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Board Leadership Forum
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.

Chairman & Lead Director Peer Exchange

Non-executive chairmen and lead directors face growing pressures in leading their boards under the microscope of shareholders and activists. This exclusive forum, co-hosted by Equilar and Nasdaq, will feature a mix of interactive panels and candid peer discussions to evaluate board leaders’ role in the ever-evolving state of corporate governance, including strategy, board refreshment, executive compensation, shareholder engagement, management relations and board oversight expectations.

Compensation Committee Forum
November 14, 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.

Executive Compensation Summit
June 4-6, 2018, San Francisco, CA

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Proxy Votes Take Board Performance to Task

As shareholder engagement moves from buzzword to best practice, boards are spending more time considering the best ways to communicate with their investors. Activism receives most of the media attention, but traditionally “passive” pension funds and institutional investors are becoming more vocal when it comes to social and environmental issues.

For example, State Street’s now-famous “Fearless Girl” statue, made to bring awareness to a lack of boardroom diversity, not only received a significant amount of attention when it was placed on Wall Street on International Women’s Day, but also won one of the advertising world’s most prestigious awards in Cannes this year. Likewise, BlackRock released its second quarter proxy voting report, which announced that the firm voted against several nominating and governance committee members in response to a lack of gender diversity.

The cover story in this issue of C-Suite focuses on another investor concern starting to bubble over—climate change and environmental sustainability. While shareholder proposals on this topic have been common for years, they are now receiving majority approval more and more often, influenced heavily by increasing support from institutional investors. We spoke with investors, board members, research organizations and shareholder advocacy groups to gauge their varying perspectives on this critical topic.

Our featured interviews in this edition of C-Suite highlight how boards evaluate and educate themselves to reach the highest levels of performance. Michael Montelongo, who has served on multiple boards, in top financial positions for the U.S. government and as a public company executive, spoke to us about the “programming requirements” for a high-performance board. Peter Gleason, President and CEO of the National Association of Corporate Directors (NACD), identified opportunities directors should pursue to remain educated on the latest issues affecting the boardroom.

As always, please enjoy this issue and feel free to reach out to me directly with any feedback.

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

Shareholder proposals on climate change flood the boardroom

By Dan Marcec
Amidst ever-present chatter about shareholder activism and its influence on short-term thinking, a groundswell of support has been bubbling up among investors with rising concerns about their portfolio companies’ commitment to long-term shareholder value.

At the heart of this focus on long-term impact of corporate activity is climate change and environmental impact—the “E” in “ESG,” or Environmental, Social and Governance issues. From 2012 to 2016, according to Equilar data, the number of shareholder proposals at S&P 500 companies on environmental and social issues increased from 148 to 192, and the percentage of total proposals that represented increased from 39% to 45% in that time frame.

The number of proposals does not reflect overall support from the investment community, and in fact, most first-time proposals receive very little support from broader shareholder bases, especially if they come from investors with smaller stakes.

“The notion of pressuring institutional investors to vote a certain way, not because it’s good for the company but because it’s good for the issue, is really widespread now,” said Donna Anderson, Vice President and Global Corporate Governance Analyst, T. Rowe Price, in a recent webinar hosted by Equilar. “This can make it difficult for asset managers to maintain our focus on what really matters, which is what’s the right vote for each company.”

At the same time, shareholder votes take the temperature of the larger shareholder base as they continue to show up year after year on proxy ballots, and there are some indications that support on environmental issues may be reaching a tipping point. For example, 2017 votes to support greater disclosure of climate impact at Exxon Mobil, Occidental Petroleum and PPL Corp. received majority support, a signal to some that a tide is turning, and a deeper level of scrutiny on climate change and environmental impact from large shareholders is becoming more mainstream.

Those are just three examples at companies with clearly high environmental impact, so to see calls for greater disclosure of how organizations are approaching climate risk may not be surprising. However, at the 250 largest U.S. companies by
27% of shareholders voted to approve climate and environmental proposals on average in 2017, up from 21% in 2016, according to Proxymonitor.org. That’s up from just over 10% in 2006 and about 17% as recently as 2015, as cited in a recent Bloomberg article.

“More and more investors believe this is important, and they realize it is up to us to engage on these issues,” said Brian Rice, Portfolio Manager in Corporate Governance for CalSTRS. “ESG can impact value, and companies are being exposed to and managing that risk.”

Playing Politics

Donald Trump won the presidency partially due to the promise of lowered regulations on balance, particularly with respect to environmental protections. With proposed funding cuts to the EPA and a declaration that the U.S. will pull out of the Paris climate accord, some of that campaign rhetoric is being fulfilled. As a result, the burden for action on climate change has shifted to the private sector, and publicly traded companies in particular are seeing their shareholders intensify the call for action on climate change in the absence of legal mandates.

“We may not see environmental regulations move forward over the next four years, and they may even be rolled back, but that doesn’t mean the risks have gone away,” said Veena Ramani, Program Director, Capital Market Systems at Ceres, a sustainability nonprofit organization. “In fact, companies are more exposed to risk from environmental and social issues than ever, and the mitigating effect of regulations has gone away. This has made investors feel that boards need to step up and provide more active oversight of environmental and social issues.”

Ironically, the loosening of regulations—or the promise thereof—is resulting in more activity from investors and companies recognizing this shift in responsibility. In a highly regulated scenario, companies may be more apt to comply with the letter of the law and nothing more. With broad-sweeping regulations on climate and environmental risk pushed to the back burner, investors are demanding that each individual company identify specific, material risks and disclose that information.

“We’re seeing a trend in real-time moving from gestures to action, which is unprecedented,” said Jean Rogers, Founder and Chair of the Sustainability Accounting Standards Board (SASB). “Shareholders are leveraging their rights as investors to material information on environmental impact and are voting their proxies to see this disclosed.”

As the door opens to relax efforts on practices that may reduce climate impact—which may be disruptive and expensive in the short-term—companies have the choice whether to walk through that door. Danielle Fugere, President and Chief Counsel of As You Sow, a shareholder advocacy group, cautions against the temptation to take advantage of what may help companies’ short-term bottom line.

“If you see weakened regulations as a reprieve, you’ll be behind the curve,” Fugere said. “Shareholders see risk in companies that back off previous commitments and focus on the short-term—we want to know who is being strategic.”

In other words, businesses that would see short-term cost-cutting and profits by running higher carbon emissions may set themselves up for failure later by falling behind competitors that are heeding the sentiment of their shareholders and customers. “The market values low carbon emissions—more and more consumers want to know that the companies they buy from are sourcing renewable energy,” said Fugere.

The Role of the Board in Sustainability Oversight

Rogers at SASB cited a 2015 CFA Institute survey that showed 73% of institutional investors indicating that they take ESG issues into account to help manage investment risks. Furthermore, 89 of the world’s top 100 asset managers are signatories to the Principles for Responsible Investment (PRI), including Blackrock, Vanguard, SSGA, Fidelity Investments, JP Morgan and PIMCO, committing
to incorporating ESG issues into investment analysis and decision-making processes, she noted.

With this backdrop, corporate boards are recognizing that they are responsible for the solution, and that there are a variety of steps that can be taken to increase awareness and action around climate change from the top down in their organizations. Shareholders are now coming directly to the boardroom, submitting proposals to have their voices heard. For directors, that means balancing the short-term focus of many activist investors and hedge funds with this increasing tenor around environmental and social issues and impact on the long-term from traditionally “passive” investors.

Graph 3
Percent of institutional investors who take ESG issues into account to help manage investment risks

![Graph 3](source)

Graph 4
Percent of the world’s top 100 asset managers who are signatories to the Principles for Responsible Investment

![Graph 4](source)

However, Rice cautioned that the idea of a dichotomous “short-term/long-term” strategy for corporations with respect to environmental concerns is not a zero-sum game.

“I definitely think there’s a perception that ESG is ‘long-term,’ but I see it as multidimensional,” he said. “Environmental issues can affect you today—oil spills, mine collapses, etc.—and corporate managers are appreciative of our position to think more broadly, and approach the concept of sustainability as balancing what the company needs to be successful in the present and the future.”

The question remains how boards create a comprehensive strategy to strike this balance.

Tanuja Dehne, former EVP, Chief Administrative Officer and Chief of Staff at NRG Energy, who currently serves on two public company boards, is also a Senior Advisor for The B Team, a not-for-profit initiative led by global business leaders including Sir Richard Branson, Marc Benioff and Andrew Liveris. She said that it’s critical that boards consider all stakeholders, beyond investors, including the community, customers and employees.

“Boards and management teams have to be vigilant on creating long-term value and to avoid getting sucked into a short-term focused vortex,” said Dehne.

“One of the ways boards can motivate and empower management teams to focus on the long-term is by instituting longer-term incentive programs.”

For many boards, oversight of risk starts by identifying to what degree climate impact is material to corporate performance. All corporations will have to consider this at some level, but there are very clear lines drawn for some companies.

Rogers at SASB noted that sustainability issues manifest themselves differently from one industry to the next. In terms of climate change, just seven out of 79 industries account for 85% of the Scope 1 carbon emissions from public equities, she said.

However, the remaining 72 industries still have to consider climate risk, even if it’s indirect and not a specific threat based on carbon emissions. For example, apparel companies must consider their ability to source cotton, which is highly affected by shifting weather patterns. Commercial banks have to vet loans to oil and gas companies, industrials, utilities and other industries whose own risk exposures could threaten their ability to repay or refinance. Automakers are focused on developing alternative-fuel vehicles in response to shifting consumer demand patterns.

Board composition also plays a role. For example, Exxon Mobil added a climate expert to its board of directors earlier in 2017 in response to shareholder pressure, and the assessment of materiality to the business goes hand in hand with who is making those decisions.

“Irrespective of the committee where environmental risk assessment is housed, it should be linked to board discussions on strategy, risk and compensation, and not in a silo,” said Ramani. “You don’t necessarily need a technical expert or Ph.D. on the board, but your directors do need to be able to ask...
the right questions and make those linkages to strategy.”

Dehne, who has first-hand experience with the subject, agrees. “Boards are bombarded with so many emerging issues and risks that they have to stay ahead of,” she said. “However, there needs to be a greater sense of urgency on the issue of climate change because there is a deadline that must be met to stave off the worst impacts.”

Mitigating Risk With Better Disclosure

The shareholder proposal process may not be the most comfortable way for companies to address issues that are simultaneously sensitive and quite complicated, admits As You Sow’s Fugere, but it is the principal mechanism shareholders have for dialogue with the company.

“Shareholder resolutions are important for identifying change, and while companies may not look forward to this process, many that we work with every year look to us for what’s new on the horizon,” she said.

She also noted that the democratic basis for shareholder proposals is important. As the numbers show, climate proposals are still generally in the minority, so companies still have a lot of control over these outcomes through engagement with investors and other means. It’s all part and parcel of keeping companies accountable and ensuring that they’re paying attention to what may be coming to the forefront.

Indeed, a critical portion of this dialogue is disclosure. While not required, and not likely to become so—especially not in the U.S. in the near-term—the more companies can engage in clear communication with their stakeholders about their environmental impact, the better opportunity they will have to push strategy forward. And in that respect, disclosure and engagement has the potential to mitigate some of the friction around the proposal process.

According to Rogers at SASB, 100% of corporations are confident in the quality of ESG information they report, but just 29% of investors are confident in the quality of the ESG information they receive. Research by her organization shows that 69% of companies are already addressing at least three-quarters of SASB disclosure topics for their industry in SEC filings, and 38% are already providing disclosure on all SASB disclosure topics. However, more than half of sustainability-related disclosures in SEC filings use boilerplate language, which is inadequate for investment decision-making, she said.

“[S]uccessful investors are demanding a clearer link to social responsibility from companies,” Rice at CalSTRS agreed. “Disclosure is central in our decision-making process. We search all the sources of public information and find out if these companies are or aren’t paying attention to the risk, and that allows us to make more informed investment decisions.”

Market Forces at Work

Beyond the relationship between the board and the company’s shareholders, there is the simple matter that consumer sentiment is shifting toward wanting to see a clearer link to social responsibility from companies in general. If those voices become loud enough, regulation may be immaterial to faster movement toward broader sustainability practices.

“I’m optimistic that market forces, corporate leadership and consumer demand will speed the transition to a clean energy future,” said Dehne. “Companies may not be as vocal on this issue right now, but many are taking advantage of the value creation opportunities and listening to what their consumers want when it comes to sustainably sourced goods and services. The pace of change, however, has to pick up.”

“We have to move beyond this false idea that sustainability is a choice between ‘doing well’ and ‘doing good,’” Ramani added. CS
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CEO pay is on its way up. Again. Or it’s not—depending on how you want to look at it.

The release of publicly reported compensation during “proxy season” every year—the period in March and April during which nearly 3,000 public companies file their annual proxy statements—gives corporate critics, defenders and ostensibly objective observers (i.e., the media) a platform and a megaphone to espouse their opinions on what the numbers mean for the corporate world and American society at large.

The fact of the matter is that CEO pay is not uniform and straightforward, and it doesn’t exist in a vacuum. For example, let’s look at the following three statements:

1. Median CEO pay increased 9.5% to $16.9 million in 2016
2. Median CEO pay increased 6.1% to $11.0 million in 2016
3. Median CEO pay fell 0.8% to $6.1 million in 2016

Each of these statements is accurate, representing different analyses from the same sample of companies. These three numbers all use U.S. public companies with more than $1 billion in revenue as their base sample size. The first figure represents the median compensation package...
CEO pay is not uniform and straightforward, and it doesn’t exist in a vacuum.

for the 200 CEOs with the highest-valued pay awards in 2016, according to proxy disclosures. The second number represents the 500 largest companies by revenue, regardless of what the CEO was paid. That means companies like Alphabet, which award their CEOs $1 in salary and stock, would be included, but so are companies like Charter Communications, where CEO Tom Rutledge had a compensation package in 2016 of nearly $98 million. Finally, the last figure represents the median chief executive pay package for all U.S. companies that met the $1 billion revenue threshold—about 1,500 in all.

These three numbers support a popular narrative—pay is going up for the 1% of the 1%. The top-paid CEOs saw significant increases year over year and the largest companies paid their executives more, but overall, wages for the market were relatively flat, even at the CEO level.

Ways to Calculate CEO Pay Complicate the Conversation

On the surface, the perception that pay is on the rise for only the top rung of the corporate ladder is not dissimilar from analysis about the difference between CEO pay and that of the average U.S. worker. For example, the AFL-CIO Executive Paywatch counted the ratio of the average S&P 500 CEO to that of the average nonsupervisory U.S. worker, and found a difference of 347:1. With CEO pay reported to the SEC on the rise, and wages generally stagnant, this gap continues to widen and is seen broadly as an indicator of growing wage inequality in the U.S.

Starting in 2018, companies will have to begin reporting the ratio of CEO pay to the median employee in SEC filings—a rule many companies and other corporate governance and executive compensation professionals were hoping would be amended or repealed following post-election changes to the SEC’s membership. At this point, the rule remains on the books, and those responsible for filing proxy statements must make sure they have this information not only calculated, but prepared to be communicated. For most companies, the most difficult conversation will be with the half of their employees who are below the median wage.

Most of the opponents to reporting this ratio are not against addressing income inequality. They are concerned that the way the number must be universally reported will inaccurately show the difference. There is not a one-size-fits-all approach to CEO pay, and there is not a one-size-fits-all employee profile that would make ratios make sense in context. These critics are much more concerned with the fact CEO pay packages are structured quite differently to those of the average nonsupervisory worker, and the way executive compensation is reported to the SEC further complicates that comparison.

Awarded Vs. Actual

The key question to ask when comparing CEO pay value is directly related to what is being measured. For the most part, including in Equilar studies, compensation values cited are from the summary compensation table (SCT) of the proxy statement, which is a mix of both actual pay—base salary, cash bonus and the value of benefits and perks earned in any given year—and an estimated value of any stock or options based on the number of shares in the grant on the day the award was provided.

"Unfortunately, there is no easy way to calculate earned pay when it comes to equity compensation due to the varying time periods over which gains may be realized," said Virginia Rhodes, a Lead Consultant with Meridian Compensation Partners, who contributed to the recent Equilar report, CEO Pay Trends. For example, Rhodes noted, restricted stock may vest over a three- or four-year period on a prorated or cliff vesting schedule, and stock options also have varied vesting schedules and are even further complicated by the fact that actual gains realized are dependent upon the timing of exercise, which is at the choice of the executive. Performance-based equity grants can typically be earned at more or less than target based on achievement of specified performance criteria (which will vary from one company to the next).

"As a result of all of this, the figures that appear in the proxy statement can vary widely from what an executive actually earns, and none of these gains [or losses] described ever hit the summary compensation table," added Rhodes. "Instead, the gains realized for equity grants are reported in the options exercised and stock vested table, which is largely overlooked by most readers."

A calculation for “realized pay” may provide a more accurate portrayal of what a CEO puts into his or her pocket, and there has been some movement to include these realized values in the proxy statement, most notably through an SEC proposal from 2015 that would attempt to normalize “pay for performance.” The proposed rule, which has remained stagnant for more than two years and seems unlikely to go anywhere, would compare a realized pay figure to a company’s total shareholder return in relation to a peer group.

Like the CEO pay ratio, this standardized ruling across the board would provide a new piece of data never reported by all companies, and may have some unintended consequences. At the very least, realized values may be much higher (or lower) than what is reported in the SCT, which may cause further confusion.
Take for example, Elon Musk, whose reported pay most years is equivalent to the minimum wage in California—in the neighborhood of $46,000 in 2016. Yet, he was fifth on the highest-paid executives in the most recent Bloomberg Pay Index, which put his compensation for fiscal year 2016 around $100 million.

How does this figure arise? Once again, it is completely accurate using a proprietary methodology. There are two key differences in the Bloomberg Pay Index that puts this value into a different stratosphere than what companies report in proxy statements. The article states:

“All equity awards are valued at each company’s fiscal year-end. The index’s figures can therefore differ from those disclosed in filings, in some cases by a lot, depending on stock-price changes and dividend payouts. Recurring annual grants of stock or options are included in the year they’re bestowed, not when they vest. One-time grants, meant to pay an executive for several years, are allocated over the life of the award as explained in regulatory filings.”

That means in Musk’s case, part of his total compensation figure in the Bloomberg Pay Index includes one-tenth of a 10-year, 5 million-plus share option grant awarded in 2012, valued at the stock price on December 31, 2016. When that award was granted, the company’s stock was less than $30. By the end of last year, the stock value was over $200. (It’s also worth noting that since then, the stock has skyrocketed to nearly $400, meaning that the value of any options vested would be significantly more today.)

Musk’s options award was initially reported in 2012 as $78.1 million in grant-date value for all 10 years, as reported in the proxy. For 2017, if valued at the $375 stock price where the shares were hovering when this article was written, the value of one-tenth of the award would be $197,625,000.

Companies Must Tell Their Own Pay Story

Ultimately, Musk’s scenario is a good example of how the philosophy behind CEO pay has evolved in recent years. While the nuances of how pay is awarded, reported and eventually paid is not a simple relationship to explain, the underlying reasoning for how it works has good intentions.

Public companies are beholden to create shareholder value, and the public markets are built on that foundation. That’s why pension funds and large asset managers whose investments are heavily concentrated in retirement funds like 401ks are becoming more active and vocal. These funds are responsible for growing the investments of millions upon millions of individuals. And how do these investments grow? Through long-term company performance.

Since the introduction of Say on Pay in 2011, a mandated shareholder advisory vote on executive compensation, pay philosophy has evolved to align better with shareholder return. Along with that, disclosures about pay have also evolved. Companies are seeing increasing pressure from their shareholders not only to address problematic pay practices but also to ensure that they are including detailed enough information so that shareholders will be able to make informed votes.

“Although many companies dread the Say on Pay vote each year, overall, the changes that have occurred because of the enacted legislation can be viewed positively in many regards,” said Meridian’s Rhodes. “All of these changes have made organizations more forthcoming with disclosure describing the rationale for pay actions and more accountable for paying leadership teams only when warranted—or else suffering the potential consequences.”

In the end, those who want to criticize or defend CEO pay will be able to use numbers to their advantage—a feature that isn’t unique to CEO pay, of course. Statistical analysis is notoriously repurposed to support any agenda as seen fit, and particularly when you have large CEO compensation numbers compared against a stagnant wage in the U.S., the potential for scrutiny ratchets higher.

The onus is on all stakeholders in corporate America—boards, executive management, investors, customers, employees, the media and the general public—to seek out available information to carry on a constructive conversation about how executive pay and wage inequality are interrelated. It is also the board and management’s responsibility to communicate this information to these constituents in the clearest ways possible through the avenues they have—public filings, internal communications, and the like—to ensure that they have the opportunity to tell their own story before someone else tells it for them.

“Unfortunately, there is no easy way to calculate earned pay when it comes to equity compensation due to the varying time periods over which gains may be realized.”

Virginia Rhodes
Lead Consultant, Meridian Compensation Partners
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Designing executive compensation packages employs both art and science, and in the process of structuring executive pay, a majority of companies utilize an external set of comparator companies as a reference to inform pay decisions. Known as a peer group, this comparative exercise enables boards to assess pay levels and incentive structures at like companies for compensation decisions in support of executive talent recruitment, development and retention.

Pay for performance assessments by proxy advisory firms and institutional investors complicate the matter of constructing peer groups. These firms also often use their own peer groups for issuing companies as an additional point of comparison, frequently differing from a company’s proxy-disclosed peer companies. Since such assessments weigh heavily in Say on Pay voting decisions, boards in the process of building an effective peer group closely consider the competing interests of the company, its investors and other stakeholders.

“Changes to peer group composition have been positive as they’ve added credibility to retrospective evaluations of pay versus performance alignment, as internal and external stakeholders are more likely to view the peers as having similar operational profiles and external influences,” said Margaret Engel, Partner, and Matt Vnuk, Principal with Compensation Advisory Partners (CAP), who provided independent commentary for the recent Equilar report, Peer Group Composition and Benchmarking.

Companies most often disclosed similar industry classifications as criteria for peer group inclusion, with 442 companies in the Equilar 500—an index of the 500 largest U.S. public companies by revenue—naming this as a deciding factor in peer assessment. Revenue followed as the second-most popular peer group criteria, with talent being another common factor.

“Over the past few years, we have seen peer group development often include an increased focus on operating characteristics of a company,
such as profit margin or percent foreign revenue, in addition to standard size screens such as revenue or market capitalization,” said Engel and Vnuk.

**Peer Groups Benchmarking**

Most companies—95%—disclosed one compensation benchmarking peer group, with 4.3% utilizing two and less than 1% including three groups of peers in their proxy statements. Companies that leverage multiple peer groups often reference one group to assess the CEO’s pay, and a separate group to assess the pay packages of other named executive officers (NEOs). Alternatively, one peer group may serve as a benchmark for the amount of pay while another informs decisions on incentive plan design.

“Companies use multiple peer groups for several reasons, such as understanding the difference between industry-specific and general industry data, when they operate in multiple distinctly different industries, or where they may want to review data from non-U.S. peers separate from U.S. peers,” said Engel and Vnuk. “When multiple market reference points are used, in our experience, it is helpful to pre-define what is the ‘primary’ and what is the ‘secondary’ data point.”

As an example, Dollar General disclosed separate peer groups for its CEO and non-CEO compensation decisions—11 companies were peers in both groups. The company also disclosed its use of proxy and survey-sourced data for the purpose of benchmarking its officers’ specific roles. Since only the CEO and CFO are included in every proxy statement, beyond those positions certain companies will have to seek other sources to benchmark pay.

Furthermore, companies often choose additional peer groups to benchmark performance.

“Compensation peer groups and performance peer groups serve different purposes,” said Engel and Vnuk. “Compensation peer groups are typically used as a reference point for setting target pay for executives. In contrast, performance peer groups are most often used to determine a formulaic compensation outcome, that is, the amount of incentive compensation earned.”

It is a common practice for boards and their advisors to aim down the middle of their peer groups, both in terms of selection criteria and designing executive compensation packages. The Equilar study reflects the practice, where a majority (86.1%) of companies fell in the middle two quartiles of their peers as measured by revenue.

On the other hand, despite targeting median levels of pay, reported compensation in the proxy statement often falls in various distributions vs. a peer group for a variety of reasons. For example, 4.7% of the Equilar 500 reported the maximum CEO total direct compensation (TDC) among their peer companies, whereas 61.1% reported TDC in the middle two quartiles (Graph 1).

Although TDC represents a mixture of compensation actually earned (salary and cash incentives) and accounting estimates of awards realizable in the future (stock and option awards), most companies still report annual CEO pay within a relatively narrow range bracketing their peer group median. These same CEOs also may fall elsewhere among their peers in terms of realized pay once long-term incentive awards, many of which are affected by company performance and stock price movement, are settled in the future.

“Compensation committees typically use the compensation peer group to test the degree to which pay and performance are aligned,” said Engel and Vnuk. “In this process, the compensation committee evaluates relative pay positioning and compares it to relative company performance. The objective is to achieve alignment; for example, high pay and high performance or median pay and median performance are good outcomes.”

As an example, Wells Fargo disclosed a separate performance peer group (“Financial Performance Peer Group”) from its compensation peer group (“Labor Market Peer Group”) to determine payouts for performance awards. Though both peer groups were similar in scope, Wells Fargo disclosed that the performance group contained peers that it competes with for customers, whereas the compensation peer group included peers that it competes with for executive talent.

“It’s crucial that company disclosure have credibility, both internally and externally,” said Engel and Vnuk. “Proxy disclosure is a marketing tool designed to help external constituencies understand and buy into the rationale for a company-defined peer group. Inadequate disclosure can impact credibility, and potentially lead to adverse Say on Pay implications.”

<table>
<thead>
<tr>
<th>Graph 1</th>
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<tr>
<td><strong>Equilar 500 Pay Ranking vs. Peers</strong></td>
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<table>
<thead>
<tr>
<th>Percentile Rank</th>
<th>Percent of Companies</th>
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<tr>
<td>Minimum</td>
<td>4.4</td>
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<tr>
<td>1st–24th</td>
<td>14.5</td>
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<td>25th–49th</td>
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<td>50th–74th</td>
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<td>75th–99th</td>
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<td>Maximum</td>
<td>4.7</td>
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Source: Equilar

Dan Marcec is the editor-in-chief of C-Suite magazine. He can be reached at dmarcec@equilar.com.

Matthew Goforth is a research manager and managing editor for Equilar research reports.
The Missing Piece of the Executive Compensation Puzzle

The discussion surrounding executive compensation is largely focused on cash compensation and various forms of equity arrangements for key C-suite leaders. With the emphasis on these forms of compensation and tying them to performance, other components of the executive compensation package are overlooked. Yet, such benefits can be regarded as highly valuable by the C-suite. One such aspect that often gets missed—or is simply misunderstood—is executive health benefits.

I suspect the reason for this is twofold: you may think it is no longer possible to provide additional health benefits for just a few, or you may think that health benefits should be a one-for-all, all-for-one proposition. In both instances, I would argue, there is far more to the story.

With the right structure (in the form of excepted benefits), executive supplemental health benefits are alive and well. In fact, many leading organizations are making them an integral part of their executive compensation packages. In effect, executive health benefits are similar to supplemental retirement or disability benefits where you provide more to executives. Unlike some of those benefits, health coverage continues to top the list as the most valued benefit you can provide.

Even more, executive health benefits are a financially savvy way to boost compensation. As insurance, they are not subject to payroll taxes, so the company can deduct that expense while the reimbursements are non-taxable for the executives. This translates into employers investing the same amount but offering more than a comparable level of cash compensation.

That brings me to the second rationale, equality of health benefits. Health benefits are important to everyone, but offering an extra layer to retain current and future leaders makes good business sense on a number of levels. First, you don’t want these key people distracted by the frustrations and shortcomings of most primary health plans. Offering a benefit that makes healthcare easy is a strategic way to safeguard productivity. Second, the nature of executives’ high pressure jobs puts them at higher risk for disease. And the ripple effects of an absent or distracted leader can have significant negative impact on the company’s bottom line. Thus, providing executives with enhanced health benefits is critical. For all of these reasons, you want to encourage (and pay for) proper preventive actions such as executive physicals, provide emergency evacuation services and offer guidance to top specialty care—all of which serve to support productivity and save the company from the monetary loss associated with travel emergencies and health disruptions.

Expense reimbursed insured plans are far from a perk or luxury benefit, and more companies need to take a holistic view of executive compensation packages to make a place for them. These plans provide a cost-effective means to care for those who can make or break the company’s success today (as well as the ones you are developing for tomorrow). It’s time to support what no company can survive without: the health of its leaders.
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Shareholders and shareholder advisors expect that executive compensation programs will demonstrate an alignment between executive pay levels and company performance. In 2017, shareholder views of the pay and performance relationship are likely to be the single biggest driver of shareholder voting on the Say on Pay proposal—and potentially on compensation committee director nominations.

Unfortunately, there is still not a clear standard that shareholders and shareholder advisory firms apply when evaluating pay and performance. In fact, the approaches that the shareholder advisory firms use to assess pay for performance continue to present many challenges, even with potential changes coming. As a result, it is critical for companies to be clear in defining how they view performance and to demonstrate that the pay levels executives receive are consistent with performance results.

The definitions of pay as well as performance used by shareholder advisory groups in their pay for performance assessments are imperfect. Examining these definitions can help provide direction on what a better approach may be and to better address their evaluations of your pay programs.

**Pay Definitions**

To date, Institutional Shareholder Services (ISS) and Glass Lewis have used Summary Compensation Table (SCT) compensation as the definition of pay in their quantitative assessments of pay (with slight modifications for valuing stock options in the case of ISS). Because the amounts reported in the SCT are grant values, this approach is fundamentally flawed as the majority of CEO pay (in many cases as much as 75% of total pay) is delivered in equity-based long-term incentives.

Since the point of long-term incentive compensation is to reward executives based on the mid- to long-term performance of the company, it is much more useful to look at the value realized from long-term incentive compensation as it incorporates changes in the stock price from the date of grant to the date of vesting for restricted stock units and performance share units. For performance share units, looking at the value realized also incorporates the number of shares actually earned, which could in many cases range from 0% to 200% of the target shares.
Stock options remain problematic, as the time from grant to exercise can be as long as 10 years, but using the grant value of options is less relevant for a long-term pay for performance assessment. In our view, the most reasonable approach is to use a realizable value for stock options, recognizing the change in the value of the stock price from the grant date to the end of the performance period under assessment. An approach of using the intrinsic value of the stock options or an updated Black-Scholes value is superior to using the grant date value of the stock options.

Performance Definitions
ISS has historically used total shareholder return (TSR) on an absolute basis for a five-year period and relative to peers over a three-year period in their quantitative assessments. Glass Lewis looks at performance for five measures over a three-year period for their relative assessment: TSR, earnings per share (EPS), change in operating cash flow (with a substitute measure for financial services firms and REITs), return on equity (ROE) and return on assets (ROA). For the 2017 proxy season, ISS incorporated into its qualitative review of pay a financial performance assessment with up to seven measures considered: TSR, ROE, ROA, return on invested capital (ROIC), cash flow from operations, revenue growth and EBITDA growth. The weightings of the measures are customized by industry in recognition that some measures are not applicable to certain industries.

While the move to include financial performance measures into the pay for performance assessment is a positive change, there are two main issues with the approaches of ISS and Glass Lewis. When compensation committees and management teams design incentive plans, they typically select performance measures that best reflect the company’s success in achieving its strategic objectives. These are the measures that should be used to assess performance over a one- to three-year period. Over the long term (e.g., five to seven years), TSR is likely the single most important measure of how well the company has implemented its strategy. However, overemphasizing TSR in a one-year or three-year assessment of performance is too short a period of time to see if the company’s successful execution on strategy has led to financial results and subsequent shareholder returns. We think that the most effective performance assessment would place the most weight on the measures of performance that the company is actually using in its annual and long-term incentive plans.

Another issue with using financial performance measures to assess performance on a relative basis is making sure that the comparisons reflect the sustainable operating performance of the companies being compared. ISS and Glass Lewis both use the GAAP financial statements to derive the financial performance measures used in their assessments. In one sense, this facilitates “apples to apples” comparisons across companies. However, most external parties (e.g., investment analysts) who conduct financial performance comparisons will look beyond GAAP accounting figures to strip out “special items” that are unique to one year and are not expected to be repeated. Over time and across a large sample of companies, “special items” may balance out; however, when calculating point-to-point growth or single-period performance, “special items” can have a potentially misleading (either positive or negative) impact on financial performance comparisons.

We think that using GAAP accounting figures is a reasonable shortcut in conducting the pay for performance analysis; however, ISS and Glass Lewis should do an in-depth analysis of the financial statements of companies included and should be careful in drawing conclusions if any of the years in the performance assessment included major special items (e.g., gain or loss on sale of the business, asset value write down, legal settlement, change in accounting policy, etc.). Companies may want to consider showing in the proxy statement what the differences are between GAAP performance and the definition of the measures for incentive plan purposes and provide a supporting rationale for why the committee thinks the adjusted performance measures make sense for purposes of the incentive plan design.

Conclusion
The importance of pay for performance relationships in determining Say on Pay votes makes it an issue that management teams and compensation committees cannot ignore. It is important to understand the inherent flaws in the way that shareholder advisory firms assess the pay and performance relationship. With an understanding of these imperfections, it is critical for companies to conduct their own assessments of the pay and performance relationship, including what period of time defines long-term (e.g., three to five years, CEO tenure, etc.) and to demonstrate in their Compensation Disclosure & Analysis that the company does have an alignment between the performance measures in its incentive plans and the pay levels that the company has established. In addition, the company should be able to demonstrate that over the long term, the movement in realized/realizable pay levels is consistent with its TSR performance on an absolute and relative basis.
Among their myriad responsibilities, boards of directors are expected to review CEO performance as well as their own. Directors use various processes and models for conducting these evaluations, but they all have one common factor: Conducted away from public eyes, these reviews are something of a black box to investors and other audiences.

It is increasingly clear that board and CEO performance evaluations matter deeply. This process of performance evaluation can result in constructive feedback to the reviewee, helping him or her to identify and improve upon areas of weakness. When necessary, the review may result in an acceleration of the board refreshment or CEO succession process.

Either way, having a robust and functioning process is critical to mitigating the negative impact of sub-par performance. Given the importance of these processes and their confidential nature, how can investors and other stakeholders have confidence in a robust and effective process at their portfolio companies?

One way to provide this assurance is through clear discussion in the proxy statement, and also in year-round corporate governance and investor relations messaging. Here, we see great divergence in company disclosure practices.

To be clear, we are not saying that the results of performance reviews be made public. Rather, that the disclosure and description of the process should be sufficiently specific—and presented in clear language, not legalese or boilerplate—so that investors can have confidence in the process and that it will work as intended to mitigate downside risk. Unfortunately, in reviewing hundreds of proxy statements each year, we have found that such confidence-inducing disclosures are not prevalent. The good news, though, is that each year we are seeing more companies focusing on and improving the clarity of these disclosures.

Board Evaluation Disclosures More Robust Than CEO Succession Disclosures
We have seen greater evolution in board evaluation and refreshment disclosures than in disclosures around CEO performance and succession planning. Assuming both are equally important, the stronger showing in the board evaluation and refreshment disclosure is understandable.

Most boards have between eight and 12 directors. With an increased focus on board refreshment and using 10 years as a dividing line between short- versus long-tenured length of service, it is expected that companies will cultivate a pipeline of potential candidates that can bring added diversity and skill sets to the board. It is also common practice that one or more incumbent directors may be candidates for rolling off the board in any given year (whether or not this actually occurs).

Since companies typically have one CEO at a time (with a couple of notable exceptions), CEO turnover is not as regular an event as is the replacing of an individual director. According to Equilar data, in 2014, the average S&P 500 CEO had served an average of 7.4 years, and 6.0 at the median. Ten years prior, those figures were 6.6 and 5.2 years, respectively. What’s more, boards may feel that CEOs might be sensitive to significant public discussion of succession plans and are thus reluctant to say too much about these processes, other than to confirm that succession discussions are a regular and important topic of board consideration.

One caveat to this is that following a CEO succession event, we may see that the board indicates that the recent succession event was in part a result of the board’s robust annual evaluation and succession planning and a testament to its effectiveness.

Examples of Effective Board Evaluation Disclosures
The following companies, in their most recent (2017) proxy statements, use a combination of text and visual elements to explain their board evaluation processes in such a way that the discussion is easily located, digested and understood. These and other companies are raising the bar on the important topic of board evaluation. On the other
What Should You Do?

- Review your current process for board and CEO evaluation and succession planning process.
- Review your most recent proxy and other disclosures about these critical processes.
- Review your peer companies’ proxies and other disclosures.
- Ask yourself: If our processes are strong, are our disclosures of these processes equally strong? And are our processes likely to engender confidence on the part of investors and others who don’t have a direct window into how CEO and board performance evaluations are conducted?

Goldman Sachs Group Inc.

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

Verizon Communications Inc.

The 2016 Board Self-Assessment Process

- **Questionnaire**
  Written questionnaires for the Board and for each committee solicit Director feedback on an unattributed basis

- **One-on-one discussions**
  Candid, one-on-one discussions between the Lead Director and each independent Director elicit further color on the Director’s observations and suggestions

- **Reporting**
  Summary of self-assessment results are provided to the Board

- **Private sessions of independent Directors**
  Closed session discussion of Board self-evaluation facilitated by our Lead Director, and committee self-evaluation discussions facilitated by our independent committee chairs

- **Feedback incorporated**
  Policies and practices updated as appropriate per self-assessment observations and suggestions

- **Ongoing**
  Director suggestions for improvements to self-assessment questionnaire and process incorporated the following year

hand, companies that stand still too long on this and other key disclosure issues risk becoming seen as relative laggards when viewed in the context of peer company disclosures.
Recently, there has been a lot of discussion centered on what board structures should look like with respect to the number and types of committees. As today’s boards strive to oversee new risks and improve responsiveness, such questions abound: Have increased cyber risk threats prompted the need for a risk committee? Does it make sense to have an executive committee to conduct business for the board between full board meetings?

There are others who question whether the three standard board committees of audit, compensation and nominating/governance can be reduced to two by merging nom/gov and compensation. These questions are fair to ask, and they also reflect some moving parts within the conventional board committee wisdom. First let’s establish some facts and assumptions about corporate board committees.

### Facts

Corporate law empowers boards to establish board committees and to delegate certain responsibilities to them. The committees and their duties are set forth in the bylaws or established by board resolution and subsequently published in a committee charter that is available to shareholders. Common law rule also allows for specified board approvals through these committees, although certain matters cannot be delegated to committees where a resolution of the entire board is appropriate.

Typical examples of those situations are matters involving shareholder action, any amendment to the bylaws of the corporation, or the declaration of dividends. In addition to common laws, there are stock exchange listing requirements and SEC regulations that guide audit, compensation and
nominating committee requirements. However, as we shall confirm, many companies have gotten creative on how they structure those required committee duties.

Assumptions
Assumptions are exactly that: someone’s belief, without proof, of what has occurred. But they are important as we dig deeper into the philosophy and value of board committees.

One important observation is that most of the “heavy lifting” of a board’s duties is now done in the committees. There was a time when most thought that the only truly tasked committee was the audit committee. Sarbanes-Oxley and stock exchange listing requirements further emphasized those audit and risk responsibilities. Then, the introduction of Say on Pay, along with the responsibility to disclose compensation risk, mandated a more sophisticated and structured compensation committee agenda.

As many of us have seen over the last 10-plus years, added investor oversight and media infatuation with CEO annual payouts have hiked executive compensation to an entertainment art form. Interestingly, the complex nature and scrutiny of the compensation committee has prompted a lights-heart debate among directors about which committee is more challenging to serve. Some will claim, “The compensation committee is the new audit committee.”

The nom/gov committee was traditionally thought of as the ugly stepchild, exemplified by a much lower committee chair fee and a lack of appreciation for how important board composition and CEO succession was to investors. Institutional shareholders have made it extremely clear that their No. 1 concern in 2017 is board composition, and many have stated that they expect boards to respond with effective board evaluations and serious efforts to build diversity of thought, gender, age, ethnicity and skill sets into public company boards. Watch for nom/gov committee chair fees to grow closer to other major committees in coming years.

Committee Structure
I can remember some interesting debates when I chaired Corporate Board Member’s Academic Council, where corporate governance-savvy professors would make the argument that you can’t form a committee every time the board feels the need to focus on a particular corporate challenge. They weren’t speaking about special committees, which are not permanent, but formed to oversee a critical transaction like a merger, acquisition, or an internal investigation around fraud or an SEC investigative inquiry. At the time, they were referencing proposed committees like a technology or strategy committee. Their point, which is still relevant, was to make sure it warrants permanent committee status and that you have enough board members to fill extra committees, especially if it requires only independent directors.

Sentiment around the role of committees seems much different today. Companies and boards are much more open to considering “unconventional” board committees that address critical issues for different industries. The Dodd-Frank Act certainly gave credence to new committees when it required financial institutions to have a risk committee. Many people thought that, with the added risk of cyber attacks, all companies should consider risk committees so that audit committee agendas (which were often already overwhelmed) could focus on financial reporting-type issues, and a risk committee could address other risks like cyber, compensation or reputational risk. The debate about the merits of a risk committee continues, but nothing has slowed the consideration of new board committees.

Committees du Jour
Today, it is tough to keep track of all the new board committees that have been formed at public companies. According to Equilar data on the Russell 3000 companies, there are over 800 registered board committees with names other than the standard audit, compensation or nom/gov. Some of those are just popular iterations of the core committee names like Audit, Compliance & Enterprise Risk Committee or Compensation & Management Development Committee, but many of them are new committees addressing what the board feels are important issues that their industry and company should be focused on. Examples include Airline Safety Committee; Clinical Quality Committee; Environmental, Safety & Sustainability Committee; and Technology & Innovation Committee (just to name a few). Outside of the more recent discussions about Risk or ESG committees, it seems like the most popular formal committee formations are the finance, strategy or executive committees.

The proliferation of the Executive Committee is interesting in that it receives authority from the full board to make decisions or perform routine functions between board meetings. The Executive Committee often includes the CEO, board members and possibly other senior officers, and it allows companies to respond more quickly to certain operating challenges with board input and support. Executive committees are common in the financial services industry and seem to be gaining favor in other industries as well.

Let’s not forget that all committees ultimately report to the full board, either for confirmation or approval. At the same time, the bottom line is that there should be no reason a board can’t structure itself in whatever permitted form is best suited to meet the challenges and needs of that company, provided all regulatory and independence requirements are met.
Build Trusted Relationships So Egos Get Checked at the Door

Having grown up as a global client-serving partner at a Big Four, I had always focused first on building trust and personal relationships with my clients to deliver shared success. I didn’t fully appreciate how much more important this becomes in a high-powered public company boardroom, populated by high-profile CEOs and CFOs that must operate as a true peer group to be effective.

On my first public board, I was fortunately able to meet every board member and get to know them a little bit before the first meeting—that meant we were all very clear on our individual areas of contribution, roles and most importantly, the collective voice and ethos of our team as a whole, especially on the top three to five critical matters. This early “getting to know one another” was incredibly valuable in helping the other board members understand what they could expect from me, and the candor, trust and respect strengthened the dynamics of our bilateral and team relationships.

When I walked into my first meeting, I was so energized to see the team in action because we had established camaraderie, a shared commitment to help the CEO and management team be the best they could be, and a shared purpose. The fact that we didn’t echo each other and brought unique, deep and diverse industry perspectives, listened really well and learned from each other, meant that we could cover vast swathes at a rapid pace and yet appropriately focus on the topics that were more controversial and critical.

I encourage first-time directors to be intentional and take the time to build trusted relationships first, “break bread together,” and focus on establishing a shared purpose.

Ekta Singh-Bushell is on the Board and Audit Committee of TeleTech Holdings Inc. (NASDAQ: TTEC) and DecisionGPS LLC. Her extensive global, multi-sector experience in finance, audit, digital, technology and cybersecurity provide necessary and desired skills, experience and perspective to public, private and start-up boards. Most recently, she served as Deputy to the First Vice President, COO executive office, at the Federal Reserve Bank of NY. She spent most of her career in various leadership roles at Ernst & Young, including global client services and managing partner, Global & Americas IT Effectiveness leader, Northeast advisory people leader and U.S. innovation & digital strategy leader.
Erin Lantz is the Vice President & General Manager, Mortgages, where she leads Zillow Group’s mortgages business. Prior to Zillow, Erin was senior vice president at Bank of America and before entering the mortgage industry, she worked at the Boston Consulting Group. Erin serves on two public company boards: Washington Federal and TrueCar. She holds a BA from the University of Pennsylvania and an MBA from Harvard Business School.

Set Goals for Your Search and Target Boards Where You Can Add Value

It’s well understood that boards are among the most influential leadership roles, and most aspiring executives have board service somewhere on their roadmap. And that should start early. For me personally, I started thinking about it seriously after I had my head down building a specific business for a few years. While I love what I’m doing, as a next step in my career, I recognized I could lend my expertise to other organizations and other teams as a way to contribute outside of my current role.

Earning a board seat is a long process, and I found that boards, and in particular search firms, are most often looking for sitting board members, sitting CEOs or recently retired CEOs. That was and still remains the box to check for a lot of searches, and I received that feedback, both directly and indirectly. My hope is that we start adjusting that framework to be more inclusive, as alternate profiles can do a lot to serve boards.

My network and my CEO here at Zillow Group were very supportive in making introductions and helped me in terms of getting my foot in the door. While those introductions opened up a lot of initial conversations, they were just one component. As I became more educated about the process and determined what I might be able to offer, I targeted the specific boards that interested me and what value I could bring. As I was meeting people, I focused in on what kinds of board searches I was looking for—public, private, industry and skills needed. So my advice would be to spend that time to get really targeted. My process didn’t involve working with search firms, it was more about educating myself, understanding my unique value proposition and making connections. So understand the value you bring, and try to identify a great fit. You want it to be very clear how you add value to the board seats you’re seeking.

Joining a Board to Bring a Unique Perspective

When I was being recruited to be on boards, I discovered that my skills and experience mapped well to director service. However, there is a difference between having the qualifications on paper and putting those skills into action, and it was only after I joined my first public company board that I saw that this was true. For me, being able to ask tough questions and give advice in a way that doesn’t undercut or embarrass management and being able to be critical without being negative is one skill set I gained from my years working as an advisor and equity analyst in the investment community.

I’ve been on the board of Northwest Pipe now for just over two years, and I started out knowing really only one person, and very little about the business. But because I am a good interviewer and have spent a lot of time asking questions, I was able to understand the business quickly and put the puzzle together. I was surprised how quick the learning curve was, and equally surprised that the other board members—people who had no idea who I was—quickly accepted me.

When you talk about diversity, one critical element is diversity of backgrounds. Having spent three decades working with the institutional investment community gives me unique perspective in this environment because I understand how investors look at things. I recently attended a seminar on activism, and it was interesting because the kinds of conversations on both sides resonated with my every day job of what investors looked for. There is a historically meaningful disconnect between what investors say about and to companies and what they actually want. Companies don’t always understand this. When you talk about diversity you don’t see a lot of boards with someone with this kind of diverse perspective.

Michelle Applebaum is currently a Board Director at Northwest Pipe (NASDAQ: NWPX), the country’s largest steel water pipe company. She is a Financial Expert on the Audit Committee, is the Chair of the Nomination and Governance Committee, and has also served on the Compensation Committee. For 23 years she was at Citigroup/Salomon Brothers, where she became the #1-ranked steel equity analyst and Managing Director and co-founded the firm’s steel investment banking unit. She also led a capital markets advisory boutique from 2003 to 2014 where she competed with bulge bracket firms providing equity research to money managers and advising public/private companies and PE firms.
In recent years, investors in general—not just activists—have become more engaged in boardroom decisions and more vocal about their expectations from boards. As a result, companies have faced increased scrutiny from shareholders in regards to executive pay, performance incentives, buybacks and, more and more commonly, board composition.

Equilar recently hosted a webinar with Blair Jones, Managing Director, Semler Brossy, Donna Anderson, Vice President and Global Corporate Governance Analyst, T. Rowe Price, and Eileen Cohen, Managing Director, U.S. Equity, JP Morgan Asset Management to discuss the key factors investors look at when evaluating boards and the impact these factors have on investor voting decisions. Below is a summary of the discussion as well as a short preview of the webinar.

The Top Investor Issues of 2017
Over the last five years, shareholder proposals at large-cap companies have seen a steady increase, in particular those related to general shareholder rights and social and environmental issues. The recent Equilar report Executive Compensation & Governance Outlook found that there were 192 social and environmental proposals in 2016 alone.

These types of proposals can often be a central focus for advocacy groups, who may feel very strongly about the issue rather than the goals and strategy of the company.

“The notion of pressuring institutional investors to vote a certain way, not because it’s good for the company but because it’s good for the issue, is really widespread now,” said Anderson. “This makes it difficult for asset managers to maintain our focus on what really matters, which is what’s the right vote for each company.”

Because of the politicization of some social and environmental shareholder proposals, asset managers must closely review each proposal and issue individually, making sure their vote is in the best interest of the company.

“Each vote is always case by case. If we did support a proposal, it doesn’t mean that we supported it across the board,” added Cohen. “We still look at these proposals in the individual situation and where it makes sense for a company. If it doesn’t make sense for a company we will not support it.”

How Investors Influence Board Composition
Shareholder activism is having a major impact on board composition, as many activist campaigns are often aimed at taking seats on the board. In addition to skill sets, investors are also taking a much closer look at gender and ethnic diversity, often viewing a lack of diversity as a signal that there is a problem on a board. This has led nominating and governance committees to become much more deliberate in their succession planning, making diversity a top priority when looking for new candidates to fill positions on the board.

“It’s a front and center issue for boards today,” said Jones. “There’s a constant focus on diversity by nominating and governance committees and also in the compensation committee room as you look at leadership succession, leadership compensation and gender pay equity.”

The Importance of Board Refreshment and Succession Strategies
The increased shareholder focus on board composition and refreshment is having a direct impact on the average tenure of boards. In recent years, the average director tenure at public companies has seen a decrease in age.

“Board refreshment didn’t happen on its own, it only happened after shareholders turned the heat up,” said Anderson. “When we see average director age and tenure creeping up and diversity levels totally stagnating, the answer is the lack of board refreshment. So, it’s important for companies to understand why shareholders are fixated on that.”

Cydney Myers is the associate editor for C-Suite magazine.
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What board performance issue(s) will be on the radar for investors and activists in the second half of 2017?
Accountability to Shareholders on Compensation and Diversity

As we enter the second half of 2017, investors and activists are paying particularly close attention to board accountability, compensation and diversity.

More and more companies are offering shareholders proxy access. Not long ago, few companies offered it. Today over half of the S&P 500 has proxy access, and shareholders are making the most of it. With that power in hand, they are particularly focused on making sure boards are managing for cyber and environmental risks.

Meanwhile, smaller companies are starting to behave more like large companies in terms of holding board members accountable to shareholder interests—for instance, by imposing annual elections in the director election process. Additionally, “poison pill” plans, a tactic utilized by companies to prevent or discourage hostile takeovers, are becoming increasingly rare.

Of course, performance issues in almost any role are almost always followed by compensation questions. It’s no different now for boards. Between 2012 and 2016, non-employee board member compensation grew by almost 20%, whereas median CEO pay in the S&P 500 grew less than 10%. If CEO compensation is trending up only moderately, it’s natural to wonder or expect board pay to moderate as well. In fact, there has been an uptick in high profile lawsuits where shareholders allege excess pay to board members. The NYSE and NASDAQ are also looking at board member compensation as a metric of “independence” when assessing listing eligibility. And while directors have had to disclose pay for a long time, only recently was the disclosure standardized with a table spanning the previous five years.

Average tenure and whether boards are sufficiently diverse are also growing issues. Diversity is improving very slowly—women account for just over 17% of directorship positions, while about 10% of board members are minorities. To address these concerns, more and more boards are imposing age limits, tenure limits and instituting regular evaluation processes.

Robert Barbetti, Managing Director, is the Global Head of Executive Compensation and Benefits at JP Morgan’s Private Bank. As a senior member of the Private Bank’s Advice Lab, Robert focuses on maximizing and optimizing executive compensation for insiders. His expertise includes managing single stock concentrations, employment and severance packages, pre-IPO planning, M&A transactions and capital market solutions for executive compensation. In particular, Robert focuses on issues related to Sarbanes-Oxley and good corporate governance, especially those challenges faced by boards of directors. He was one of the architects of JP Morgan’s tradable stock option program used by Microsoft in 2003 to cure its “underwater” stock option problem.
Yaron Nili is an Assistant Professor at the University of Wisconsin Law School where he teaches courses in Corporate and Securities Law. His scholarly interests include corporate law, securities law and corporate governance, with a particular focus on the role and function of the board of directors, shareholder activism, hedge funds and private equity. Professor Nili’s recent publications appear or are forthcoming in the Hastings Law Journal, the Wisconsin Law Review, the Harvard Business Law Review, and the Journal of Corporation Law. Professor Nili’s work is available for download on his SSRN page, at the URL above.

Maureen O’Brien is Vice President and Corporate Governance Director at Segal Marco Advisors. She joined the firm in September 2011. At Segal Marco, she engages companies on corporate governance issues and oversees the proxy voting service. Ms. O’Brien serves on the Advisory Council to the Council of Institutional Investors. Ms. O’Brien’s work in shareholder advocacy began in 2003 as a Research Analyst for the Investor Responsibility Research Center. Ms. O’Brien previously served as Head of Engagement at Conflict Risk Network, where she held dialogues with companies operating in Sudan and other conflict zones. In a previous role, she was Research Director at the Center for Political Accountability, a non-profit, non-partisan organization, where she promoted transparency in corporate political spending.

Addressing Composition for Short-Term Needs and Long-Term Value

In my view, the main board performance issue that will be on the radar of investors and activists in the second half of 2017 is a fundamental one—board composition.

The last couple of years have turned the spotlight on this issue. Investors are becoming increasingly concerned about board composition, specifically with respect to the issues of director tenure and board diversity. The general lack of refreshment on boards has led to a rise in the tenure of directors, with many directors serving for over 20 years, leading to concerns about their ability to perform their roles effectively.

In addition, gender diversity is still very much lacking in most large public corporations. The recent initiative by State Street to address gender diversity, voting against the chair of a board’s nominating and/or governance committee if a company fails to take action to increase the number of women on its board,

Dissent and the Drive to Think Differently

In an old issue of the Harvard Business Review, Jeffrey A. Sonnenfeld wrote that a key characteristic of What Makes Great Boards Great is a culture of open dissent. “Directors are, almost without exception, intelligent, accomplished, and comfortable with power. But if you put them into a group that discourages dissent, they nearly always start to conform. The ones that don’t often self-select out,” he wrote.

Most directors at U.S.-listed firms were only recently elected for the year ahead. When investors cast their votes in favor of candidates during the spring meeting cycle, we do so expecting them to act as a check on management and to protect the assets entrusted to their oversight. At Segal Marco, the assets of our clients are the retirement savings for working men and women throughout this country. Our clients invest in the capital markets to earn returns for their retirement plans and receive the collateral benefit of being a driving force in our country’s economic growth.

Investors sit on the outside of the boardroom and must rely on past experience and thoughtful judgment to assess how boards should be structured to allow for sustainable performance. After all, as the recruitment firm Spencer Stuart reports, the majority of boards have an average director tenure of between six and 10 years. In almost all cases, pension funds will own broad-based index stocks for multiple decades.

While investors and directors are aligned in their interest to participate in the success of the company, they may disagree about the means to achieve it. That’s why the process
Beyond the classic board performance issues investors and activists focus on, some of these groups will be focusing on the impact on shareholder value and brand equity related to a board and company’s preparation for and ability to deal with various levels of crisis communications.

Long and forever gone are the days when a company controlled much of its messaging through trade/consumer press, investor relations and advertising. Social media has changed that reality in the most fundamental of ways, but many companies simply have not caught up with the times and are not prepared to deal with the social media tsunami created by a negative incident videoed on a cell phone and then amplified to the nth degree via myriad social channels.

No need to name the companies that have recently not been properly prepared to respond to these types of crisis communication situations. The headlines do that and are a cautionary tale for all boards and companies.

While crisis communication planning has not typically been in the direct purview of boards, given the truly incredible power of social media to create or destroy shareholder value and brand equity, investors and activists will increasingly expect boards to require management teams to have sophisticated crisis communications planning in place that acknowledges and embraces today’s messaging ecosystems.

This means boards need to hold senior management accountable to having proactive and reactive crisis communications and social media strategies and plans in place so when the inevitable happens it’s plug and play. Due to the speed and amplification of communications in 2017, there is no time to figure out, “How should we handle this?”

It also means boards should increasingly be involved in dialogue with C-suite executives to guide and help ensure that the sophisticated digital core competencies to deal with proactive and reactive social media messaging exist within the organization, and that the executive team is united on exactly what to do when that nightmare video or information goes viral.
Culture and Accountability Pose Greater Risks Than Ever

The issues for the second half of 2017 will be culture and accountability. Of course, attention still will be paid to factors that can be measured easily, are comparable readily across companies and generate memorable sound-bites. Investors looking to truly assess board performance in modern times, however, will evaluate the board’s role in setting, measuring, encouraging and holding constituencies accountable for company culture.

Recently, we have seen multiple examples of significant value destruction that have their root cause in corporate culture. Near-instantaneous, mass communication, particularly in the context of rising populist sentiment, has intensified the potential consequences of conduct rooted in negative culture. On the other hand, leaders consistently state that, when a good culture is in place, it can be felt throughout the entire organization. The result of a strong culture is high morale, good employee retention and sustainable long-term success.

Although it is readily accepted that boards are responsible for setting tone at the top, it is difficult for investors to evaluate how effective boards are at doing so. Boards looking to communicate the quality of their oversight of culture could consider answering proactively some of the following types of questions:

- How has the board acted to establish the company’s purpose, values and culture?
- Has the company engaged in internal surveys or other benchmarking to assess its culture and how is it progressing toward its goals? How often is culture a board agenda item? How do the company’s incentive and succession programs support its stated culture? How has the company held individuals accountable for significant breaches in culture?

These questions are designed to cover the different facets of the board’s relationship to corporate culture. The board and leadership’s role in culture begins in establishing a clear purpose—why the company exists and what is there to do. One size does not fit all when it comes to culture. A company’s culture must be appropriate for the context in which it operates and there must be alignment between purpose and strategy. After purpose comes measurement. Many companies know where they want their culture to be but few have an objective understanding of the current state. Without establishing a baseline, it is difficult, if not impossible, to measure progress and set next steps.

Succession and compensation are two of the most powerful tools for boards in communicating and encouraging the culture of a company. Culture at its core is what people observe and do. Mostly people look at what succeeds and what does not and then try to align themselves with the former. Finally, it has become increasingly important that individuals are being held accountable for breaches in culture. It is an unstated expectation that significant culture lapses result not only in job loss, but also in the recovery of compensation paid during the period it occurred.

As long-term owners become increasingly sophisticated with respect to corporate governance, they will increasingly turn their attention to healthy corporate culture as a valuable asset, a competitive advantage and a necessary component of long-term value creation.
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A Calculated Approach to Board Education

An Interview with Peter Gleason, President and CEO of NACD

Peter Gleason is the President and CEO of the National Association of Corporate Directors (NACD). Gleason is a recognized expert on board leadership and corporate governance issues. He serves as a member of NACD’s national faculty, is regularly quoted in the national media, and is a frequent presenter on the subjects of corporate governance, executive and director compensation, risk, strategic planning, and board/shareowner relations.

Gleason currently serves on the board of NACD and on the advisory board of Nura Health, Inc., a development-stage healthcare company. Gleason is also a director of the NACD Capital Area Chapter, Deputy Chair of Global Network of Director Institutes, and is a NACD Board Leadership Fellow. He is the former chair of the International Professional Practices Framework Oversight Council of the Institute of Internal Auditors and was formerly a director of The Patriot Fund.

Before joining NACD, Gleason was a management consultant with both Ernst & Young and Pritchett & Associates. In addition, he served as Vice President and Director of U.S. Research for Institutional Shareholder Services. Gleason is a graduate of Dartmouth College and Virginia Tech, from where he has a MBA with concentrations in both Finance and Marketing.

The boardroom is undergoing consistent changes as the marketplace shifts. From new regulations to rolled back legislation to cybersecurity to social media, maintaining a broad perspective on the strategic opportunities and risks for public companies continues to become more complex. C-Suite spoke with Peter Gleason, the newest president and CEO of the National Association of Corporate Directors (NACD) to gain insights into how board members are educating themselves and preparing to face these changes—whether they are new to the boardroom or have been tenured over 20 years.

C-Suite: You’re relatively new in your role at NACD—what are the strategic imperatives for the organization as you fulfill your mission of providing resources to directors in the midst of this changing corporate environment?

Peter Gleason: I’ve been President and CEO for just over six months, but I’ve been here since 2000, and our mission hasn’t changed. That said, the question of how we continue to advance exemplary board leadership is always at the forefront of what we do. Growth in our membership and attendance at our director education programs has been tremendous, especially over the past several years as the profession of director has become more complex. The bigger we get, the more strength we have in delivering on our mission. We’re now just shy of 18,000 members, and my job is to continue this growth.

How has the organization changed its approach to board education, and likewise, how should directors be reevaluating their own approach to education outside the scope of what they are doing to prepare for meetings and issues related specifically to their companies?

Gleason: On the education front, we have gone above and beyond. We offer three different levels of director professionalism foundation courses, and we also offer targeted programs around cyber, strategy, risk, and a multitude of other topics.

Different board members have different needs, and we have to tailor our education offerings to meet these varying needs. If you’ve joined your first board, your first responsibility is to understand your fiduciary duties. New directors have to learn to move from an operating role to an oversight role. Many don’t have that baseline level set and are looking for educational opportunities. As we like to say, you rarely see an actual job description for a board seat.

For people who have been in the director’s seat for 20 years, the focus is more on how do they share ideas, and how do they talk about what’s happening at their companies and share those trends with their peers. For example, cyber breaches may be technically different, but the things board members have to consider are the same—law enforcement, lawsuits, triage, communications—and we facilitate that kind of discussion in closed-door sessions.
What are some of the issues and risks board members must be prepared to address now that they may not have had to worry about in the past?

Gleason: Cybersecurity is up there at the forefront of everyone’s mind, but at the same time, given the environment we are in, geopolitical risk can have a dramatic impact on companies as we become an increasingly global economy. You also have domestic uncertainty from tax reform to regulations. Directors are operating in a risk-rich environment, and the immediacy with which you’re asked to respond is now a lot faster than 10 to 15 years ago. As the Mike Tyson quote goes, “Everyone has a great plan going into the ring, and then they get punched in the mouth.”

How has the evolving climate of board assessment from third parties changed the way boards have to approach their internal evaluations and disclosures?

Do you think they’re doing enough?

Gleason: Our Blue Ribbon Commission Report three years ago focused on strategy development, and we followed that with another BRC on the board’s role in long-term value creation. As we dug in, we kept coming back to board composition. We look at board composition and refreshment as an ongoing process. You have to be constantly evaluating directors to ensure your board remains fit-for-purpose and is well-positioned to oversee the company’s strategy. These were all recommended in our BRC on the Strategic Asset Board.

There used to be a stigma attached to leaving a board. We need to change that.

How have calls for more board diversity affected board recruiting? In what ways can boards improve their efforts in this realm?

Gleason: You don’t have to rotate all directors at once; this allows you to retain critical institutional knowledge. You can look at succession planning as tranches of directors—experienced directors at 8 to 12 years, mid-level at 5 to 8 years, and newer directors of 1 to 4 years. Then you can pursue a disciplined refreshment strategy at each level.

From a broader perspective, too many boards fall back on age and term limits. And you can’t base director succession on an evaluation. Board evaluations should be used to look for opportunities to improve, and if you use them as a tool to get someone off a board, you lose that opportunity and create negativity. Re-nomination should not be about whether an evaluation was poor, but structured more as a blank sheet of paper, looking at the board’s skill set matrix to consider what you have around the table and what you need.

How has shareholder activism affected boardroom strategy and evaluations?

Gleason: It’s hard to paint all activists with a broad brush. You may find yourself in a situation where they want to bring in three directors—well OK. But how do they know those three are the best directors for that board? I’ve had discussions with directors who have been put on activist slates, and I’ve had the opposite, people trying to fend them off. It is a challenge for the nominating and governance committee to go through a continual refreshment process to make sure the board is fit for purpose, and then have a new slate of directors proposed whose skill sets don’t align with the company’s strategy. We advocate the concept of “think like an activist,” and we’ve seen this raise the bar with respect to the performance of the board.

What does it take to perform well as a board?

Gleason: I look to proactive engagement with management, which includes positively challenging the executive team. Not asking “Why haven’t you done this,” but suggesting “Here are five things another board was dealing with, how are you looking at these issues?” These things might be competitive threats, geopolitical pressures or cybersecurity risks—and what actions they need to consider. Directors should also be the biggest supporters of the company and serve as ambassadors for the company.

Another critical element to exceptional leadership is director education. The pace of change is faster than ever before, and if the board is not staying current on trending issues, they may be left behind. When a crisis hits, the first question is always “Where was the board?” We want to make sure directors are aware of the critical issues that should be on the board’s agenda.

I’ll circle back to something I mentioned earlier—the role of the board is oversight, not operations. Directors should not be expected to be experts in all areas, but they can be expected to stay educated, share best practices with their peers, and look honestly at themselves to ensure the board remains fit-for-purpose.
A confluence of factors including the rise of shareholder engagement and activism, high-profile corporate scandals, and an emphasis on a lack of diversity has put more focus on public company boards of directors in recent years. In particular, company stakeholders are paying closer attention not only to what decisions are being made in the boardroom, but also who is making them, and the concept of defining board performance more acutely has become an imperative for these entities.

C-Suite had the opportunity to speak with Michael Montelongo, currently a multi-boarded director and former executive in both the public and private sectors, who outlined what he believes comprises a well-rounded and high-performing board. In short, high performance requires both the right hardware and software to operate effectively.

C-Suite: What led you to seek out board service, and in what ways has your range of experience contributed to your roles at various companies?

Michael Montelongo: After several corporate executive-level assignments, including a presidential appointment as a “wartime” CFO in the Pentagon during the initial 9/11 campaign, I was ready to take the next career development step and add value in a broader, more impactful way. I’ve always sought out challenging, high-profile, high-stakes opportunities that enable me to be part of a meaningful venture, serve and contribute, learn and grow, make a difference and leave an organization better off than I found it. Directorship offers that. It’s a unique opportunity and privilege to serve at what some consider the pinnacle level of corporate leadership and play a key role in enhancing the economic sustainability of the corporate enterprise and bolstering stakeholder confidence.

As you point out, besides functional expertise, a multi-sector perspective or the ability to navigate the private, public and civic sectors, and understand the nexus among them is what my background brings to the boardroom. That kind of fluency can be helpful to companies seeking to better measure their total impact on and define their role in
society, engage more broadly and effectively with a wide array of constituencies—especially those with a deep interest in ESG issues—and tap into insights and best practices from multiple sectors.

Beyond that, associating with organizations and colleagues who have strong ethics codes, honor, a strong service orientation, and a strong commitment to customers, employees and their families, and the communities they live and work in matters a great deal. These are traits that translate into a best practice “mission first, people always” or “tone at the top” governance model that all boards aspire to create. Starting with West Point, I have been fortunate to be on teams who cultivate these traits and pass the “bring home to mom or grandma” test of character.

There has been a lot of talk about board “performance” lately, but what that means is somewhat unclear—and certainly can vary depending on a company’s objectives. What is the definition of a “high-performing” board in your view?

Montelongo: I agree the answer varies according to one’s perspective and the specific context at play. In general terms, a high-performing board has the right people at the right time doing the right things right. In my view, at least two factors must be present for this to occur—the right hardware and the right software. “Hardware” includes such elements as sound board policies and practices—quality control, clarity on role and focus, robust structures, rigorous processes and administration, the right information that is timely, concise, accurate, and thorough, and a focus on the right issues which are the strategic issues.

“Software” is about having the right people and a healthy board culture or environment in place. More specifically, that means selecting the right directors in terms of diversity, experience, independence, integrity and courage, and leaders who practice Level 5 or servant leadership. The right culture—challenging, respectful, transparent and open dialogue—fosters a healthy board environment where everyone is treated, respected, dignified and served as they themselves would like to be.

The first condition—hardware—is a necessary but insufficient one. The second condition—creating a healthy board and board culture or a balanced board team with trust, mutual respect,
aligned with and supportive of the company’s core values, mission, vision and business strategy. The payoff is considerable—research shows that highly ethical performance cultures directly correlate to companies that consistently maximize long-term shareholder value.

**Where and how does board performance break down?**

**Montelongo:** As I suggested previously, sometimes unidentified risks or “unknowns” can throw curves at a high-performing board. But for those elements boards can influence, some do not address both the hardware and software components I mentioned earlier with the necessary sustained rigor. Some either fail to identify and address areas for improvement or fail to commit the energy and resources necessary for real growth. In these instances, there is also a lack of clarity, poor process management, lack of alignment and agreement on company strategy, poor team dynamics, and suboptimal board composition. Finally, time and information deficits can contribute to this breakdown.

**Boards that bring varied backgrounds and experiences to the table will generally engage in more robust discussions and produce more robust results.**

**How does diversity on a board contribute to high performance? Are there struggles to get there, in your experience?**

**Montelongo:** It’s well-documented that teams and groups and boards that bring varied backgrounds and experiences to the table will generally engage in more robust discussions and produce more robust results. Yet, it’s also well-documented that achieving that diversity can be challenging because the task is to go beyond the traditional sources and networks for such talent. An enterprise must attract directors who can provide valuable, strategic input, while building a board that can draw on the diversity of its members’ expertise and backgrounds—across geographies, gender, race and experience—to create a whole that’s literally greater than the sum of its parts. One approach is to seek out leaders with diverse, multi-sector backgrounds who are equipped to tackle the complex issues and problems that increasingly challenge business, government and civil society. Another idea adopted by some is to consider instituting some form of the Rooney Rule to generate more diverse slates (a concept in the National Football League that requires teams to interview minority candidates for open positions).

**If there is one piece of advice you could offer to an aspiring director, what would it be?**

**Montelongo:** I’m not sure I can distill it to just one piece, especially since there is no magic bullet, and it often takes a healthy dose of good luck besides good preparation and persistence. But for starters, be certain you want to do this for the right reasons, perform at a high level and build your credentials to be a competitive candidate, develop your messaging and market yourself using your networks, do your due diligence to ensure there’s a good mutual fit with prospective companies, then pursue this as a vocation, serve selflessly in your new role, and pledge to make a difference for your shareholders and stakeholders.
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At the Compensation Committee Forum in New York City, co-hosted by Equilar and Nasdaq, investors dug deep into the issues facing companies when it comes to executive compensation—both in terms of goal setting, pay for performance strategies and how those decisions are communicated to shareholders.

What to Consider

Companies are moving away from total shareholder return (TSR) as a central measure, so they are reconsidering how much weighting it should have. The question is centered on whether it should be 100%, 50% or as some sort of modifier. According to some analysts, the “holy trinity” of performance metrics would be return on invested capital (ROIC), earnings per share (EPS) and TSR.

Shareholders are requesting that companies must make disclosure simpler with energy focused on the summary overview that many companies now provide, specifically looking at how it integrates with the business model. If the company is successful, pay and performance alignment will be pretty straightforward to communicate (or shareholders won’t be all that concerned). However, in downturns there may be a problem. If the industry went down, and TSR went down, but your people performed better than the industry, what do you do? Even if a pay increase is justified by outperforming competitors, you have to take what happened to the shareholders into account.

High shareholder approval votes can lead to complacency, and when something unexpected does happen, investor relations can go south quickly. Some companies actually don’t want to be above 95% on Say on Pay approval, because that could lead to their boards and management getting lazy when it comes to engagement.

What to Do

Clearly shareholder outreach and communication is considered necessary. But pay plans are not one-size-fits-all. As one panelist put it: “If you have a program you change every time the proxy advisors ask a question, not only do investors not understand it, the executives don’t understand it either. If you say ‘I don’t want to deal with this, I’ll add TSR. I don’t want to deal with this, I’ll add performance shares.’ Then no one knows how you got there and how it works.”

To that point, another attendee spoke from experience as a plan designer. “We rarely change the plan,” he said. “When you do it often, it confuses people on the inside, and often confuses investors. Having an enduring plan should be good in the long run. At the same time, there tends to be a more homogeneous approach to comp these days, and I’m not saying that’s a good thing.”

What’s next, then? Companies should feel empowered to stray from the straight and narrow, with the caveat that they must clearly communicate how and why they’re doing it, if they want their shareholders to support them.

“After Say on Pay was passed, all of corporate America has been on this steep learning curve, and it’s been reactive,” said one board member. “Hopefully it will shift to something more sustainable.”

Additional Speakers

JOHN BORNEUMAN
Managing Director, Semler Brossy

AUBREY BOUT
Managing Partner, Pay Governance

DAVID CHUN
Chief Executive Officer, Equilar, Inc.

TK KERSTETTER
Host, Inside America’s Boardrooms

DOREEN LILIENFELD
Partner, Shearman & Sterling

KELLY MALAFIS
Partner, Compensation Advisory Partners

GREGG PASSIN
Senior Partner & North America Executive Rewards Practice Leader, Mercer

ANNE RUDDY
Former President & CEO, WorldatWork

RON SCHNEIDER
Director, Governance Services, Donnelley Financial Solutions

DARLA STUCKEY
President & CEO, Society for Corporate Governance

STACIE SWANSTROM
EVP of Corporate Solutions, Nasdaq

DAVID SWINFORD
President & CEO, Pearl Meyer

LOUIS TAORMINA
Principal, FW Cook

MARC ULLMAN
Partner, Meridian Compensation Partners

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LOUIS TAORMINA
Principal, FW Cook

MARC ULLMAN
Partner, Meridian Compensation Partners
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<td>Board Member, Union Pacific, Former Board Member, GM, BP, PPG Industries, Alliant Energy</td>
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<td>Manager, Compensation, Benefit Plans &amp; Policies, Human Resources, Exxon Mobil Corporation</td>
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One out of five public large-cap companies disclosed a shareholder engagement program in 2012, a figure that grew sharply to 66% in 2016. Moreover, nearly 7% of the same companies disclosed engagement with proxy advisory firms, which advise institutional shareholders on proxy voting decisions. Meanwhile, activist investor campaigns increased 61% from 2010 to 2015 and assets under management (AUM) at activist funds grew nearly $150 billion over the same period. In the wake of Dodd-Frank, Say on Pay and corporate governance scrutiny, there remains little doubt that public boards currently operate in an investor-centric environment.

Shareholder engagement and activist activity were just two of the subjects recently examined at the recent Equilar Board Leadership Forum in Dallas, co-hosted by Nasdaq. Corporate M&A best practices, risk strategy and director pay were also reviewed in the context of shareholder sentiment and achieving both short- and long-term business objectives. The event brought board members, executives and investors together to discuss the dynamics between public company boards of directors and company stakeholders in an evolving governance landscape.

Corporate Transactions and Risk Strategy
The environment for corporate M&A remains robust, even as the IPO market lags previous years. Noted one board member speaking at the event, “The synergies that are won or lost in M&A occur in the first 90 days, so processes and discipline must be instilled even before deal approval.” Governance advisors also emphasized the importance of aligning incentive compensation agreements with executives and post-deal retention goals.

Growing concerns over cybersecurity enter the fray of M&A as well. “Migrating data can be an enormous integration issue, and cybersecurity is becoming a growing concern and risk,” said one board member. On the subject of cybersecurity and other risks, directors noted that “curiosity is key,” and urged their colleagues to “do your research on markets, supply chain, compensation and cybersecurity to bring in the best external advisors in those key areas.” Boards should be prepared for contingencies, noted panelists, advising them to consider the individual director’s responsibility for specialized areas of risk should threats emerge.

Board Composition and Refreshment
Institutional investors have made plain their concerns over the present state of board composition, pushing for more scrutiny of board diversity. Both State Street Global Advisors and BlackRock (both with trillions in AUM) addressed board diversity in March, ahead of annual meetings in each firm’s portfolio.

At the Equilar event, a few investors lamented the culture of lifetime membership on some boards. “The perception that a director has a job for life needs to change,” one investor noted. “People say they support diversity, but there’s resistance when it comes to implementation,” said another. More and more, investors want to know whether the board is up to speed on company strategy and competitive markets, and just as importantly, if directors can articulate that strategy during shareholder engagement meetings. Aligning boards and shareholders is certainly a two-way street.
Featured Speakers

KEN BERTSCH  
Executive Director  
Council of Institutional Investors

INGRID KEISER  
General Counsel,  
Secretary, and EVP  
People Strategy  
ClubCorp Holdings

MARIBESS MILLER  
Board Member  
Triumph Bancorp,  
ZixCorp.

KAREN BOGART  
Board Member  
Mohawk Industries,  
Michelman

TOM KLEIN  
Board Member  
Cedar Fair

RAO MULPURI  
Chief Executive Officer  
View Inc.

ALAN CRAIN  
Board Member  
EP Energy Corp.

NEIL KURTZ  
Board Member  
Medidata Solutions,  
TeamHealth

MAUREEN O’BRIEN  
VP & Corporate Governance Director  
Segal Marco Advisors

JONATHAN FOSTER  
Board Member  
Berry Group,  
Lear,  
Masonite International

THOMAS LEPPERT  
Board Member  
View Inc.

TERRIJO SAARELLA  
Corporate Governance Director  
State of Wisconsin Investment Board

GINA FRANCE  
Board Member  
Cedar Fair,  
CBIZ,  
Huntington Bancshares

TONY LEVECCHIO  
Chairman  
LegacyTexas,  
Financial Group  
Board Member  
Uni-Pixel Inc.

MARGARET WHELAN  
Board Member  
The Gorman-Rupp Co.

ANN HARLAN  
Board Member  
The Gorman-Rupp Co.

KERN MCPHERSON  
Senior Director,  
North American Research  
Glass, Lewis & Co.

BILLIE WILLIAMSON  
Board Member  
CSRA,  
Energy Future Holdings,  
Janus Capital Group,  
Pentair
Each year, Equilar conducts a study with the Associated Press that analyzes CEO pay across the U.S. Part of that study identifies the largest pay packages in each state for top executives at companies with more than $1 billion in annual revenue. This year’s report found applicable data in 45 states (plus Washington, D.C.).

This is certainly not an exhaustive list, considering it represents less than 1% of the public companies in the United States. And it’s also not a “highest-paid” list, as about one-quarter of the CEOs included here were awarded less than the median $6.1 million for all CEOs at public companies over $1 billion in revenue, according to Equilar data. Rather, this provides a snapshot into the wide range of compensation packages that exist, highlighting further that there is always more than meets the eye when it comes to CEO pay, and there is no one-size-fits-all way to display it.

### Coastal Bias: Four of Five Top CEOs Are in the Northeast

<table>
<thead>
<tr>
<th>STATE</th>
<th>COMPANY</th>
<th>CEO</th>
<th>TOTAL COMPENSATION (IN MILLIONS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CT</td>
<td>Charter Communications</td>
<td>Thomas M. Rutledge</td>
<td>$98.0</td>
</tr>
<tr>
<td>NY</td>
<td>CBS</td>
<td>Leslie Moonves</td>
<td>$68.6</td>
</tr>
<tr>
<td>CA</td>
<td>Walt Disney</td>
<td>Robert A. Iger</td>
<td>$41.0</td>
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<tr>
<td>MD</td>
<td>Discovery Communications</td>
<td>David M. Zaslav</td>
<td>$37.2</td>
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<tr>
<td>PA</td>
<td>Comcast</td>
<td>Brian L. Roberts</td>
<td>$33.0</td>
</tr>
</tbody>
</table>
Coast-to-Coast

Compensation in millions of dollars.
Data unavailable for Alaska, Montana, Vermont, West Virginia and Wyoming.
Source: Equilar

Year 1
Year 2

44 male CEOs, 2 female CEOs

CEO Pay—from New York to LA—By the Numbers:

$16.1 million = median value

$3.3 million to $98.0 million = overall pay range

Contact researchservices@equilar.com for more information on Equilar research and data.
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