consider whether the balance of insurance and investment is appropriate given your threat environment and legal obligations.

Implementing a cybersecurity program should look like implementing any other serious compliance program. Boards should be looking for a dedicated program, well-resourced and well-led, with the clear backing of management. There should be accountability mechanisms for the people responsible for the program and periodic assessments of their efforts. There should be trainings in place for the workforce on security and safe computing and established protocols for dealing with third parties, like law enforcement, in the event of an incident. It’s also essential to understand how your company assesses the cybersecurity posture of its vendors and partners and what those third parties expect from you.

3. Do you know for sure if your organization can identify and detect problems?
The best-resourced cybersecurity program in the world is useless if there isn’t a way to detect when something goes wrong. Boards and management should be fully briefed on how their program identifies a cybersecurity incident or potential threat and what triggers a response. Ask whether employees know to whom they should report if they get a phishing email or accidentally expose information. Ask the IT team how they detect whether a cybersecurity incident might turn into a breach. And make sure that your organization’s cybersecurity program addresses the human factor: It’s key to have a process in place to detect and address the threat of “insider” attacks that come from people, not programs.

4. Have you tested and practiced incident response?
When your organization detects a possible breach—now what? Every company should have a plan for what to do. Documented incident response plans should be in place and regularly practiced and updated—ideally annually or within the last 18 months. Ask what lessons the team learned from their last rehearsal or actual event and how those lessons have been incorporated into the current plan. Every company’s needs are a little bit different, so boards and management will want to consider what makes a cybersecurity event material for their business. How will you know whether disclosure obligations are triggered? Are appropriately experienced legal counsel looped in early? And when will senior management and the board be involved? Companies that make a plan for trouble when things are calm will be better able to respond rapidly when something goes wrong.

5. And most importantly, have you prepared for the inevitable?
In this day and age, the question isn’t if your company will have a cybersecurity incident. It’s when. Effective cybersecurity risk management doesn’t just mean preparing for how to respond. It also means preparing for how to cope. Make sure your company has backup plans if cybersecurity incidents impair operations. Is there a business continuity or recovery plan? Are your core systems backed up? What does recovering from the back up require? And just like with response, practicing how to deal with a loss of operations is key. Check with your cybersecurity team to ensure they are testing their plan to recover and restore operations at least every 18 months and incorporating lessons learned.

An effective cybersecurity program is one that identifies the risks, adopts the approach best-suited for the organization, detects problems, plans for incidents and prepares for the worst. Boards that keep these five core considerations in mind will be in the position to confirm that their companies are appropriately managing the security risks of an interconnected world.
High-profile bankruptcies in the financial services sector in 2008 led to increased scrutiny on the risks built into incentive pay programs. The SEC responded in December of 2009 with a new disclosure requirement to alert investors to material adverse risks that may be created by a company’s pay programs. Companies adopted compensation risk assessment processes and began including disclosure in their proxies, frequently going beyond SEC requirements to include disclosure even when they did not find material adverse risks (the SEC only requires disclosure when such risk exists). Compensation experts recently reflected on where we are today with risk management of incentive compensation arrangements since the SEC disclosure rule took effect in 2010.

Impact of SEC Regulation

Members of the WorldatWork Executive Rewards Advisory Council* expressed mixed thoughts as to whether the SEC rules have had much effect. A few thought that outside the financial services industry, there has been little effect on behaviors and/or results and felt the results seen today would not have been very different had the rules not been adopted. And while financial services firms have made a number of changes to their incentive plan designs, these changes were mostly made in response to Federal Reserve guidance and not the SEC disclosure requirement. One member remarked they haven’t seen program design change as a result of the regulation and another questioned whether all this work has prevented excessive risk taking or simply exonerated the compensation programs. However, many others thought the regulations have led to some positive developments overall—some of which have been unexpected.

Where many of the council members did agree was in the belief that the regulation has led to positive developments overall by providing focus on an area that is sometimes partially overlooked. Perhaps somewhat unexpected, the new regulations enabled corporate human resources to gain entrée and oversight of all incentive plans, which is welcomed among compensation leaders.

Often in many large and/or decentralized companies, compensation programs are developed in various business units without the involvement
of the enterprise’s compensation team. As a result of new risk assessment processes, corporate-level compensation teams have been given authority to monitor, and sometimes even discover, the incentive plans and other compensation commitments in place throughout the organization. They have gained entry into the design of these business unit-developed “legacy plans,” been successful in requiring implementation of best practices and have introduced governance where it wasn’t present in the past. This also includes being drawn into sales compensation from the perspective of risk—because these plans are very often designed and managed locally. Just the fact that incentive programs are reviewed by the board’s compensation committee lends a seriousness and legitimacy to the exercise, which is helpful to compensation management.

Additionally, the new regulation has assisted corporate compensation in conducting a more comprehensive review of the balance between risk and reward in compensation programs. It also has supported the effort to achieve that balance more consistently across all programs relevant to participants whose actions are more likely to expose the company to significant business risk. Compensation committees have also benefited from having a broader understanding of the full incentive landscape. Committees have been encouraged to get better acquainted with organization plans that extend beyond their immediate purview. At many companies, the analysis received more attention from the compensation committee the first time around than it has subsequently—except in cases in which HR brought a big change in plans or results to the committee.

This oversight and monitoring has led to improvements in controls in some cases, as well as better consideration of unintended consequences of incentive program design. This additional oversight is recognized as good and a positive development, but the amount of time and effort involved is substantial.

**Check the Box vs. Rigorous Process**

Some suggest that the risk assessment process is merely a “check-the-box” compliance exercise, and critics lament that disclosure in proxy statements appears to be standard boilerplate. Compensation experts directly involved agree that it can take the form of a check-the-box exercise, but that alone adds value as long as one is using a best practice checklist. Checklists that include design features that may impact (either positively or negatively)

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the risk profile of an incentive plan have evolved. Going beyond this, collaborating with the enterprise risk management function to address any significant risks unique to an industry or company ensures a comprehensive overall view is taken. That collaboration also can build in any additional mitigation factors that are not in the generic best practices playbook. Regardless of the rigor of the analysis, the disclosure of the results is generally about the same: a high-level summary. So, compensation experts agree there is probably some truth to the “standard boilerplate” description—companies don’t necessarily want to stand out as different, possibly resulting in extra scrutiny or questioning of results.

**Opportunity for Improvement**

The advisory council members expressed concern that today’s risk reviews focus mostly on plan design itself rather than how incentive plans are used by managers and the ecosystems in which they operate. Attention is paid to the plan design as it exists on paper, reviewing plan design features or the compensation “hardware” (e.g., types of measures chosen, balance between short-term and long-term measurement, caps on payouts). These design elements lend themselves to a check-the-box approach, and most industrial companies have not had trouble complying. However, when things go wrong from a risk perspective, it’s often the ecosystem or “software” surrounding the incentive plans—management style and decision making protocols, culture, administration—that lead to or exacerbate bad business outcomes. Controls also are an important element of the ecosystems; approval requirements for various kinds of commitments are absolutely critical to risk management and should be considered in the compensation risk review process. In addition to a bottom-up review of the hardware, companies can improve their risk review process by including a top-down review of the software, looking at whether the compensation plans might exacerbate any of the business risks (i.e., financial, operational, reputational, regulation/compliance). For example, when looking at financial risks, are there weak controls around financial statements that could affect incentive outcomes? Are there conflicting goals across the organization that could lead to inappropriate behaviors or inefficiencies? Are executives so focused on incentive plan goals that they ignore other core drivers of performance?

**Caution Ahead**

The requirement has demanded a significant amount of work, and has had some positive outcomes, both intended and unexpected. Incentive plan risk management will continue to evolve, and scrutiny and calls for further regulation will continue.

A key aim for well-designed pay programs is not to minimize absolute risk, but rather to understand both short- and long-term implications of program design. Built-in checks and balances, continuously monitored results and incremental adjustments are effective mitigators of the risks inherent in business and in variable compensation. Business is driven by sensible risk taking, when growth and profits are the reward. It should not be the intent to eliminate risk taking entirely. Looking ahead, caution is warranted to not go too far with further regulation, especially to avoid stifling necessary business risk taking as well as avoiding unnecessary overhead expense and loss of competitive advantage for U.S. companies in the global economy.

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*The views expressed are the professional opinions of the members of the WorldatWork Executive Rewards Advisory Council. They do not reflect the opinions or positions of their employers.*
Investors have a limited line of sight into most boardrooms, and the proxy statement is typically an investor’s primary window into board decisions and strategy. To better understand how institutional investors use proxy disclosures, this past year RR Donnelley collaborated with Equilar and Stanford University’s Rock Center for Corporate Governance on a survey of investor use of proxies.

The results, which included responses from 64 institutional investors with a combined $17 trillion in assets under management, revealed that investors are attuned to what they can decipher with respect to board oversight of risk. In particular, they are highly likely to seek out information about how boards analyze risk when it comes to voting and investing decisions. Disclosure of risk oversight was ranked eighth out of 20 topics investors indicated they review carefully in proxies, with 43% of respondents indicating this was an important topic in making voting decisions.

With this in mind, further analysis of how boards disclose this information provides examples of how companies engage their shareholders regarding risk and how they can increase transparency on this important issue.

Types of Disclosure
We typically see the topic of board oversight of risk covered in one of three ways:
• General or even boilerplate narrative discussion

Goldman Sachs Group Inc.
Proxy filed on April 8, 2016: p.28

Effective proxy disclosure to generate understanding and confidence among shareholders

By Ron Schneider
DONNELLEY FINANCIAL SOLUTIONS
• Thoughtful, company-specific narrative discussion, often discussing roles of the full board, key committees and senior management
• The above supplemented with visual imagery that draws the reader’s eye and conveys key messages with greater impact

As we assist a range of clients that are evolving their proxies each year, companies seem to be getting the message from their investors about the importance of this topic. This understanding is reflected in how an increasing number of companies communicate their risk oversight stories effectively to a range of investors and other constituencies.

To get a better understanding of just what cutting-edge disclosure might look like, please consider these examples from 2016 proxy statements. Due to space limitations in this article, we are sharing the visual aspects of these companies’ disclosures. For a full view of their disclosures, consult their proxies to see the context of these images, including accompanying narrative discussion.

These disclosures effectively convey the message that these companies truly take board oversight of risk seriously, and such an approach may generate greater investor confidence and support—whether in voting, investing or both—in these companies versus peers/competitors that do not provide similar clarity around their risk oversight processes.

What Should You Do?
Now is a prime opportunity to rethink your proxy disclosures, looking at what your peers and some best-in-class companies are doing.
• Recognize that as companies innovate in these and other areas of proxy disclosure and raise the bar, this similarly elevates investor expectations for such disclosure.
• Review your peer company proxies and see how they may be upping their game—as this may cause companies that stand still to appear to be relative laggards in these areas.
• Ask yourself: Are your present disclosures effectively telling your risk oversight and other key stories? Or are you selling yourself short? What can you do better going forward?

Ron Schneider is the Director of Corporate Governance Services for Donnelley Financial Solutions. He can be reached at ronald.m.schneider@dfsco.com.

Philip Morris International Inc.
Proxy filed on March 24, 2016: p.14

Mastercard Incorporated
Proxy filed on April 29, 2016: p.22
For the last decade, I have used the phrase “common sense” to reference the governance principles espoused by investing giants such as BlackRock and The Vanguard Group. So it comes as little surprise that these world-class asset managers are part of the driving force behind the recently released “Commonsense Principles of Corporate Governance,” which were announced in late July.

Over the past couple of years, BlackRock and Vanguard gathered together with several large public company CEOs, an activist, mutual and pension fund peers, and the bigger-than-life investor, Warren Buffett, to see if they could reach a “commonsense” consensus about how to define—or some might say reaffirm—a set of corporate governance principles.

Few would argue that today’s corporate governance model has become a mishmash of ill-conceived regulation, governance guidelines and proposed best practices submitted by hundreds of authors and experts. Certainly, it took a gathering of these well-known investors and titans of business to be heard above all that noise and respected on this topic, but the real question is, Will this in any way change the status quo?

To answer this question, I believe it’s necessary to address the following issues in this column:

1. What I think of the quest and principles outlined by this “commonsense” group.

2. How the investing masses, particularly governance experts and proxy advisors (who weren’t invited to participate), will respond to this call to action and sensibility.

3. What I would add, delete or suggest to improve on with what they published.

Instant Analysis

To address my first agenda item, I want to clarify several points. The gathering body was quick to point out that one size doesn’t fit all companies—rather that these principles were a best effort to reach consensus. The group referenced that sometimes parties disagreed, but on the whole, the tone of the principles was accepted by all. And finally, these corporate leaders cautioned that as conditions and circumstances change, so too must documents like these principles change in order to keep pace. I commend the group for giving the level of thought they did to a topic so important to the future of this country and American business. I do not take their efforts lightly, and any comments
are made in an effort to make the status quo even better. However, I would prefer to have seen the group expanded to include one of the proxy advisors and either a retired Delaware Court of Chancery judge or legal guru, which would have comprised a more diverse group of contributors. As to the size of the group they selected, their open letter used the phrase, “so we could have a mature conversation”—as if that was a valid reason for not inviting participants who might be skeptics of their quest.

Reactions and Responses

The responses to these principles will be mixed. Even with this impressive group gathering, there may not be enough ongoing momentum to move the SEC or Congress into changing regulations and laws. I reached out to Institutional Shareholder Services (ISS), a leading worldwide proxy advisor, and the Council of Institutional Investors about what they thought. I was particularly curious to hear the ISS response, presuming they were not invited to join the deliberations. I wasn’t surprised at their legal response, but I give them a lot of credit for answering two tough questions with a respectful handclap supporting the effort and a notice to public companies that these Commonsense Principles establish a good floor or foundation for what ISS expects. I also reached out to Ken Bertsch, a longtime governance guru and new executive director for the Council of Institutional Investors, who provided insight into both of these challenging questions.

What was your first reaction to reading the recently released Commonsense Corporate Governance Principles?

ISS: The principles demonstrate broad consensus among market constituents on key corporate governance concepts. Many of the recommendations concerning board accountability, transparency and qualifications are consistent with what our investor clients have been telling us for many years and are reflected in ISS’ benchmark policies. It’s encouraging to see this level of engagement—and collaboration—between investors and their portfolio companies.

Ken Bertsch: I think the principles reflect areas of broad consensus and usefully articulate strong practices in a number of areas. I was struck by multiple references to robust shareholder/company engagement, including with board members. The principles reflect the mainstreaming of a number of ideas, namely that some directors have professional experience directly related to the company’s business, unfettered director access to management even below the CEO’s direct reports, rigorous approaches to board diversity and to board evaluation, commitment to board renewal, executive sessions of outside directors at every board meeting, and high-level attention and focus on proxy voting at asset management institutions.

All that said, there are areas of disagreement and where, from my standpoint, the principles could have gone further—most notably on proxy access and shareholder rights, but also on independent board leadership (although there are some good elements on that score). But given the breadth of views of those behind the principles, and the leading role in particular of CEOs (who cannot always be expected to be attuned to agency issues at the heart of some corporate governance concerns), I thought the contribution was positive.

What kind of impact can we expect the principles to have?

ISS: The principles are indicative of much of the constructive engagement that occurs between market participants. This initiative raises the bar for companies whose governance structures and practices fall short of widely accepted practice while also demonstrating tangible benefits stemming from dialogue between investors and companies.

Ken Bertsch: I am not sure. I think it depends to some extent on the follow-up of the sponsors, but also whether members of boards that have resisted shareholder engagement (and some of the other best practices identified in the principles) reconsider their view. There are interesting references to asset manager stewardship responsibilities—a subject of much discussion in other markets, but not as much in the United States.

Potential Improvements

With all the principles they proposed, there was only one small section where my suggestion is meaningful enough to ask for further clarification. It falls under the heading of “Director Effectiveness.” The first sentence reads, “Boards should have a robust process to evaluate themselves on a regular basis, led by the non-executive chair, lead independent director or appropriate committee chair.” I’d recommend the language be amended to suggest that, periodically, the evaluation process is conducted by a respected third-party to ensure the best evaluation results possible. My concern, simply put, is that other board members might be reluctant to be candid to one of their own and/or the internal facilitator may not recognize when they in fact are part of the problem. I recommend engaging a trusted outside facilitator at least every third year or when there has been major change in the company or board structure.

All in all, these kinds of announcements and declarations are exciting. As stated, I doubt that it will move the SEC or Congress to action, and I don’t expect any Wall Street gains or losses tied to these principles. Regardless, we are always curious to know how key business figures feel about the status quo, and these principles give us some better insight. What lies ahead remains to be seen, but any communication on the topic of corporate governance is a welcome deliberation.
What advice would you give first-time directors as they either seek to join or have just joined their first board?

Champion the Skills That Today’s Boards Require
The companies that I interact with are typically experiencing huge shifts in customer expectations and customer engagement facilitated by technology. Their boardrooms and investors are therefore starting to appreciate the value of diverse director skills and perspectives to assist in addressing these business model shifts. Boards are looking at directors with the ability to provide not only insight but also foresight to a strategy discussion. Changing board composition also leads to exploring different networks to fill the few open positions.

First-time directors can benefit from expanding their networks and should be able to articulate concisely what value they can bring to a board beyond traditional functional and industry skills. Identifying boards and their nominating and governance chairs that might benefit from a specific skill set enables a more targeted approach to networking. Being proactive earlier in a career to develop gaps in skill sets positions a younger director for a first-time board seat. Being highly visible to the director community and speaking on topics that highlight a highly sought after skill set like strategy, international experience, and digital or cybersecurity skills has also seen proven results.

Kapila Anand was recently elected to the NYSE-listed board of Extended Stay America, Inc. where she serves as the chair of the Nominating and Governance committee and on the Audit committee. She also currently serves as the lead director of the WomenCorporate Directors Education and Development Foundation (WCD Foundation), the Board of the U.S. Fund for UNICEF, and the advisory board of ASCEND, the largest Asian Pacific Islander organization. She has served on the Boards of KPMG LLP in the U.S. and Americas, as the chair of the KPMG Foundation as well as KPMG’s Diversity Advisory Board. Kapila recently retired as a partner with KPMG and is currently engaged by KPMG as a senior advisor on certain industry matters.

The Path Ahead
Forge the Path to Your First Directorship

Although there are many elements of building an effective board brand, these four pointers will start you on the path to your first board. Good luck!

Manage your expectations. Whether it’s a non-profit, quasi-government, private or public company board, expect to spend between 100 to 300 hours per year as an engaged board member. Board work is not glamorous nor a source of wealth. Boards will consider whether you will reach age or term limits over the next decade when assessing your candidacy. Depending on the type of board you’re searching for, it could take you up to five years to land your first as more boomers and younger generations are pursuing board opportunities. Be prepared for rejection and unanswered questions. “Why not me?”

Learn your craft. What do directors do? What don’t they do? How do they do it? What are best practices? What are the risks involved with board service?

Build your network. Highly placed sponsors and contacts are critically important. Approximately 70% of board opportunities are sourced through personal contacts. Put yourself in the right environment to maximize board connection opportunities wherever you are.

Know your value. What skills and attributes do you bring to the boardroom? How you contribute is equally as important as what you contribute. Understand what others think and feel about how you engage with people at different levels of an organization, how you process information and how you perform in difficult circumstances. This information will help you position yourself for board opportunities.

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Make an Impact as an Effective Director

It’s important to make an impact as an effective director from your first day in the boardroom. Based upon my experiences as a director, I would offer the following advice:

- Know your value to the board → invest in yourself to continue to bring that value
- Listen, learn, ask questions → challenge recommendations that go beyond your area of expertise

An effective board comprises a group of people with a diverse set of skills and experiences. Before joining a board, it is important to have a clear understanding of how you will add value to that board. In order to continue to bring that value to the board, and therefore to the company, directors need to keep current on the industry and on their own expertise. Directors need to understand the significant governance challenges and trends impacting the environment. If you are working in your area of expertise, it is easier to stay current. If you are no longer working, attend industry seminars and read as much as possible.

Additionally, although you are likely very knowledgeable in many areas, a board focuses on all strategic issues faced by a company. It is important to listen to management and other board members on issues where you are not an expert. Directors need to question and challenge issues and recommendations on all topics, even those where they do not have expertise. Boards are most effective when they use the power of the group to challenge issues and then support management.

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Angela Brock-Kyle chairs the audit committee and serves on the nominating and governance committee of Infinity Property and Casualty Corporation (Nasdaq). She is an Independent Trustee of the Guggenheim/Rydex Funds, the YMCA Retirement Fund Board and she sits on the Board of the Executive Women’s Golf Association Foundation. Angela is Founder and CEO of B.O.A.R.D.S., a privately held governance, strategy and risk advisory firm launched in 2013. For 25 years Angela was a senior leader at TIAA where she managed a $9 billion global portfolio, launched the $400 billion end-to-end Asset Management business, and deployed risk management culture and systems across the enterprise.

Jane Chwick currently serves on a number of boards for corporate, government and not-for-profit organizations, including Voya Financial and MarketAxess where she is the chair of the Technology, Innovation and Operations Committee and the Risk Committee, respectively. Jane is the Co-founder of Trewtec, Inc., providing corporate directors, chief executive officers and chief technology officers with the information they need to improve their oversight of a company’s technology function. Prior to creating Trewtec, Jane was a partner at Goldman Sachs where she had a 30-year career in technology, including most recently as the Co-Chief Operating Officer (Co-COO) of the technology division.
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Pressure Points

What will be the biggest risk issue for boards in 2017?
Anticipating Unexpected Risk Through Board Assessment

Corporate directors serve an especially critical role in overseeing the management and mitigation of the full range of risks to which their firms are exposed—by virtue of the industries in which they compete, the macroeconomic and regulatory environment to which they are subject, and the operating decisions that they make. Ensuring that the board aligns its own composition (the qualifications, experience, and background of directors individually and in the aggregate) as well as its practices (committee structure, board evaluation and succession planning) with the company’s long-term strategy is an essential prerequisite to effectively managing risk and leveraging opportunity.

The board’s collective ability to guide, advise and oversee companies—in good times and bad—is among its greatest responsibilities. Across the hundreds of companies with which we engaged over the past year, boards that stood out as well positioned for success were those that regularly review and align their skills and expertise against the strategic challenges that lie ahead. Some, however, found themselves in more difficult circumstances—perhaps wrestling with the emergence of a complex risk, or gaining unwanted attention from activists or agitators. More frequently than not, boards that fell into the latter category had not articulated a coherent process for aligning their composition with the evolving strategic needs of the firm over time.

A highly qualified, strategically relevant board serves as a critical risk mitigation measure for firms. Boards that recognize this reality will be better positioned to leverage strategic opportunities in a controlled fashion. Those that ignore it do so at their own—and shareholders’—peril.

GLENN BOORAEM
Principal
VANGUARD GROUP

Glenn Booraem is a principal of the Vanguard Group, Inc. and the treasurer of each of the Vanguard Funds. He has worked for Vanguard since 1989, where he currently oversees the firm’s corporate governance program covering approximately $2 trillion in equity market value. He is a periodic speaker on governance to industry groups, and has served on the New York Stock Exchange’s Proxy Working Group and Commission on Corporate Governance. Most recently, Glenn served on the advisory board on corporate/investor engagement for The Conference Board Governance Center and the working group for the SDX (Shareholder/Director Exchange) Protocol. He has been recognized for the past 5 years (2011-2015) on the NACD’s Directorship 100 list of the “most influential people in corporate governance.” In addition to his governance-related duties, Glenn is responsible for global fund accounting operations, security valuation, and fund compliance monitoring for the Vanguard funds. Glenn earned a BBA from Temple University, and he is a graduate of the Advanced Management Program at Harvard Business School.

SIMONE PETRELLA
Chief Cyberstrategy Officer
CYBERVISTA

Simone Petrella is Chief Cyberstrategy Officer at CyberVista, where she focuses on product development and delivery of training and education curriculums, as well as workforce initiatives for executives, cyber practitioners, and continuing education. Previously, Simone led the cyber threat intelligence business in the national security sector at Booz Allen Hamilton, where she also supported commercial sector businesses through the creation and implementation of cyber fusion centers. Simone has a JD from Catholic University and an MA and BA from Georgetown University. She is a member of Women in International Security (WIIS) and is admitted to the New York Bar.
Cybersecurity Continues to Increase As a Boardroom Risk

A recent study by market intelligence firm IDC predicts that by 2018, 75% of chief information security officers (CISOs) and chief security officers (CSOs) will report directly to the CEO or board of directors. While that is a great step toward increased communication and understanding, many boards are still treating cybersecurity as a technology issue relegated to technology leaders. Too few business leaders are treating cyber for what it is: an enterprise-wide threat that impacts all aspects of an organization.

A recent survey by Bay Dynamics found that 26% of board members identify cyber risks as their highest priority, yet many organizations fail to educate top decision makers.

To effectively build and reinforce a culture of security across the enterprise, training must be mandatory and cover more than basic awareness—even at the board level. While many business leaders react to data breaches and attacks following an incident, the focus should be on implementing proactive steps before a damaging breach hits. One of the most effective ways to train leaders is by providing baseline literacy in cybersecurity issues. Cyber literacy enables boards to make accurate assessments of enterprise risks and ultimately allows them to make more assertive and confident business decisions.

As part of cyber education, directors and executives need to learn to be able to ask the right questions from management. At the same time, those executives need to use that literacy to also set the expectations for security leadership: What assets are most important to the mid- and long-term business objectives of the company? What are the potential operational and financial impacts of a cyber incident to the enterprise? How do we protect our customers, partners and shareholders?

Incentivizing Company Performance in Volatile Markets

One of the key risks facing corporate boards in 2017 will be to maintain focus on the long-term strategic objectives of the organization, while operating in what promises to be a turbulent environment.

Uncertainty around the presidential election, the evolving impact of Brexit, and the potential for increased trade restrictions will impact most industries. Management teams and boards are at risk of spending too much time focusing on the near-term challenges facing the business, at the expense of innovation and investments that will drive long-term success.

From a compensation perspective, we encourage boards to think creatively about ways to encourage long-term thinking by the management team while still recognizing annual performance. One approach is to tie a portion of the annual incentive to incremental success on long-term projects that support long-term goals. We also think that there is a continued role for stock options as they generally have a 10-year term and can align with a longer-term view. Finally, restricted stock that vests over five or more years could be used to encourage a focus on the long-term. Compensation plans that align with long-term business plans and are supported by clear and transparent disclosure are often well received by shareholders.

Kelly Malafis is a founding partner with Compensation Advisory Partners in New York. She has approximately 20 years of executive compensation consulting experience working with compensation committees and senior management teams on all areas of executive and board of director compensation. Kelly has worked with public and private companies across multiple industries, including financial services, pharmaceutical and insurance. Kelly’s areas of focus include compensation strategy development, evaluating the pay and performance relationship for senior executives, annual and long-term incentive plan design, compensation program governance and board of director compensation. She is a frequent speaker on executive compensation topics and has written articles for several publications, including Directors & Boards, Executive Counsel, and WorldatWork’s workspan.
36 FaceTime in conversation

Perspective on Shareholder Activism

An interview with Cindie Jamison, Chairman of the Board, Tractor Supply Company, Board Member at Office Depot, Darden Restaurants and Big Lots

Cynthia (Cindie) Jamison serves on the Board of Directors of Tractor Supply Company (NASDAQ: TSCO), a position she has held since 2002, where she is Chairman of the Board, after serving as chair of the audit, compensation and corporate governance committees. She also serves on the Office Depot board (NASDAQ: ODP) and sits on the audit, corporate governance and compensation committees. Cindie was elected to serve on the Darden Restaurants Board (NYSE: DRI) in October 2014 as part of a complete board replacement slate; there, she serves as chair of the audit committee as well as serving on the compensation committee—she also served on the CEO search committee that appointed Gene Lee as CEO in 2015. In May 2015, she joined the Big Lots, Inc. (NYSE: BIG) board, where she sits on the audit and corporate governance committees. Her previous board roles included Horizon Organic Holdings, Cellu Tissue, Caribe Media and B&G Foods.

Prior to her full-time board service, she served as a partner with Tatum, LLP from 1999 to 2009 and has been CFO or COO of eMac, Inc., and Cosi, Inc. From 2009 until her retirement in 2012, she served as the chief financial officer of AquaSpy, Inc., an Australian environmentally responsible irrigation company.

Though certainly not a new concept, shareholder activism has reached a fever pitch in the past few years. Observers of activist situations will typically analyze the issues from the perspective of a potentially struggling company or as an opportunity in the investor’s eyes. In these activist transactions, there is often a focus on the board members who get replaced, but rarely on what happens years down the road with the new board after the dust settles.

C-Suite sat down with Cindie Jamison, who was recently added to boards at Office Depot and Darden Restaurants, to hear her success stories after being added as a director in activists’ attempts to take these companies to the next level. She also shared her experience as a long-standing director at Tractor Supply Company, where she is now Chairman, and Big Lots, where she was one of four women added to the board last year.

Your board experience is extremely varied—multiple boards over various years, and you’ve served on all three major committees. How have the demands for directors changed in the years that you have been a board member?

Cindie Jamison: The areas of focus for public company boards have certainly changed, and while it was never easy work, now it is even more work. In the last 5 to 7 years, the amount of board material to review has gotten really voluminous. We used to have board books that were a couple of hundred pages, and now some of my board books are 700+ pages.

When I first came on boards in the early 2000s, the audit committee did the heavy lifting after Sarbanes-Oxley. That demanded a ton of extra hours. Then after Dodd-Frank, the focus shifted to compensation—everyone was focused on executive pay and measuring pay for performance. There were debates about performance metrics and defining total shareholder return, and that took over the spotlight. Neither of those things have gone away, but now the spotlight is progressively shifting to nominating and governance because of things like activism, board composition, proxy access and preparing for dealing with shareholder communications, friendly or not friendly.

The areas of focus for public company boards have certainly changed, and while it was never easy work, now it is even more work.
On that note, you were directly involved in Starboard’s successful activist campaign to replace the board at Darden, coming on with the new slate. Can you walk us through the process of how an activist goes about a campaign to replace a board?

Jamison: I joined Tractor Supply and Big Lots through traditional avenues. I was put on the other two boards through Starboard. Darden was a complete replacement, and then with Office Depot, Starboard ended up getting three board seats. I wasn’t involved in the early part in either case—they approached me once the process was well underway.

With Office Depot, I got a call out of the blue. I can’t speak to how Starboard identifies companies to target or how they plan their campaigns—I have never been involved with that in any way. But I can say that when they wage a campaign, I believe they are looking for experienced board members who are affiliated with high-performing companies. I have been extremely fortunate to be involved with successful companies like Tractor Supply, Horizon Organic and B&G Foods. As a result, I came on their radar screen. Initially I didn’t really want to talk to them. I was hesitant.

So what made you decide that it would make sense to join an activist campaign?

Jamison: I was intrigued less by the activism angle, that was just sort of the venue. I was intrigued by Office Depot. I came from a turnaround background, I was really intrigued by whether or not they could merge with OfficeMax at that point. I thought it would be fun and up my alley.

But the activism angle was new to me, so I was careful to try to understand the situation thoroughly. After a few calls, they invited me to meet with Jeffrey Smith at Starboard. I was already in New York, and I agreed to the meeting. I went in expecting him to show me a definitive “Starboard” plan for the company and see what I thought of it. So as I sat in Jeff’s office, he walked in, introduced himself and said: “What do YOU think we should do”? That is where it turned for me. I was fascinated by that. No decisions were made, and they were open to looking at the company and trying to figure out the best answers with the best people for the job. As a matter of fact I did most of the talking in that first meeting.

“Activism has come a long way in a short time, and today it doesn’t have the stigma that it used to. There’s also a broad range of activists, and you can’t lump them all together. Some are short-term, some look to rip the company apart and sell the pieces.”

Do you have a sense of whether that is typical?

Jamison: Starboard is very thorough and very serious, and since they are the only ones I have been associated with, I can’t make broad assumptions. But I will say that activism has come a long way in a short time, and today it doesn’t have the stigma that it used to. There’s also a broad range of activists, and you can’t lump them all together. Some are short-term, some look to rip the company apart and sell the pieces. That’s not what Starboard is.

A lot of times activist campaigns get a stronger trajectory when the company doesn’t want to talk or the concerns get stronger when they do talk. After several rounds of not having a satisfying conversation, activists may want to go after some additional board seats because they’re not comfortable that what’s being discussed in the boardroom is going in the right direction. When it gets to that step, they’ll propose six seats and get three, for example. And that’s what happened at Office Depot.

What about Darden? Was it a similar scenario?

Jamison: Once again, I wasn’t involved at the early stages. But from what I understand, at Darden, things started out the same way but the experience went the opposite way. With every conversation the tone and tenor was getting worse, and Starboard eventually asked for the whole board. It was really unprecedented.

Darden is a study in how not to respond to an activist. It could have been negotiated far less publicly and with far fewer board seats lost. It was a very public and very embarrassing fight to lose and somewhat destructive for the company at the time.
It’s since rebounded amazingly. The company and management and the board have come together beautifully, and it’s a tremendous story to be a part of. But at the time, the company was beleaguered. It’s hard to have a proxy fight and have disappointing results, and hard to not know if your board is going to stay or leave. It was tough on management, and I applaud them for working with the new board so enthusiastically.

**Given that these were two different scenarios, what is it like coming together with a new group of directors, all at once?**

**Jamison:** Once Starboard had the slate proposed, even before they knew they were going to be successful, they had all of us come together for half-day meetings to talk about the company and get to know each other. So by the time we assembled as a board, it wasn’t the first time we’d been together.

But it was still the first time we interacted with management, and the first meetings were a little odd. The stress level was high for management, understandably, but they did a fantastic job. The first thing we wanted to do was detail a strategic plan, and through working on that everyone got to know each other better. As Audit Chair, I called probably 15 people one-on-one just to talk for an hour on the phone. I asked questions like, “What’s your career path,” and “How do you feel about resources?” I think that was an important outreach and one that I hope built some trust. It also aligned everyone to march in the same direction and not for or against each other.

You also are on the Big Lots board, which has shown up in some of our research studies because it added four new female directors recently—earning the distinction of the Fortune 1000 board with the most progress in gender diversity last year. **What went into Big Lots’ decision to refresh the board?**

**Jamison:** Kudos to the Big Lots team. Led by their Nominating and Governance Committee, they looked at composition of the board, and they decided to focus on diversity in their board refreshment. The CEO, who has been there for three years now, came in and came up with the concept of “Jennifer,” the Big Lots shopper. Jennifer decides to go there or Target or Walmart or whatever. And they have put a lot of effort into understanding who Jennifer is and how she makes decisions. They have an extremely detailed profile of her, who she is, where she shops, what she watches on TV, in other words deep consumer intimacy. Tying this back, ultimately, they decided they wanted “Jennifers” on their board. I believe they initially wanted two women, but were pleased with what the search turned up and so ended up adding four.

As an aside, my very first board seat was at Horizon Organic, and a lot of people buy that milk for their kids. The consumer base is largely moms, and I was brought on that board because in addition to my financial expertise as a CFO, they preferred a mom. In both cases, the idea is to have someone at the board table who is also the customer.

**Given that you’ve worked in pretty much every board position and in a number of unique scenarios, what would you say are the attributes of a multi-faceted board member?**

**Jamison:** It’s the basics, but it’s not easy. You have to have the ability to juggle a lot while thinking through things practically and communicating thoughts clearly.

You have to be willing to work hard and be extremely ethical. You have to have good judgment, and not only technical judgment and functional expertise but also knowing when to elevate an issue, when not to, when to let management make a decision, and when the board needs to step in. Some discretionary matters can be less than clear, and honing those skills and becoming a more mature board member takes more time and experience. The problems that get to the board level are often complex problems without clear solutions. If they were simple, someone would have figured them out.
Keith Higgins was named Director of the Securities and Exchange Commission’s Division of Corporation Finance in May 2013. Mr. Higgins came to the SEC after 30 years at the law firm of Ropes & Gray LLP, where he was a partner in its Boston office. In that position, he advised public companies about securities offerings, mergers and acquisitions, corporate governance, and advised underwriters in initial public offerings and other public equity offerings. He has been a frequent writer and lecturer on securities law, executive compensation and corporate governance, and is a past chair of the Federal Regulation of Securities Committee of the American Bar Association.

As the rulemaking body responsible for corporate disclosures, activities undertaken by the Securities and Exchange Commission (SEC) are constantly on the radar for public companies and their boards. Particularly in the past six years since the passing of Dodd-Frank, executive compensation and corporate governance professionals have kept a keen eye on a consistent stream of disclosure policies that have changed the face of their annual proxy statements and financial filings. Of course, the SEC’s role of optimizing the flow of information between companies and investors also involves cutting back on unnecessary or outdated disclosures. C-Suite sat down with Keith Higgins, whose division is leading an initiative to evaluate the effectiveness of current company requirements, in order to discuss the process and the potential changes on the horizon.

Companies are eagerly awaiting the final rulings on executive compensation proposals such as pay vs. performance, clawbacks and hedging, which have been on the table for a while but not yet official. In the meantime, the SEC is busy with other initiatives. Can you give a sense of what those look like?

Keith Higgins: Since coming to the Commission, the Chair has an agenda of finishing up the work on JOBS Act and Dodd-Frank mandates. I’m happy to report that the Commission completed the JOBS Act mandates, and in the area of Corporation Finance, the Commission proposed everything we are required to under Dodd-Frank mandates, which you mentioned.

In addition to the mandated acts, we also have made advances on some things the Chair wanted to consider—one of which was the disclosure effectiveness initiative, and I was very keen to take that up. The Division of Corporation Finance is focused on disclosures, and we really wanted to examine our disclosure system. There are a lot of people saying it could be better, investors are saying it could be better, companies are saying it could be better. They may come at it from different directions, so we are taking a look and are engaged in an exercise of updating and modernizing and taking a look at what’s there and what’s not there.
What was the catalyst to take a harder look at those?

Higgins: We prescribe disclosure rules that companies are required to follow and provide the information upon which billions and billions of dollars worth of securities trade and investors make investment decisions. In other words, the information our rules require to be disclosed is pretty important.

When I hear people express surprise that we’re undertaking it, it seems to me that that’s exactly what federal agencies should be doing—taking a look at the rules they’ve mandated and whether those rules are still serving their purpose.

That does make a lot of sense. How did you decide where to start?

Higgins: Recognizing it’s a big undertaking, we started first looking at the business and financial information that companies are required to provide in their periodic reports. We put in “Phase Two” the compensation and governance related information, not because we don’t think that’s important, but we made an initial analysis that you can’t do everything at one time. And those rules had been addressed more recently and more frequently than the business and financial information.

With that in mind, there are three things we’ve done so far.

We want to examine if there are ways we can ease the [compliance] burden while still providing access to all material information for investors.

First, we issued a concept release on financial information of entities other than the company, things like financial statements required in acquisitions or financial statements required by guarantors or other entities.

Next, we put out a concept release on business and financial information and stockholder information—things that go into periodic reports. We also teed up a lot of issues, asked a lot of questions, and are trying to elicit investor and issuer feedback. And we asked how information gets delivered or how can it best be delivered to investors that makes it more navigable and usable and easier for them to digest.

Finally, in June, we put out a proposal that we call our technical release—disclosure update and simplification. This really takes a look at a lot of our rules that have built up over the years that have in some instances been superseded by changes to U.S. GAAP (generally accepted accounting principles). In some instances, they’ve been outdated—for example, there are all sorts of references to the public reference room at the SEC where people could come and read reports. There is a small room in the library, but it is not really used much anymore since people have access to the reports online. The Commission also proposed that we remove the stock price table, recognizing that investors probably don’t go to the 10-K of a company to look at what the stock has done over the last eight quarters. That’s also been supplanted by the internet.

One of the other things to come out of the SEC in recent months was the amendment to what defines a smaller reporting company. As far as I understand it, the proposal stands to raise the threshold quite a bit.

“We prescribe disclosure rules that companies are required to follow and provide the information upon which billions and billions of dollars worth of securities trade and investors make investment decisions.”
Higgins: That’s right. The proposal is to increase the threshold from $75 million to $250 million. The comment period is open and we’re looking for feedback. Compliance burdens may fall disproportionately on smaller companies, so we want to examine if there are ways we can ease the burden while still providing access to all material information for investors.

In the compensation realm, for example, you don’t have to do a CD&A, you’re only required to have three executives in the summary compensation table, and for smaller companies that may be all that’s necessary.

What was the impetus to take a look at this now?
Higgins: The $75 million threshold is 10 years old—it’s not that old, but has been around since about 2007. We have an advisory committee on small and emerging companies that meets quarterly, and they’ve had that on their agenda, to provide increased access to scaled disclosure. When it comes down to it, $75 million of market float is a really small company, and they thought that the benefits of scaled disclosure should be extended. It’s hard to know what the right number is, but $250 million was the recommendation we had from the advisory committee and the government small business forum.

Thanks for the insight on those initiatives. More generally, what changes to the financial and regulatory climate have occurred since you’ve entered your position, and how does that affect the SEC’s decision-making process?
Higgins: Shareholder engagement has been a big change since I’ve been practicing law, and even more so in the last half a dozen or so years. Engagement by shareholders has become increasingly important, whether it’s institutional investors, such as mutual funds, that have taken a greater interest in making improvements in how they engage with their companies, or whether it’s activists or other parties. Direct engagement by institutional investors is up, and shareholder proposals—which my division administers—have become more active. At times, it’s controversial, but it is a way that shareholders can engage with companies they own.

I certainly believe, and again speaking for myself, shareholder engagement is a good thing, but generally as an agency, we don’t take sides. The SEC mission and priority has always been to provide investors with the information that they need to make informed voting and investment decisions.

With that in mind, in what ways are you looking to the future?
Higgins: We definitely observe what’s going on in the shareholder proposal process. But I don’t think just because something gets on the ballot and gets voted on necessarily means broader rulemaking is required. Proxy access is a great example where success through the shareholder proposal process has caused companies to decide they would go ahead and do it on their own.

We are mindful that what investors are looking for is not a static concept, and it’s evolving. As new investors enter the marketplace, and as the millennial generation starts making investment decisions, the kinds of information they consider significant in voting and investment decisions could be very different than was the case 30 years ago.

Back to our disclosure effectiveness project, we are interested in getting feedback in our concept release about what the investor of today, and more importantly—as we want to build a system that will last for quite a long time—the investor of the next 10 years, 20 years, finds important and significant.

That’s why we’re looking at topics as wide ranging as sustainability and other governance related items that increasingly, in my observation, are important to a broader range of investors than was the case even 10 years ago. But we’re also mindful that compliance doesn’t come without a cost, so similarly we’re looking at scaled disclosure.

What effect do you expect these changes to have on public filings and company reporting?
Higgins: As a going-in proposition, the staff doesn’t believe that disclosure will change materially, but it will streamline our rules and make the task of putting together our reports easier.

We have been encouraged in the division on voluntary efforts companies are making. They are realizing they can avoid repetition, and streamline without losing any material. I’d encourage readers to follow Mark Twain’s rule—if I’d had more time, the letter would have been shorter. Spend a little more time on it, make it better, and probably you can make it shorter as well.

The SEC mission and priority has always been to provide investors with the information that they need to make informed voting and investment decisions.
On Board with Shareholders

Narrowing the gap between investors and boards

The rise of shareholder activism has brought to light concerns investors have around various issues in corporate governance from executive pay to board oversight of risk. The activist environment often paints company-shareholder relations in a contentious light, but the reality is that issuers and their investors are consistently engaging with each other to reach productive solutions to achieve similar goals.

To get to the heart of these matters, the Investors Board Performance Review recently hosted a live taping at the Nasdaq MarketSite in New York City, featuring Glenn Booraem, Head of Corporate Governance of Vanguard, Bob McCormick, Chief Policy Officer at Glass Lewis, and Ed Garden, Chief Investment Officer and Founding Partner at Trian Fund Management.

According to TK Kerstetter, host of the Review as well as its sister program “Inside America’s Boardrooms,” this new platform gives large investors and proxy advisors the opportunity to provide open feedback to boards on what they’re doing well, what they need to improve on and how they should move forward. The discussion ranged various topics focused on the panelists’ roles as investors and advisors.

What Boards Are Doing Right

The things that boards have always been good at, they’ve refined and are doing better than ever—such as engagement, disclosure and working with management. This is partially because they’re working harder than ever, and also partially because they know the stakes are higher with their shareholders.

“A trending positive is that boards are communicating with shareholders better than they ever have, both in terms of their mandated disclosures going beyond compliance to use the proxy statement as a communications tool to tell their own story as well as through direct one-on-one engagement,” said Booraem.

“Twenty years ago, it was almost like the beginning of a joke: A priest, an actor, an architect and a grammar school principal walk into a boardroom ... and that was an actual S&P 500 boardroom,” added McCormick. “We’ve come a long way to eliminate those crony boards and to look at the right mix of skills and experience and doing a good job of explaining it.”
Where Boards Need to Improve

Boards must have a better purview into operations and strategy, the panelists said. While the focus on compliance and risk is absolutely necessary, they need other members who have experience in the former. Ultimately, this plays into the board refreshment, diversity and skills conversation. There will be a rising need for people with operational oversight—and a need to identify and vet those candidates.

“We simply don’t spend enough time on the operations of a business and working with management to benchmark how individual business are doing,” said Garden. “When we invested in Dupont, I doubt the directors understood that five out of seven divisions that made up [the company] had lesser revenue growth and margins than smaller, standalone competitors. Think about what that means.”

The State of Shareholder Engagement

While disclosures are becoming more robust and detailed, they’re just the starting point. Proxy statements are well-crafted and “lawyered up,” and they don’t tell the story you will get by engaging. A 200-word director bio in the proxy statement doesn’t communicate how the board works together. A CEO coming in to discuss his or her own pay package is “at best, uncomfortable.”

“Engagement efforts that involve board members are often in response to a high shareholder vote against—it’s almost reactionary rather than proactive,” said McCormick. “Recognizing that shareholders can be trusted—not to be kept at arm’s length and reached out to only in a panicked situation—and building that goodwill can pay dividends in developing a mutual trust and rapport.”

“Realistically, we do want to engage with everyone over time to incorporate the board perspective and our ability to convey to the board our perspective on a much broader range of issues,” said Booraem.

“We’re investing in fundamentally great companies, but where management has struggled operationally over an extended period where we feel like we understand how to get the company back on track,” said Garden. “To do that, my expectation is to have respectful confrontation. Put a spotlight on opportunities and problems, cut through any rhetoric, and attack what we can do better. We always say ‘We’d rather be rich than right.’ We’re not dogmatic, we don’t want to do anything to hurt the business, we are not here to embarrass you or fire you or make you look bad—we want the business to win.”

The Future Boardroom Landscape

Boards are evolving to take more of an ownership mentality and will become more of a public/private equity hybrid in the future, Garden said. There has been a transfer of wealth from public shareholders to private equity, and public shareowners are asking themselves why private companies are doing better.

“For the past 100 years, there’s been a divide between ownership and management. But all that has changed and changed forever,” Garden added. “I could make the case that there has been a transfer of wealth from the public shareholders to private equity over the last 30 years because private equity can do something with a business that for some reason the public management team couldn’t do.”

The panelists brought up the example of Dell, which famously went private so that they could have “freedom to take a long-term view,” a sentiment working under the assumption that the current public markets overemphasize short-term gains.

This sentiment affects investments of long-term shareholders, who are willing to hold onto stocks while a company reinvests—assuming that long-term strategy is clearly communicated—rather than having to pay a huge premium if it goes private and then comes back into the public markets later on.
According to a 2015 PwC study, 39% of board members said that they believed someone on their board should no longer be on it. Meanwhile, investors are calling for refreshment that will help maintain independent, objective viewpoints across company boards with a long-term view, whether that be through mandatory retirement or tenure limits.

While nearly 40% of the S&P 500 discloses a mandatory retirement age for their board members, according to a recent Equilar report—and far fewer have term limits—governance experts don’t believe that setting hard parameters like that is always the right answer. Instead, they recommend ongoing board evaluations that objectively assess the board as a whole and their fitness to continue serving.

At the recent Board Leadership Forum co-hosted by Equilar and Nasdaq, directors, consultants, legal experts and institutional investors gathered to discuss the most effective ways for boards to evaluate themselves, and how to decide what is the best time and who are the best directors to bring new life into the boardroom.

**One-Size-Fits-Few**

“Board evaluation is socially awkward,” noted one panelist kicking off the conference discussion.

The evaluation process is something that happens at almost every board, but the degree of depth varies widely. Indeed, few people enjoy being put through a rigorous evaluation process, but as former executives, most of them likely have been throughout their careers.

“It doesn’t have to be a ‘bad’ thing to be evaluated or even removed from a board—it may just not be a good fit,” said one attendee. “So why don’t we see it more?”

**Open Records**

While investors and other stakeholders aren’t asking to see a detailed evaluation sheet and a numerical grade for each director, they do expect more transparency around the process from boards. According to one panelist, just 2% of the S&P 500 say they even have some sort of evaluation, let alone include the finer details in a proxy statement.

“There is internal and external pressure for clearer board evaluation processes from investors and regulators to see if disclosure is sufficient, and on the activist side, lack of clarity could be a vulnerability,” said one board member, who formerly spent years at a large institutional investor.

A detailed and agreed-upon process allows boards to address the diversity issue naturally and on an ongoing basis as well. Many stakeholders believe boards are not diverse enough in terms of gender, race, ethnicity and skills backgrounds. It’s not easy to tell directors they need to be replaced, especially if they are still contributing at a high level.

Very few boards do evaluations well, but those that do have rigorous processes typically embedded in the nomination committee. They don’t always go smoothly, but when directors have the right expectations, boards can effectively plan for the future.
Keynote:
STEVE ODLAND
President & CEO,
Committee for Economic Development
Former Chairman & CEO, Office Depot Inc.
Board Member, General Mills Inc. and Analogic Inc.

Additional Speakers
DONNA ANDERSON
Vice President & Corporate Governance Specialist
T. Rowe Price

John Beckman
Partner
Hogan Lovells LLP

Barbara Berlin
Director
PwC’s Governance Insights Center

Robert Bostrom
Senior Vice President, General Counsel & Corporate Secretary
Abercrombie & Fitch

Paul Denicola
Managing Director
PwC’s Governance Insights Center

Cindy Fornelli
Executive Director
The Center for Audit Quality

Featured Speakers
Raymond Milchovich
Board Member
Nucor Corp., NTS, The Dow Chemical Co.

Jane Sadowsky
Board Member
Yamana Gold

Ken Bertsch
Executive Director
Council of Institutional Investors

William Murdy
Board Member
LSB Industries Inc., Vectrus Inc.

Laurel Shanahan
Board Member
Cedar Fair, Charlotte Russe Holding Inc., Deckers Outdoor Corp.

Bob McCormick
Chief Policy Officer
Glass Lewis & Co.

Gary Retelny
President & CEO
Institutional Shareholder Services

Christy Wood
Board Member
H&R Block Corp.

Bess Joffe
Managing Director, Corporate Governance
TIAA-CREF

T.K. Kerstetter
Host
Inside America’s Boardrooms

Nels Olson
Vice Chairman & Co-Leader,
Board & CEO Services
Korn Ferry

Ron Schneider
Director, Corporate Governance Services
Donnelley Financial Solutions

Martha Steinman
Partner
Hogan Lovells LLP

Darla Stucken
President & CEO
Society for Corporate Governance

Hope Taitz
Board Member
Diamond Resorts International and Apollo Residential Mortgage

Tiger Tyagarajan
President & CEO
Genpact

Visit equilar.com/equilar-events to learn more about the next Board Leadership Forum in San Francisco on February 2.
There was a sizable difference between CEO pay reported in public filings for U.S. and non-U.S. companies for fiscal 2015, according to a new report from Equilar. Median total compensation for CEOs of U.S. companies reported in proxy statements was almost three times larger than what CEOs of non-U.S. companies reported in annual filings, reaching $14.9 million vs. $5.3 million for companies based outside the U.S.

2015 Median CEO Pay, by Country

- U.S. — $14.9 million
- Japan — $1.5 million
- U.K. — $13.5 million
- France — $4.0 million
- Germany — $5.6 million
- All Non-U.S. — $5.3 million

Source: Equilar
In the U.S., compensation practices have evolved to heavily favor equity, displayed by the fact that more than 60% of the average pay mix for U.S. CEOs in the study came from either stock or options, with the inverse being true for companies based outside the U.S.

Equilar’s Global CEO Pay Trends 2016, featuring commentary from Equatex, examines CEO compensation at the 50 largest U.S.-based companies and the 50 largest companies based outside the U.S.—as measured by revenue—on the Fortune Global 500 list. For more information, please visit equilar.com/reports.html.
**SEYMOUR CASH**

"Seymour Votes for President"

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**Cartoon Image Description:**

A man in a suit stands outside a voting booth. He speaks, "WELL, THERE IS REALLY ONLY ONE LOGICAL CHOICE." He is pointing at a vote for Clinton, Trump, or Seymour Cash.

In the background, there is a scene of a person entering the White House, with a man in a suit standing beside them.

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**Text in the Image:**

"WELL, THERE IS REALLY ONLY ONE LOGICAL CHOICE."
PUT (your company) IN GOOD COMPANY

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