WE SURVEYED THE TOP 100 US PUBLIC COMPANIES

- 23% of board seats at the Top 100 Companies are held by women, and 13 of these companies have a female CEO.
- NONE of the 32 compensation-related shareholder proposals passed a vote.
- 43% of the Top 100 Companies have included some form of alternative pay disclosures in their CD&A.
- 75% of the Top 100 Companies have a forum selection bylaw provision, and 84% of the IPO companies surveyed adopted an exclusive forum provision.
- 7 of the Top 100 Companies were the target of an activist campaign in 2016.
- Pledging policies at the Top 100 Companies have increased 62% since 2013.
- Of the Top 100 Companies, 7 were the target of an activist campaign in 2016.
73 of the Top 100 Companies with financial-related clawback policies provide for discretion in their application.

69% of the Top 100 Companies have adopted proxy access.

24 board chairs at the Top 100 Companies are independent.

The average cost of a data breach incident is $4 million.

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INTRODUCTION

We are pleased to share Shearman & Sterling’s 2016 Corporate Governance & Executive Compensation Survey of the 100 largest US public companies. This year’s Survey, the 14th in our series, examines some of the most important governance and executive compensation practices facing boards today and identifies best practices and emerging trends. Our analysis will provide you with insights into how companies approach governance issues and will allow you to benchmark your company’s corporate governance practices against the best practices we have identified.

Special Committees
Special committees of independent directors are an important tool for boards that can facilitate the discharge of their fiduciary duties in connection with evaluating change of control transactions, shareholder derivative litigation, as well as investigations into potential misconduct at the company.

When special committees are properly formed and functioning, they can lead to more favorable outcomes for the company and its board of directors. A recent example is the decision of the New York Court of Appeals dismissing a legal challenge to the 2012 Kenneth Cole Productions “going-private” transaction, based in part on the transaction having been approved by a fully functioning special committee of independent directors.

Shareholder Activism
Shareholder activism continued to gain momentum, with seven of the Top 100 Companies being faced with activist campaigns over the past year. Activist investors continued to target an increasing number of large, established corporations that may have thought they were relatively immune from such approaches until recently. However, certain recent activist situations have highlighted the reality that activist campaigns, even where initially successful, can leave the targeted company...
(or companies) in a meaningfully weaker position. For example, if an announced transaction or other initiative sought by an activist is ultimately not consummated, the costs to the company and its shareholders can be very high. This past year, a number of large, high-profile M&A transactions involving activist investors ultimately faced significant opposition from antitrust regulators. Among these was Halliburton Co.’s proposed $28 billion acquisition of Baker Hughes, Inc., which was terminated in May 2016 after being challenged on antitrust grounds. In this instance, the fallout extended beyond the impact of the terminated transaction on the merger parties, as the lead activist — ValueAct Capital Partners LP — was ultimately fined $11 million by the US Department of Justice when its stake-building in both Halliburton and Baker Hughes was found to have violated the Hart-Scott-Rodino Act’s “investment-only” exemption.

Shareholder Engagement
Shareholder engagement has become a much broader topic and a focus of many more shareholders in recent years. The Survey delves into the broad variety of engagement methods employed by public companies, including those required by regulatory bodies, expected by shareholders and additional activities companies have begun to pursue in an effort to connect directly with their shareholders. Eighty-one of the Top 100 Companies made shareholder engagement disclosures in their annual proxy statements, and 60% of those companies also disclosed their reasons for engaging.

Proxy Access
The adoption of proxy access has increased dramatically over the past year, and as of August 31, 2016 includes 69% of the Top 100 Companies, 40% of the S&P 500 and 34% of Fortune 500 companies. The Survey presents our findings with respect to proxy access proposals received, and proxy access bylaws adopted, by the Top 100 Companies as well as the broader universe of US public companies. We expect shareholders to continue to pressure companies to adopt proxy access in the years to come, but some level of uncertainty will remain with respect to how proxy access is implemented.

IPO Governance
New to this year’s Survey is an analysis of the governance practices adopted at companies formed through an IPO. Newly formed public companies differ from well-established companies, and their governance policies are often developed with this in mind. However, in its Executive Summary of 2016 Global Benchmark Policy Updates, ISS Governance outlines its intention to generally recommend voting against governance practices it believes diminish shareholder rights. Our Survey reviews the governance practices adopted by new public companies and how the
market thinks about IPO companies versus established companies. Spin-off companies are similar in many respects, and we explore the factors that impact their choices of day-one governance policies as well.

**Proposed Clawback Rules**

Financial clawbacks — the ability of an employer to recoup incentive-based compensation under certain scenarios — is viewed by the US government as a mechanism that can help curtail the types of behavior that contribute to financial crises and scandals. The SEC proposed its long-awaited rules to implement Section 954 of the Dodd-Frank Act in July 2015 (Proposed Rule 10D-1), and final rules are expected shortly. While 90 of the Top 100 Companies surveyed have voluntarily implemented clawback policies, only 15 require mandatory clawbacks. It remains to be seen whether Proposed Rule 10D-1 will provide relief in response to comment letters submitted to the SEC, but in its current form the proposed rule does not generally allow for discretions. Depending on the constructs of the final rule, many companies may have to amend their clawback policies in order to be compliant with the new regulation. This year’s survey discusses several obstacles to complying with Proposed Rule 10D-1.

**Privacy & Data Protection**

Understanding the risks related to data breaches has become an increasing area of focus for boards of directors. The implications of such an incident are far-reaching and include the financial cost of investigating and responding to the breach, the impact on customers whose data was compromised, reputational risk that can affect stock prices and overall confidence in the business, as well as potential litigation.

Our survey explores examples of recent data breaches, industry trends and best practices to help minimize the harm caused by data breaches.

Given the estimated 26% probability that an organization will suffer from a material data breach in the next 24 months, coupled with the $4 million average cost of a data breach incident, it is imperative that boards of directors recognize cybersecurity risks within the broader context of risk management practices.

**Board Leadership**

Separation of the chair and CEO roles, and independence of the chairperson more broadly, have remained topics of intense focus across corporate America. In this year’s survey, the number of CEOs who also serve as board chair at the Top 100 Companies has held steady at 63. However, we have seen a slight increase in the number of independent board chairs, from 21 in 2015 to 24 in 2016.

**Women in Leadership**

Board diversity is important across a variety of dimensions, and gender
diversity is only one aspect of this important topic. This year’s survey reveals that 23% of board seats at the Top 100 Companies are held by women. Within executive leadership roles, women serve as CEO and / or CFO at 24 of these companies and as General Counsel at 32 of these companies. Only one company has a woman in all three of these senior executive positions.

**Board Refreshment**

Board composition remains an important topic for nominating and governance committees, and we have seen a continuation of the complex debate weighing the benefits of director continuity against the needs for fresh perspectives, diverse viewpoints and specialized experience on corporate boards. While mechanisms such as mandatory retirement ages and term limits provide straightforward ways to encourage the addition of new board members, they do not necessarily take into account whether a director is an effective member of the board regardless of tenure. Our Survey looks at issues related to average tenure, including the extent to which retirement ages and term limits are utilized by the Top 100 Companies.

**Compensation Disclosure and Practice**

In many ways, the compensation disclosures and practices of the Top 100 Companies reflect a “follow the pack” mentality. With the advent of say-on-pay and increased shareholder activism, our review of these companies’ proxies reveals compensation disclosures that are growing in size and incorporating flashier graphics, but in some cases are becoming less distinguishable from company to company. This extends not only to policies but also presentation styles. For instance, many companies present disclosures through a straightforward “what we do” and “what we don’t do” chart that looks very similar from company to company. Among the results of the 2016 Survey, we see that the compensation mix has been rather stable across the components of cash, stock and executive perks. This year’s Survey also saw a continuation of a trend that has been apparent over the past several years, with 84 Top 100 Companies maintaining pledging policies, the majority of which apply to directors as well as employees.

**Say-on-Pay**

2016 represented the seventh proxy season under Dodd-Frank’s mandatory say-on-pay regime. 94 of the 95 Top 100 Companies that held a 2016 say-on-pay vote received approval (the other five companies have triennial voting and therefore did not hold a say-on-pay vote this year). The approval rates in say-on-pay votes have generally been quite strong, which may be the result of successful shareholder engagement efforts.
SPECIAL COMMITTEES: AN IMPORTANT TOOL FOR BOARDS OF DIRECTORS

By Rory O’Halloran, Alan Goudiss, Robert Katz and Zach Bench

Special committees of independent, disinterested directors are an increasingly important component of the board of directors’ toolbox for managing corporate risk. Corporations and their directors potentially face a number of situations that can involve actual or perceived conflicts of interest, and special committees, if properly utilized, demonstrate that a decision or action of a board has not been unduly influenced by directors with a stake in the outcome. Unlike standing committees of a board, special committees are constituted by boards on an ad hoc basis and generally operate with a specific mandate and for a limited period of time. Three types of special committees often constituted are:

- **Special Negotiation (or “Transaction”) Committees**
  - used to consider potential change of control transactions or other transactions involving related parties.

- **Special Litigation Committees**
  - used to determine whether or not derivative claims brought by shareholders should be pursued.

- **Special Investigation Committees**
  - used to investigate alleged or potential internal corporate wrongdoing and to recommend whether (and what) action should be taken.

Special committees, when properly constituted and operated, can give boards of directors greater confidence in the objectiveness of their decision-making process and provide board decisions with at least some insulation from legal challenge. Below, we discuss three common types of special committee, and certain legal and practical considerations that boards should keep in mind when determining when and how to use a special committee.

**Special Negotiation (or “Transaction”) Committees**

Special negotiation committees (“SNCs”) can be useful when considering a transaction where a majority or meaningful minority of the board has a conflict of interest with respect to the transaction, or when a controlling shareholder is the counterparty or otherwise participating in the transaction. In a transaction in which a controlling shareholder stands on both sides of the transaction, or in which there is a conflicted board, the courts (at least in Delaware and New York) evaluating a legal challenge to such a transaction will generally apply the “entire fairness” standard of review (rather than the significantly more deferential “business judgment rule” standard of review). When the “entire fairness” standard is applied, the board must prove, by a preponderance of the evidence, that the challenged transaction was both at a fair price and the result of fair dealing.

It is well-settled in both Delaware and New York, however, that either a negotiation by a properly formed and functioning special committee or a vote of the majority-of-the-minority of shareholders may shift the burden of proof to the plaintiff, even if the entire fairness standard still ultimately applies.

Two recent court decisions in Delaware and New York also set forth a framework under which an SNC, if coupled with a vote by a majority-of-the-minority of shareholders, can be used to invoke the more deferential business judgment rule standard of review, underscoring the benefits of utilizing an SNC in these situations.
In 2013, in the case of *Kahn v. M&F Worldwide*, the Delaware Court of Chancery examined a transaction in which the controlling shareholder of M&F Worldwide (“M&FW”) acquired all of the shares of M&FW that it did not already own through a “going-private” transaction. Prior to commencing negotiations with M&FW, the controlling shareholder established that it would only proceed with the transaction if it was recommended by an SNC and approved by a majority-of-the-minority shareholder vote. The transaction was structured in this manner, and following its public announcement plaintiff shareholders filed a lawsuit alleging breaches of fiduciary duties by the M&FW board.

The Delaware Court of Chancery took into account that the process included both an SNC and a majority-of-the-minority vote, and analyzed the following six factors to determine whether sufficient minority shareholder protections were present to justify the application of the business judgment rule:

1. The controller conditioned the transaction from the outset on approval of both the SNC and a majority-of-the-minority shareholder vote.
2. The SNC was independent.
3. The SNC was empowered to freely select its own advisors and to say no to the proposed transaction definitively.
4. The SNC met its duty of care in negotiating a fair price.
5. The vote of the minority was fully informed.
6. There was no coercion of the minority.

Based on a review of these factors, the Court determined that the correct standard of review was the business judgment rule, rather than entire fairness, and consequently adopted a general presumption that the directors acted on an informed basis, in good faith and in the best interest of the company. On appeal, the Delaware Supreme Court affirmed the Court of Chancery’s decision.

In 2016, the New York Court of Appeals adopted and applied the Delaware six-prong test in *In re Kenneth Cole Productions, Inc., Shareholder Litigation*, a case involving Kenneth Cole’s going-private transaction, in which the Court determined that the process used by the board justified the application of the business judgment rule.

It should be noted that the transaction structure employed by M&FW and Kenneth Cole is not “one size fits all.” Indeed, the particular circumstances of each transaction will need to be evaluated to determine whether the transaction structure employed is optimal. In particular, the inclusion of the majority-of-the-minority shareholder vote feature used in the M&FW and Kenneth Cole transactions introduces execution risk, and it is not clear (at least in Delaware) that use of such a transaction structure will allow the defendant directors to prevail at the motion to dismiss stage.

Courts have broadly defined independence in the context of special committees, but some factors that have been evaluated by courts and that should be considered by boards of directors are:

- material financial or employment relationships or significant business dealings with an interested party, including a controlling shareholder; and
- personal or other relationships with an interested party that could suggest control by, or an obligation to, such interested party.
In a shareholder derivative lawsuit, a shareholder may pursue a lawsuit on behalf of the company to recover damages or enforce company rights. But before doing so, the plaintiff shareholder will generally make a pre-suit demand on the corporation describing the claim and requesting that the corporation take action itself. In such cases, the purpose of a special litigation committee ("SLC") is to fulfill the board’s obligation to evaluate such claims and determine whether to pursue them. A properly formed and functioning SLC may be able to dismiss a pre-suit demand if it determines that pursuit of such claims is not in the best interests of the company. Such a result would save the company from costly and time-consuming investigations and legal fees. An SLC should be comprised of disinterested and independent directors in order to avoid any conflict of interest when deciding the merits of proceeding with the suit. The business judgment rule will apply when an independent SLC conducts a proper investigation of the claims. Courts generally use the same factors discussed above when analyzing SLC director independence.

The 2009 London v. Tyrell case illustrates the importance of an independent SLC and independent advisors in derivative litigation. The Delaware court considered an SLC’s recommendation to dismiss derivative claims against iGov, a government contracting firm. iGov created an SLC comprised of two recently appointed directors, hired its own independent counsel and financial adviser, and subsequently recommended that the claims be dismissed. The Delaware Court of Chancery denied the motion to dismiss, finding there was a material question of fact regarding the independence of both newly appointed directors based on prior relationships (including attenuated familial relationships) with certain board members.

**Special Litigation Committees**

The Kenneth Cole case provides a good example of the application of these factors. There, the plaintiff alleged that the members of the committee were not truly independent because they were nominated by either Cole himself or by directors chosen by him. The court, however, held that friendships or business relationships, without further indications of bias or fraud, do not necessarily affect impartiality and are not sufficient to rebut the presumption of independence. The plaintiff also alleged that the special committee voted at Cole’s direction, but the Court rejected this allegation given Cole’s statement that, should the committee reject his proposal, his relationship with the company would not be adversely affected.

The independence of a special committee can also be bolstered by the retention of qualified, independent outside financial and legal advisors. When choosing such advisors, a special committee should look beyond baseline expertise and ensure that the advisors they choose do not have material historical relationships that could be deemed “conflicts.”
Special Investigation Committees

A special investigation committee (“SIC”) is generally tasked with investigating potential internal corporate misconduct and recommending the appropriate response. In the event such misconduct is alleged, an internal investigation may be required by law or corporate policy. The board should determine whether such an investigation should be conducted and, if so, whether an SIC is required.

Evidence of misconduct can reach the board through several channels — for example, an audit committee report, a whistleblower or the SEC. Certain discrete allegations may be investigated internally by management, but if the alleged misconduct involves company-wide practices or implicates company directors, the board should consider utilizing an SIC composed of independent directors, generally in conjunction with outside counsel. Such action will ensure the impartiality of the investigation and provide a credible recommendation regarding appropriate company action, if any.

In addition to investigating company misconduct, an internal investigation committee can be an effective defensive tool against regulatory investigations. In light of the heightened governmental scrutiny placed upon corporations as a result of the 2008 financial crisis, these committees are of particular importance. In deciding whether to pursue legal action or to levy a penalty, the government will review the company’s internal reporting policy and its response to the alleged misconduct. Investigating the misconduct, sharing the investigation’s results, and demonstrating remedial steps may reduce penalties levied against the company or, ideally, avoid them altogether.

Conclusion

Special negotiation, litigation and investigation committees, when properly formed and functioning, can provide boards of directors with confidence that their actions will be seen as being in the best interests of the company. In the recent past, such committees have become important procedural tools that serve as proxies for third-party negotiators and investigators on behalf of disinterested or minority shareholders. Boards of directors should pay particular attention to the independence of members selected for such committees and ensure that each special committee is properly empowered to make decisions within the ambit of its focus. Additionally, the committees themselves should discharge their obligations rigorously by, among other things, utilizing independent outside advisors and generating a strong procedural record.
SHAREHOLDER ACTIVISM
By Rory O’Halloran, Clare O’Brien and Alan Sun

The 2015-2016 period may have marked the first turning point in what was previously a steady series of successful results for activist shareholders over the past decade. As in previous years, the raw numbers for activist activity continued to show significant momentum. Estimates of total assets under the management of activist funds in 2015 range to upwards of $200 billion, marking a significant increase from the $46.8 billion reported in 2010. The number of activist funds continues to grow, as do their activity levels, with activist funds announcing an estimated 355 activist campaigns in the US alone in 2015. One consequence of their increasing size, success rate and influence is that activists have become increasingly bold in targeting the largest corporations, including targeting seven of the Top 100 Companies over the past year.

Yet despite steady growth in the number of campaigns and total activist-managed assets, many well-known activists and activist-targeted companies have recently underperformed vis-à-vis the stock market. In 2015, both Hedge Fund Research’s Fund-Weighted Composite Index and the GS Activist Index largely underperformed the S&P 500’s total return for the same period. Large-cap and mega-cap companies that have bowed to activist pressures and implemented company-wide restructurings have also shown mixed results. In addition, some high-profile activist funds have suffered public reversals with respect to several of their investments, evidencing that they, like other investors, are not infallible. In the face of these developments, increased pushback to activist goals and preferred strategies could become more widespread, especially among targeted large-cap and mega-cap companies. However, these mixed results do not mean that activist influence is necessarily waning. Activist-style behavior is increasingly spreading to other influential investors, while activist firms are targeting new markets.

1 FactSet, Activist Insight, Hedge Fund Research (as of Dec. 2015)
2 SharkRepellent
Targets are now larger while activists have diversified

Conventional wisdom once dictated that large public companies were relatively immune to activist demands because, traditionally, a shareholder’s ability to influence a company largely depended on the size of his or her investment position. But activists who target mega-cap companies (greater than $50 billion in market value) such as Apple, Microsoft and Pepsi are no longer uncommon, and the number of campaigns against large-cap companies (greater than $10 billion in market value) increased from six in 2009 to 30 in 2015. Additionally, eight of the Top 100 Companies were targeted by activist campaigns in 2015, while seven of the Top 100 Companies were targeted in 2016.

The growing legitimacy of activism as an investment strategy has manifested itself in a number of ways, including the recent rise of so-called “reluctant activists,” namely shareholders who have previously invested passively now engaging in various forms of activism similar to those of traditional activist hedge funds. As reported by DealPipeline, these otherwise traditional hedge fund managers are increasingly emulating the proxy fights and director-election campaigns of well-known insurgents such as Carl Icahn and Paul Singer (of Elliot Management Corp). Recent examples include H Partners Management LLC’s campaign at Tempur Sealy International Inc., which resulted in the ouster of the company’s CEO and two directors in May 2015, and the departure of Shutterfly Inc.’s chief executive in December 2015 after Marathon Partners Equity Management LLC succeeded in its campaign to install two directors.

Mixed returns from activist-led buybacks and M&A transactions

The number of activist campaigns where a key objective was returning cash to investors as dividends or buybacks has risen in recent years. According to FactSet, 69 campaigns in 2015 involved demands for some sort of capital distribution, up from 51 in 2014, 60 in 2013, and 39 in 2012. This activist pressure appears to be at least partly effective. Of these campaigns, activists succeeded in convincing companies to launch or expand a repurchase program, or establish or increase a dividend program, at 29 companies in 2015, 19 in 2014, 23 in 2013 and 19 in 2012. Some companies have also voluntarily

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3 See FN 2
implemented large repurchase programs when faced with activist pressure to reform. For example, American Insurance Group announced $25 billion in share repurchases and dividends over two years and granted Carl Icahn two board seats when seeking to avert a proxy fight with Mr. Icahn in February 2016.

While some activists may profit from a planned deal irrespective of whether it is successful, the cost of failing to consummate a transaction can be huge for the companies targeted by such activists.

On the M&A front, activists have directly impacted a number of high-profile transactions in 2015, with several activist funds being involved in M&A activity that later resulted in significant antitrust concerns being raised by regulators. Examples of this activist influence include Pershing Square Capital Management’s efforts in the Canadian Pacific Railway Ltd.-Norfolk Southern Corp. acquisition, Elliott Management’s role in Dollar General Corp.’s bid to acquire Dollar Tree Inc., as well as the attempted mergers of Staples and Office Depot, and Halliburton and Baker Hughes.

The Staples-Office Depot transaction followed the acquisition by Starboard Value LP of significant holdings in both companies and its push for a merger. Under pressure from Starboard, the two office supply companies agreed to combine in a $6.3 billion transaction in February 2015. Following months of regulatory uncertainty, the merger was abandoned on May 10, 2016, after a federal judge granted the FTC’s request for a preliminary injunction. Starboard reportedly made a profit when the fund liquidated its stake at significantly higher prices shortly after the FTC filed its complaint in December 2015.

While some activists, like Starboard, may profit from a planned transaction irrespective of whether it is successful, the cost of failing to consummate a transaction can be significant for the companies targeted by these activists. The fallout from Starboard’s activism included both Office Depot and Staples’ share prices falling to new 52-week lows after the merger was abandoned. For Staples, the share price fall was further compounded by the $250 million break-up fee owed to Office Depot and the unwinding of planned divestments to Essendent Inc. (which were entered into in the hopes of appeasing regulators).

The fallout from the terminated Halliburton and Baker Hughes merger extended beyond the merger parties to the activist fund ValueAct Capital Partners LP. After Halliburton Co. announced its agreement to acquire Baker Hughes, Inc. in 2014, ValueAct acquired significant stakes in both energy companies and privately pushed for the acquisition to close. But the $28 billion transaction was called off in May 2016 after facing opposition from antitrust regulators, with Halliburton having to pay a $3.5 billion reverse termination fee as part of its agreement. After the transaction was terminated, the US Department of Justice settled a civil action against ValueAct for a record $11 million fine for its failure to comply with the waiting period requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, with respect to its purchases of shares of Halliburton and Baker Hughes. The US Department of Justice argued that ValueAct’s investment did not qualify for the “passive investment” exemption from the requirement to make an HSR Act filing, as its actions showed that it planned from the outset to influence

This increased scrutiny on activist funds and pushback on activist demands is reflected in the actions of regulators and important market players.
Activism appears to be spreading globally as activist investors showed an increasing willingness to utilize their strategies abroad in recent years. Although the US accounted for nearly two-thirds of activist activity in 2015 (measured by the number of companies targeted), a greater number of non-US companies are being targeted, particularly in Asia, with the number of outright victories, partial victories, and settlements achieved in Asia jumping from 29.6% in 2014 to 46.7% in 2015. Activist Insight reported that the percentage of companies targeted by non-domestic activists rose to 20%, with one of 2015’s most highly publicized campaigns being Elliot Management’s public attempt to block Samsung C&T’s merger with Cheil Industries.

**Conclusion**

While a sharp downturn in the level of activist investing seems unlikely given the levels of assets currently being managed by activist funds, activists now face increasing challenges from target companies, competing investors and regulatory bodies. Insofar as support for activism is tied to activists’ superior returns, the recent decline in results of activist funds may also lead to a decline in activity or at least a pivot to unexplored targets (such as overseas corporations). Finally, if activist tactics continue to be co-opted by newer reluctant activists, well-established funds may face stiffer competition in identifying and engaging with target companies, including those that traditionally would have been their obvious targets. Nonetheless, the increased acceptance and use of activism across the entire market means that all companies should pay close attention to, and be prepared to address, activist attention and activity.

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4 Activist Insight, “Activist Investing Annual Review 2016”
SHAREHOLDER ENGAGEMENT: AN EVOLVING LANDSCAPE

By Stephen Giove

While shareholder engagement is anything but new, it has become a key corporate governance topic for most public companies. Once limited to a few scheduled events per year, it is now more of an everyday task. It is a broad topic that raises many questions including:

- When should the company engage with shareholders?
- Which shareholders should it engage with?
- Who should be on the engagement team?
- When should directors engage directly with shareholders?
- What forums are best for engagement?
- What topics are appropriate to discuss?
- Are there topics that are off-limits?
- Should the company adopt a formal shareholder engagement policy?
- What role does the company's disclosures play in its engagement approach?

We focus on these key questions as we highlight the results of our survey of the engagement practices of the Top 100 Companies.

81% of the Top 100 Companies made shareholder engagement disclosures in their annual proxy statements.

<table>
<thead>
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<th>Yes</th>
<th>No</th>
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<td>81%</td>
<td>19%</td>
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At the 81 Top 100 Companies that made such disclosures in their annual proxy statements, the length of these disclosures was more often less than one page.

- 1/4 page or less: 24
- 1/2 page: 27
- 3/4 page: 9
- 1 page: 12
- Greater than 1 page: 9

60% of the companies making shareholder engagement disclosures in their annual proxy statements disclosed the reasons why they engage.
Why Engage?

While companies generally engage in order to develop a two-way communication process with their shareholders, the specific reasons companies give for engaging can shed some light on their engagement philosophy. About half of the Top 100 Companies disclosed why they engage with shareholders.

**Reasons companies engage with shareholders:**

1. To provide visibility and transparency into the company’s business and governance practices
2. To ensure that management and the board understand and consider the issues that matter most to the company’s stockholders
3. To ensure that the company’s corporate governance practices continue to evolve and reflect the insights and perspectives of the company’s various stakeholders
4. To build and manage long-term relationships with shareholders based on mutual trust and respect
5. Because effective board-shareholder communication strengthens the board’s role as an active, informed and engaged fiduciary

Engagement is about building mutual relationships between company executives and board members and key shareholder representatives. Relationships developed during an ongoing shareholder engagement process can be utilized when difficult issues arise in order to obtain input on future actions being contemplated by the company.

### FAST FACTS

A variety of approaches were taken by companies with respect to where in their proxy statements they made shareholder engagement disclosures.

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<thead>
<tr>
<th>Section</th>
<th>Companies</th>
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<tbody>
<tr>
<td>CD&amp;A</td>
<td>53</td>
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<tr>
<td>Corporate governance section</td>
<td>50</td>
</tr>
<tr>
<td>Both CD&amp;A and corporate governance section</td>
<td>27</td>
</tr>
<tr>
<td>Proxy statement summary</td>
<td>43</td>
</tr>
<tr>
<td>Cover letter accompanying the proxy statement</td>
<td>13</td>
</tr>
<tr>
<td>Say-on-pay proposal</td>
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Many companies made disclosures in more than one of the sections listed above:

<table>
<thead>
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<th>Sections</th>
<th>Companies</th>
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<tr>
<td>5 sections</td>
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<td>3 sections</td>
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<td>2 sections</td>
<td>23</td>
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<td>1 section</td>
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The Engagement Team

The composition of the engagement team varies depending upon the configuration of the senior management team at the company as well as the subject matter of the discussions. For most companies, the CEO, the CFO, the head of Investor Relations and the Corporate Secretary are significantly involved in the engagement process. In some companies, depending on the topic, other executives may also be included as part of the engagement team, such as the General Counsel, the head of Human Resources and other subject matter experts. A key issue in forming an engagement team is the extent to which board members (and if so, which board members) will participate in the engagement process.

Only four Top 100 Companies disclosed in their proxy statement that they have adopted a policy regarding shareholder engagement.

Regardless of formal policies, companies are disclosing that board members are engaging with shareholders.

Of the 40 companies that disclosed that their board members are engaging or open to engaging with shareholders:

- 19 report that engagement is handled by Board Members / Independent Board Members / Non-Management Directors.
- 15 report that engagement is handled by Lead Independent Director / Independent Board Chair.
- 6 report that engagement included a committee chair, generally of the compensation committee.
The Spectrum of Shareholders

A finely tuned engagement program recognizes that there is a wide variety of shareholder types. These include:

- Pension Funds
- Mutual Funds
- Hedge Funds
- Labor Funds
- Index Funds
- Socially Responsible Investment Funds
- Insurance Companies
- Endowments / Foundations
- Individual Investors

Even within a particular category of investor, there are differences in viewpoints and perspectives. A company’s engagement strategy should be tailored based on the profile of its shareholder base. About half of the Top 100 Companies disclosed why they engage with shareholders.

62 of the Top 100 Companies disclosed in their annual proxy statement the extent of their outreach to / contact with shareholders.

<table>
<thead>
<tr>
<th>Percent of the outstanding shares held by shareholders they engaged with</th>
<th>Number of shareholders they engaged with</th>
<th>Only described their engagement in qualitative terms</th>
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<tbody>
<tr>
<td>41</td>
<td>19</td>
<td>18</td>
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The percentage of outstanding shares held by such shareholders ranged from approximately 25% to 60% (with the average being 38%). 30 of the Top 100 Companies reported that they engaged with between 30% and 45% of their shareholders.

FAST FACTS

The Commonsense Principles of Corporate Governance devote an entire subsection to “Director communication with third parties.” Among other things, these Principles state that:

- Robust communication of a board’s thinking to the company’s shareholders is important. There are multiple ways of going about it. For example, companies may wish to designate certain directors — as and when appropriate and in coordination with management — to communicate directly with shareholders on governance and key shareholder issues, such as CEO compensation.
- The CEO should actively engage on corporate governance and key shareholder issues (other than the CEO’s own compensation) when meeting with shareholders.
The Engagement Menu

Depending upon their objectives, time and resources, companies are engaging in a wide variety of ways.

Of the

81

companies that disclosed shareholder engagement in their proxy statements,

only

29
disclosed the specifics as to how they engaged.

Companies engaged with shareholders through a wide variety of means, including:

- PERIODIC SEC REPORTS
- ANNUAL PROXY STATEMENTS
- PRESS RELEASES
- ANNUAL INVESTOR DAY CONFERENCES
- ONE-ON-ONE MEETINGS
- ANALYST MEETINGS
- SHAREHOLDER NEWSLETTERS
- WEBSITE POSTINGS
- INVESTOR ROADSHOWS
- ADDITIONAL PROXY SOLICITATION MATERIALS
- CSR REPORTS
- INVESTOR SITE VISITS
- QUARTERLY EARNINGS RELEASES / CONFERENCE CALLS
- “GLOSSY” ANNUAL REPORT
- INDUSTRY CONFERENCES
- SOCIAL MEDIA DISCLOSURES
- OPEN CORPORATE GOVERNANCE CONFERENCE CALLS
- AGM

The foregoing can be put into three categories:

- Required Engagement (i.e., activities that are required to be done),
- Expected Engagement (i.e., activities that are customary for US public companies to engage in)
- Extra Engagement (i.e., activities that are viewed as a higher level of engagement). It is this third category of engagement that leading companies are currently focusing on.

Deciding on the company’s engagement strategy depends upon a number of factors, including the goals the company is seeking to achieve through engagement, whether there are any issues of critical importance with which the company needs to engage, the degree to which the company’s strategy needs to be socialized with investors, what information and access investors are looking for, the engagement practices of the company’s competitors, and the company time and resources available for engagement.
The Quality of Engagement Dialogue

The quality of the engagement dialogue is not only influenced by which executives of the company are engaging with which people at the shareholders, but also by the scope of the substantive topics covered in the engagement. While the topics covered vary from company to company, vary by industry and are sometimes situation-dependent, there are some common themes.

70 of the 81 Top 100 Companies that made shareholder engagement disclosures provided some details as to the topics on which they engaged:

- Corporate governance generally, including emerging issues: 67
- Executive compensation matters and say-on-pay votes: 57
- Proxy access: 21
- CSR / Environmental, sustainability, climate change and social issues: 23
- Business and strategy of the company: 19
- Company performance: 10
- Board composition and refreshment: 12
- Board structural matters: 7
- Anti-takeover defenses: 4
- Proxy statement disclosures: 6
- Risk Management and oversight / cyber security / compliance program: 6
- Capital structure and capital allocation: 4
- Corporate governance guidelines / company and shareholder policies: 4
There are innumerable ways that a company can engage with its shareholders, but there is engagement and then there is engagement. Is a meaningful connection being built with shareholders? Are relationships developing? Engagement is in part a credibility issue. Are you consistent in your engagement approach? Are the difficult questions posed by shareholders being answered (understanding that some questions cannot or should not be answered)? How is your company’s engagement being perceived in the marketplace? Has the company been responsive to shareholders?

This is an exercise in building long-term relationships with investors and it takes time, resources, focus and energy. Shareholders are a critically important constituency that needs to be managed just as a company’s other constituencies do (e.g., employees, suppliers and customers). This can be viewed in part as a risk management exercise, as poor relationships with shareholders may increase the company’s risk that an adverse event may occur such as a poor or negative say-on-pay vote, a poor or negative vote against one or more of the company’s directors, poor stock price performance or an activist approach.

**Actions Taken in Response to Engagement**

Meaningful engagement often leads to confirmation of, and sometimes leads to a change in, a company’s existing practices, policies or approaches. In an effort to be transparent, and to demonstrate to shareholders that their input has been received, considered and incorporated, companies are increasingly disclosing the specific actions they have taken in response to engagement with shareholders.

57% of the Top 100 Companies disclosed in their annual proxy statement that they took specific actions in response to shareholder engagement, including:

- Adoption of Proxy Access
- Changes to or Reaffirmation of Executive Compensation Practices
- Enhanced Proxy Statement Disclosures or Design
- Enhanced Website Disclosures of Political Expenditures
- Corporate Governance Enhancements

Note: Some companies disclosed more than one action.

**FAST FACTS**

More than half of the 81 Top 100 Companies that disclosed shareholder engagement practices reported that they engage with shareholders throughout the year.

![Yes](https://via.placeholder.com/15) 45%  ![No](https://via.placeholder.com/15) 36%

Only 10 companies disclose their engagement calendar in their proxy statement.
Examples of other specific actions companies have taken in response to shareholder engagement include:

1. Appointment of, or enhancement of duties of, lead independent director
2. Change to board / board refreshment mechanisms or process
3. Adoption or modification of a “clawback” policy
4. Formalization of director self-evaluation process
5. Adoption or modification of stock ownership requirements
6. Change in anti-takeover defenses
7. Adoption of anti-hedging / pledging policy
8. Adoption of an “over-boarding” policy

Summary Observations
Not only is it clear that shareholder engagement is increasing, but companies are continuing to increase the quantity and quality of their shareholder engagement disclosures. In addition to the foregoing observations, some of the other noteworthy items and practices disclosed by companies include:

- Videotaped interviews with directors posted to companies’ websites
- Discussions with the leading proxy advisory firms, including Glass Lewis and ISS
- Shareholder outreach programs led by cross-functional teams from several departments
- The fact that they respond to hundreds of inquiries from retail investors each year
- Quarterly updates to the board on the feedback received from shareholders
The “war” to enact proxy access across corporate America continued apace in 2016 as shareholders showed no signs in letting up on the offensive. The New York City Comptroller (NYCC), after having kicked off the initial proxy access charge by submitting 75 proxy access proposals in 2015, fired off another salvo of 72 proposals in the 2016 proxy season. More individual shareholders entered the fray as well, with long-time shareholder proponent John Chevedden and other stalwarts joining Jim McRitchie in submitting at least 95 proposals together in 2016, well over the 13 proposals that McRitchie singlehandedly submitted in 2015.

With more shareholders than ever focusing on proxy access, the number of proxy access proposals submitted for the 2016 proxy season increased dramatically versus the number submitted for the 2015 proxy season, with approximately 200 proposals submitted as of August 31, 2016 compared to 116 in 2015. And although companies have been much more successful in keeping these proposals off ballots this year, with only 80 shareholder proposals voted on this year compared to 91 proposals voted on in 2015, and with only 42, or 52.5%, of proposals passing this year compared to 55, or 60%, passing in 2015, these numbers must be viewed in conjunction with the number of proxy access bylaw adoptions, which have totaled 226 from September 2015 to August 2016, compared to just 32 at the end of the same period a year prior.

### FAST FACTS

**Adoption of Proxy Access Across US Public Companies**

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Number of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>69%</td>
<td>Top 100</td>
</tr>
<tr>
<td>40%</td>
<td>S&amp;P 500</td>
</tr>
<tr>
<td>34%</td>
<td>Fortune 500</td>
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</table>

### Shareholder Proposals Submitted

- **2015:** 116
- **2016:** 200

72% Increase

### Shareholder Proposals Subject to Vote

- **2015:** 91
- **2016:** 80

12% Decline

### Bylaws Adopted

- **2015:** 32
- **2016:** 226

606% Increase
Headline Proxy Access Terms
(of the 264 proxy access bylaws adopted since January 1, 2013). All data in percent.

The data shows that companies have generally narrowed the headline terms to 3/3/20/20 or better for shareholders. Much of the ongoing debate in proxy access bylaws occurs in what we call “second-tier” terms, which focus on issues such as whether related entities in an investment fund may be considered to be a single shareholder, whether loaned shares count towards ownership percentage, and other provisions that affect shareholder and nominee eligibility to use proxy access.

What happened to the original NYCC 75?
As of August 31, 2016, 59 companies (or nearly 80%) of the original NYCC 75 have adopted proxy access, with an additional seven companies having the NYCC proposal pass in 2015 or 2016.
As shareholders continue to turn the proxy access spotlight onto an ever increasing number of companies in their portfolios, it is likely only a matter of time before a company is approached to address proxy access or receives a shareholder proxy access proposal. And for those companies that have already adopted, prior adoption may not be the panacea that might have been hoped for, as new “amend” shareholder proposals were first seen in 2016.

Next, we examine the best approaches available to a company that receives a shareholder proposal, with insights gleaned from the results of our surveys of the 2015 and 2016 proxy seasons.

**Shareholder Proposals**

The NYCC and McRitchie / Chevedden proposals generally did not change between 2016 and 2015, with one major exception. While a handful of companies amended their proxy access bylaws in 2015 under pressure from shareholders, 2016 saw the first instance of shareholder proponents asking companies to amend previously adopted proxy access bylaws, with a focus that extended beyond the main headline terms of ownership percentage, holding period, eligible board percentage and shareholder aggregation. Though only five such “amend” proposals were voted on this year compared to 75 “adopt” proposals, we expect that “amend”-type proposals will gain greater traction in the coming years, as we explain further below.

**Approaches in Response to “Adopt” Proposals**

For a company that has received a shareholder proposal to adopt proxy access, the first decision is whether to include the proposal in the company’s proxy statement, or to seek to exclude the proposal or have it withdrawn by the shareholder proponent.
companies included the shareholder proposal but had already adopted a proxy access bylaw prior to the annual meeting.

All except one defeated the shareholder proposal, with average votes in favor of only 34% in 2016.

The single proposal that passed amended a previously adopted bylaw.

companies included a competing management proposal alongside the shareholder proposal.

Four of the competing management proposals proposed a bylaw with “market” terms of 3/3/20/20 or better, while one proposed a 5/3/20/20 bylaw.

The four management proposals that were “market” passed with an average vote in favor of 88%.

The “non-market” management proposal failed, and the corresponding shareholder proposal passed with 57% of the vote in favor.

Overall, companies that let a shareholder proposal come to a vote were more successful than last year in defeating those shareholder proposals — as noted above, many companies solved the shareholder proposal problem by adopting, or proposing to adopt, a proxy access bylaw — the very thing sought by the shareholder proposals in the first place.
Exclusions and Withdrawals

One notable difference between the 2016 proxy season and the 2015 proxy season was a significant increase in the number of companies that were able to keep shareholder proposals out of their proxy statements. This was likely due to a number of factors, including earlier engagement with shareholder proponents, an increased willingness of some proponents to withdraw their proposals in response to adoption by companies, and perhaps most importantly, the SEC’s willingness to allow companies to exclude shareholder proposals on the basis of substantial implementation under Rule 14a-8(i)(10). Companies that received no-action relief typically had adopted bylaws with terms of 3/3/20/20 or better. A total of 38 companies excluded shareholder proposals on this basis. However, companies that requested no-action relief on the basis of having adopted a bylaw with a 5% ownership threshold were uniformly denied relief. In one case, NVR, Inc. was initially denied relief, having adopted a bylaw with a 5% threshold. NVR subsequently amended its bylaw in certain respects, including reducing the ownership threshold from 5% to 3%, and received no-action relief.

FAST FACTS

At least

57 companies were able to negotiate for the withdrawal of shareholder proposals. 52 of these came from the NYCC, who generally agreed to withdraw if the company in question had adopted a 3/3/20/20 bylaw or better. It is worth noting that five of the 52 companies were able to negotiate a withdrawal from the NYCC by putting forth a management proposal for a “market” bylaw of 3/3/20/20 or better, instead of adopting a bylaw. All such management proposals passed.

Management Proposal Only

5 companies put forth management proposals to adopt proxy access without, to our knowledge, any prior history of receiving a shareholder proposal.

7 companies put forth a management proposal after having a shareholder proxy access proposal pass last year, along with the five aforementioned management proposals included as a result of negotiations with the NYCC this year.

2 of these proposals passed (the two that failed did not receive enough support to satisfy the supermajority voting standard for a binding bylaw amendment by shareholder vote).

Approaches in Response to “Amend” Proposals

There were five shareholder proposals asking companies to amend their proxy access bylaws included and voted on during the 2016 proxy season. Two of these proposals were binding bylaw amendments submitted by the NYCC and both failed. Two others were precatory in nature — one failed (Whole Foods) and one succeeded (Noble Energy). In the final case, SBA Communications included its own proposal to “approve” its adopted proxy access bylaw alongside a precatory proposal from NYCC to amend its bylaw. The management proposal failed with 29% of the vote while the NYCC proposal passed with 68% of the vote. Just one year earlier, the company had defeated a NYCC proposal and also had its own management proposal, a 5/3/20/10 bylaw that was later adopted, win with 52% of the vote.
Proxy Advisory Firm Recommendations

ISS recommended in favor of proposals with 3/3/20/20 headline terms or better. Two shareholder proposals and two out of three management proposals it recommended against failed. Glass Lewis recommended against proposals if the company had already adopted a proxy access bylaw or had put forth a competing “market” proposal. All 16 shareholder and two management proposals it recommended against failed.

Recent H&R Block Decision

It is likely the number of “amend” proposals will increase in the 2017 proxy seasons in light of the SEC’s recent decision on the H&R Block 14a-8(i)(10) substantial implementation no-action letter.

On July 21, 2016, the SEC denied H&R Block’s no-action request to exclude an “amend” proposal under 14a-8(i)(10). The “amend” proposal had asked for:

- a minimum of two directors or 25% of the board;
- loaned shares to count towards the 3% ownership threshold;
- no limitations on shareholder aggregation; and
- no limitation on renomination of shareholder nominees.

Under the prior 14a-8(i)(10) precedent no-action letters, the argument could be made that H&R Block should have obtained no-action relief given that it had previously adopted a 3/3/20/20 bylaw that the SEC had approved of in its prior 38 grants of no-action relief and that two of the four requested amendments affected those headline terms. However, the SEC declined to find that H&R Block’s bylaw “compared favorably” to the “amend” proposal. As the SEC does not disclose the rationale for its conclusion, it is difficult to predict how the SEC will rule on other “amend” proposals.

In any case, this decision may embolden shareholder proponents to put forth more “amend” proposals.

We note that on September 8, 2016, the H&R Block “amend” proposal was defeated, as 70% of the votes cast by shareholders were against the proposal.

Concluding Thoughts: Uncertainty Abounds

It is clear that shareholders will continue to pressure companies to adopt proxy access in the 2017 proxy season and beyond. And while the variability in the terms of these bylaws has begun to narrow, the 2016 proxy season demonstrated that the proxy access tug of war between companies and shareholders, and the uncertainty it creates, will continue.

This uncertainty comes from not knowing whether to proactively adopt a proxy access bylaw, as well as uncertainty from the difficulty in designing a “market” proxy access bylaw that will stand the test of time, and not come under pressure to be amended. Even if a company adopts a bylaw in the face of a shareholder proposal, there is uncertainty as to whether the shareholder proponent will withdraw such a proposal. Additional uncertainty comes from the lack of transparency into the SEC’s thinking as to the situations under which they will permit companies to exclude shareholder proposals seeking to amend existing proxy access bylaws. So even for companies that have adopted a proxy access bylaw (and supposedly put this issue behind them), there is uncertainty as to whether to proactively amend or to wait for a shareholder “amend” proposal.

And, of course, the greatest uncertainty is when, and under what circumstances, a proxy access bylaw will be utilized. Thus far, we are not aware of any situation where a director was proposed by a shareholder pursuant to a proxy access bylaw. One thing is certain though — it will happen. It is only a question of time.
In its Executive Summary of 2016 Global Benchmark Policy Updates published in November 2015, ISS Governance (“ISS”) announced that starting in 2016 it would consider recommending a vote against directors of newly public companies due to the adoption, prior to or in connection with an initial public offering (“IPO”), of governance policies that diminish shareholder rights. The Executive Summary acknowledges that investor expectations for newly public companies may be different from those for established public companies, but the policy itself provides little in the way of differentiation, other than providing ISS with broad discretion.

Specifically, the policy states that for newly public companies ISS would generally vote against or withhold votes from individual directors, committee members or the entire board (except new nominees, who should be considered case-by-case), presumably at the first annual meeting of stockholders, if, prior to or in connection with the company’s IPO, the company or its board adopted bylaw or charter provisions materially adverse to shareholder rights, considering the following:

**ISS Focuses On:**

I. The level of impairment of shareholders’ rights caused by the provision.

II. The disclosed rationale for adopting the provision.

III. The ability to change the governance structure in the future (e.g., limitations on shareholders’ right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter).

IV. The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure.

V. A public commitment to put the provision to a shareholder vote within three years of the date of the IPO.

For newly public companies, ISS would generally vote against or withhold if the board adopted bylaw or charter provisions materially adverse to shareholder rights.

The new policy does not define “charter provisions materially adverse to shareholder rights,” but the ISS policy on director performance evaluation identifies problematic provisions to include a classified board structure, a supermajority vote requirement, either a plurality vote standard in uncontested director elections or a majority vote standard with no plurality vote carve-out for contested elections, the inability of shareholders to call special meetings, the inability of shareholders to act by written consent, a dual class capital structure, and a non-shareholder approved poison pill. With the exception of the poison pill, all of these practices are commonplace, to varying degrees, in the organizational documents of IPO companies, as borne out by our survey data.

While ISS’s action may seem like a simple extension of its governance approach to a previously overlooked group of companies, there are in fact a number of key factors that frame the way investors think about IPO companies versus established public companies.

**Purchase is Approval**

To state the obvious, every IPO involves a conscious decision by the entirety of the initial public shareholder base to invest in the company based on a comprehensive disclosure document, which includes a detailed explanation of the governance policies that have been established by the company and are expected to apply during the company’s early life. Lead underwriters pay considerable attention to these policies, monitor investor sentiment and
advise companies as to what policies are acceptable to IPO investors, and what policies will impact market receptivity and price. Notably, the ISS policy’s emphasis on a commitment to put problematic policies to a vote within three years seems to overlook the fact that investors have in effect approved the company’s policies on the pricing date by deciding to purchase stock in the IPO. In contrast, there may be more of a basis to object to these policies at mature companies that have displayed poor performance or have been unresponsive to shareholder sentiment expressed in votes in response to shareholder proposals.

**Investment Thesis**

The policies ISS opposes are generally thought to have the effect of entrenching management or preventing a change in control or acquisition of a public company that may be in the best interest of stockholders. However, investors in an IPO are buying into an investment thesis that essentially involves an acknowledgement that a particular business model to be executed by a specific management team provides a basis for growth and expected stock price appreciation. As a result, investors in IPOs are fairly insensitive to anti-takeover measures in charter documents mainly because they don’t consider a take-out the most likely path to a successful investment.

**Control**

Of the 62 IPOs we surveyed for 2015, 28 remained controlled companies (i.e., more than 50% of the voting power was owned by a single person or group) following the offering. That means that the controlling party, at least initially, had complete control over all matters submitted to shareholders for a vote. This simple fact seems to undermine the logic of the new ISS policy. First, the mischief the policy is primarily designed to prevent (disenfranchising shareholders in the context of a potential takeover) is entirely irrelevant as long as the company is controlled. Second, ISS focuses on a commitment to submit the measures to a shareholder vote within three years of the IPO rather than within three years following the time at which the company ceases to be a controlled company. Lastly, the primary focus of the policy is on directors who are in place at the time the company goes public, even though the deliberations of the board at the time would naturally be informed by the fact that the company will continue to be controlled for the foreseeable future.

**Vulnerability**

As mentioned above, the investment thesis for an IPO typically involves a projected growth trajectory unlikely to be achieved in a more mature company. Often the company is also trying to execute this plan at a time when it has significant vulnerabilities relating to access to capital, market presence, competitive position, diversification, personnel and stock price volatility. It seems reasonable that directors might conclude that investors would expect the company to protect itself from third-party interference during this vulnerable period in order to allow the investment thesis to play out.

**Prevalence of Dual Track Processes**

In many cases, sellers will approach potential strategic and financial acquirers simultaneously with preparation for an IPO to see whether a better price can be obtained from a private buyer or in the public capital markets. In cases where IPO companies have already tested the appetite of private buyers and found better value in the public markets, reasonable anti-takeover measures are not likely to significantly disadvantage public shareholders.
New and Evolving Board

Under stock exchange rules, IPO companies have transition periods for moving to a majority independent board and independent board committees. For controlled companies, the rules provide for transition periods that commence when controlled company status ceases (upon a sell-down by the controlling party, for example). As a result, IPO company boards are often in a slow transition to independence over several years, which means that the composition of the board is in flux and the board is in the process of developing a business and governance culture. Combined with the foregoing factors, this period of transition is an additional reason to delay making judgments about individual board members based on practices in place at the time of the IPO.

Because of these factors, it is not at all clear that the new ISS policy will have a major impact on the “out of the gate” governance policies adopted by IPO companies. In order to develop a baseline to measure potential change in this area, we surveyed 2015 IPOs priced with a size of at least $100 million with respect to governance practices that we would expect to be considered problematic by ISS. All but three of these companies were incorporated in Delaware, and nearly half remained controlled companies following the IPO. Listings were more or less evenly split between NASDAQ and NYSE.

Based on the data, most of the 62 IPO companies surveyed adopted practices that ISS identifies as problematic, with the exception of the dual class structure (which is highly dependent on desire to retain control) and poison pill (which has become less common as more companies tend to be prepared to adopt one if necessary, rather than employing them at all times).

Where private buyer interest has already been tested, reasonable anti-takeover measures are not likely to significantly disadvantage public shareholders.
Conclusion

We expect that law firms and banks will initially advise IPO companies not to overreact to the new ISS policy. Investors have traditionally been relatively insensitive to the specifics of corporate governance practices for newly public companies for the reasons discussed above. For issuers that remain controlled companies, the focus on governance practices seems misplaced given that the initial offering process provides substantial opportunity for investors to make their sentiments known. IPO companies should, of course, sensitize new director nominees to the fact that the ISS policy may result in lower “for” votes than might otherwise be expected, even if, for controlled companies, the vote has no real impact. Boards of newly public companies should also give careful consideration as to when it is appropriate to take another look at corporate governance practices (for example, at the time a sponsor or seller’s ownership falls below 50%) and whether it makes sense to commit to submitting any or all of such practices to a vote by shareholders.

Fresh Ideas: Spin-off Governance

The path to public equity is not always an IPO. Public companies frequently spin-off companies by distributing stock to existing shareholders. For reasons similar to those discussed for IPO companies, the needs of a newly spun-off business may be different from its large, established former parent. It is generally up to the parent company to thoughtfully implement appropriate governance practices for the new company, and these practices may not simply replicate the parent’s own practices.

Market Reception. The level of pre-spin shareholder involvement will vary. Absent a shareholder vote or a split-off approach (where existing shareholders have the option to participate in the new company), the spin-off will not involve any affirmative decision by shareholders. Nevertheless, the parent has a strong interest in ensuring that trading is robust on day one, which means not only making the case for the separation and the ongoing prospects for the business, but also ensuring investors in the new company have confidence in management, the board and its governance practices. The parent should engage with its legal and banking advisers to gauge market expectations.

Takeover Defenses. In planning, the parent should consider whether certain structural protections that may have been dismantled over the years at the parent company (e.g., classified board, supermajority vote requirement, shareholder rights plan) would be prudent for the new company to adopt. Remember that the newly spun-off company will be smaller and have no operating history on day one, exposing it to vulnerabilities similar to those described for IPOs. Further, the parent company will likely have evaluated alternatives for the disposition, including an outright sale, and concluded that the spin-off creates the greatest benefit for shareholders. As in the IPO context, these factors suggest that reasonable anti-takeover measures are justified until the company finds its feet.

Director Independence. While it may seem convenient to nominate current employees or directors of the parent to the new company’s board of directors, it is worth taking the time to evaluate the benefits of their institutional knowledge against the potential conflicts it may create. If the new company will continue to conduct business with its former parent, conflicts could arise for overlapping directors. Although NYSE and NASDAQ both provide a transition period before a newly spun-off company must comply with director independence rules, it may be worth taking the time to vet new director candidates in advance of the spin-off rather than electing individuals who would, by definition, need to be replaced in the near-term.
The government has seized upon the clawback, or the recoupment of incentive-based compensation by employers, as a preferred method to curb the types of behavior that they believe contributed to the recent financial crisis and earlier scandals.

Section 304 of the Sarbanes-Oxley Act requires issuers to recover all incentive-based compensation received by their chief executive officer and chief financial officer in the 12-month period following the filing or public issuance of a financial document that is required to be restated as a result of misconduct.

Section 954 of the Dodd-Frank Act mandates that listed companies implement and disclose policies requiring the recovery from executive officers of any incentive-based compensation in excess of what would have been received had it been determined based on an accounting restatement. The SEC proposed rules to implement Section 954 on July 1, 2015 (“Proposed Rule 10D-1”), and final rules are expected shortly. Unlike the rule under Sarbanes-Oxley, Section 954 does not require misconduct to have been a cause of the restatement.

Proposed rules under Section 956 of Dodd-Frank require certain large financial institutions to subject all incentive-based compensation payable to senior executive officers and significant risk-takers to the possibility of recoupment for seven years following vesting in the event of misconduct by the employee.
As our survey shows, many companies have already implemented voluntary clawback policies.

These financial-related policies often provide the issuer with discretion as to whether or not to pursue recoupment.

Unlike the rules proposed under Section 956 of Dodd-Frank, Proposed Rule 10D-1 generally does not permit discretion, and companies may find it difficult to enforce their policies in the absence of additional SEC relief. The graph highlights some obstacles Proposed Rule 10D-1 raises for companies attempting to comply with Section 954 of Dodd-Frank. These issues have all been addressed in comment letters to the SEC, but it remains to be seen whether any relief will be provided in the final rule.
Obstacles to Complying with Proposed Rule 10D-1

No Provision for Grandfathering
Proposed Rule 10D-1 requires that each national securities exchange and national securities association implement, within one year of the final rules being published, a listing standard mandating that each of its issuers develop, implement and disclose a policy requiring the recovery of the excess incentive-based compensation. Although issuers will have 60 days from the effective date of the relevant listing standard to adopt their policies, the policies will cover all incentive-based compensation received by executive officers after the effective date of the final rule.

Many companies promise incentive-based compensation in employment contracts and other legally binding agreements. Few of these agreements, however, contain clawback provisions that comply with Proposed Rule 10D-1. Although Proposed Rule 10D-1 permits companies to forgo recoupment if recoupment is impracticable, the preamble to the proposed rule states that an inconsistency between the proposed rule and an existing contract would not be a basis for a finding of impracticability because the contract could be amended. It is unlikely, however, that an executive will agree to such an amendment without additional compensation from the company, and a unilateral amendment will certainly risk costly litigation.

The SEC suggests in a footnote that companies can amend their bylaws to require clawbacks but asks for comments as to whether such an amendment would enable issuers to implement their clawback policies with respect to existing employment agreements.

Limited Exception When Clawbacks Violate Home Country Law
Proposed Rule 10D-1 mandates recoupment of erroneously paid incentive-based compensation unless the pursuit of recovery would be impracticable due to the expense of recovery or because recoupment would violate a home country law. To rely on the latter exception, an issuer must obtain an opinion of home country counsel that recovery would violate law. Further, the home country law must have been in effect prior to July 14, 2015, the date that Proposed Rule 10D-1 was published in the Federal Register. The SEC indicates that it does not want to incentivize foreign nations to change their laws in response to Section 954 of Dodd-Frank. Putting aside whether it is appropriate for the SEC to attempt to influence foreign employment laws, nations might still change their laws, whether as a response to Dodd-Frank or otherwise. In that event, companies will be forced to choose between violating Proposed Rule 10D-1 (and risk being delisted) or the home country law. Further, one interpretation of the rule is that the reference to home country law only refers to the laws of the issuer’s domicile. Therefore, a company may not be excused from recouping from an employee located in a different foreign jurisdiction with laws that conflict with Section 954 of Dodd-Frank.

In addition, unlike the case with foreign country laws, Proposed Rule 10D-1 offers no protection if a clawback violates a domestic wage and hour law. Many states, including New York and California, prohibit companies from collecting from their employees any wages that have already been paid. Further, to the extent an issuer has to bring a civil case because recoupment against future wages is impossible (for example, if the action is against a former employee), a state’s statute of limitations may prohibit the commencement of the action. In the absence of a preemption provision in Dodd-Frank which would enable it to supersede all state laws, Proposed Rule 10D-1 places issuers in the position of possibly having to violate state law in order to avoid delisting.
Conclusion

Although only three SEC commissioners are required for a quorum, because two of the five commissioner seats currently are vacant (and one current commissioner opposes the rule), it is difficult to predict when Proposed Rule 10D-1 will be finalized. Chair White, however, has stated that finalization of the rule is a priority. Issuers should therefore begin reviewing their clawback policies to determine what changes or additions will be required to comply with Section 954 of Dodd-Frank. Hopefully, the final SEC rule will eliminate those provisions that will cause issuers undue expense or place them in the Catch-22 of having to choose which law to violate.

Required Application When Stock Price or Total Shareholder Return is the Performance Metric

Proposed Rule 10D-1 defines incentive-based compensation as any compensation that is granted, earned or vested based wholly or in part upon the attainment of a financial reporting measure. Financial reporting measures are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements, any measures, derived wholly or in part from such measures, and stock price and total shareholder return. While the inclusion of stock price and total shareholder return is understandable due to the prevalence of these metrics in incentive-based compensation plans, calculating the actual impact of improper accounting on stock price will be a costly and difficult exercise for those companies forced to determine the amount of compensation that must be recovered.

Although the SEC will permit issuers to use reasonable estimates in determining what the stock price would have been if financial statements had been presented correctly, the SEC suggests that companies engage in an “event study” to capture the valuation impact. Not only can this approach be costly (as the SEC acknowledges) but, as commentators have pointed out, it may lead to costly litigation by executives and shareholders unhappy with the calculations.
DATA BREACH TRENDS: ARE YOU PREPARED?

By Richard C. Hsu and Jeewon Kim Serrato

In today’s world, there are two types of organizations: those that have been breached and those that just don’t know it yet. Breaches in 2015 succeeded not because the victims lacked security altogether, but because thieves found and exploited a small hole in their security programs.

Businesses and organizations of all sizes across virtually every industry must think strategically about threats to their data, intellectual property and assets, and implement appropriate security, protection and risk management practices as data breaches escalate and regulatory pressures increase. Data breach response is increasingly becoming a board-level issue.

It only takes seconds or minutes to compromise an organization’s network, and within days, the data has already been stolen.

According to the Ponemon Institute’s 2016 Cost of Data Breach Study:

- The average total cost of a data breach is $4 million, a 29% increase since 2013.
- The average cost paid for each lost or stolen record containing sensitive and confidential information is $158.
- Estimated 26% probability that an organization will suffer from a material data breach involving 10,000 lost or stolen records in the next 24 months.

In recent years, data breach detection and escalation costs have increased substantially. Organizations must recognize that the longer it takes to detect and contain a data breach, the more costly it becomes to resolve.

Investments in certain data loss prevention controls and activities such as encryption and endpoint security solutions are important for preventing data breaches. But we believe the best strategies for reducing the overall costs and occurrence of any given data breach cannot solely rely on technologies and tools. Improvements in data governance policies and procedures, incident response plans, and the development of employee training and awareness programs help create a comprehensive data protection strategy for the organization that does not ignore the people aspect of the security program.
Timeline of high-profile breaches in 2015

**January**

- **Bitstamp**: theft of 19,000 Bitcoins, worth more than $5 million.
- **Mandarin Oriental**: customer credit card data stolen.
- **Premera BlueCross**: records of as many as 11.2 million customers exposed.

**February**

- **Twitch**: user names, passwords and other personal information hacked.
- **Atlassian**: up to 2% of the usernames and passwords database stolen.
- **Anthem Inc**: personal information stolen from tens of millions of customers.

**March**

- **Carefirst BlueCross BlueShield**: 1.1 million members' names, birthdates, email addresses and subscriber information hacked.
- **Adult FriendFinder**: personal data stolen from up to 4 million members.

**April**

- **Harvard University**: more than 20,000 records compromised.
- **Ashley Madison**: more than 25GB of user data stolen and leaked publicly.

**May**

- **CVSphoto.com**: stolen credit card and personal information from online photo site.

**June**

- **Hacking Team**: attackers claimed 400GB in dumped data.
- **Office of Personnel Management**: 4 million federal employees' personal information stolen.
- **WEB.com**: 93,000 customers' credit card information stolen.

**July**

- **Hilton Hotels**: credit card information stolen by malware infection.
- **CVSphoto.com**: stolen credit card and personal information from online photo site.

**August**

- **Adult FriendFinder**: personal information stolen from up to 4 million members.
- **Hacking Team**: attackers claimed 400GB in dumped data.
- **WEB.com**: 93,000 customers’ credit card information stolen.

**September**

- **Hilton Hotels**: credit card information stolen by malware infection.
- **CVSphoto.com**: stolen credit card and personal information from online photo site.

**October**

- **Halifax / Bank of Scotland**: account activities visible for up to six years.
- **Scottrade**: 4.6 million customers’ personal, credit card and Social Security information stolen.
- **Experian / T-Mobile**: personal information compromised for over 15 million customers and applicants of T-Mobile.
- **LiveStream**: customer database compromised.

**November**

- **Vtech Holdings**: 5 million customers’ accounts breached.
- **Amazon**: passwords compromised.
- **Landry’s**: credit card breach.
- **Hyatt Hotels**: malware infection stole credit card information.
- **Starwood**: customer credit and debit card information compromised in 54 locations.

**December**

- **Livestream**: customer database compromised.

Industry Trend: Attacks on Healthcare

In many ways, 2015 was the year of the healthcare breach. According to the Office of Civil Rights, there were over 253 healthcare breaches in 2015 that each affected over 500 individuals. Five of the eight largest healthcare security breaches since the beginning of 2010 — each with over one million records reportedly compromised — took place during the first six months of 2015. The three biggest healthcare breaches of 2015 alone — Anthem, Premera BlueCross, and Excellus BlueCross BlueShield — resulted in over 99 million records lost, stolen or misappropriated by unauthorized third parties.

The reported number of records compromised in each healthcare breach:

80M
Anthem

11M
Premera BlueCross

10M
Excellus BlueCross BlueShield

Anthem and Premera BlueCross suffered cyberattacks on the same day in 2015 and were affected by the same hacking method. In both cases, the hackers created bogus domain names and published copycat websites that imitated each company’s corporate services. Then, company employees were reportedly targeted with phishing emails that lured them to the phony websites, allowing the hackers to collect login credentials that eventually allowed them access to the companies’ IT systems. No definite information currently exists as to how Excellus BlueCross BlueShield was hacked.

1 IBM 2016 Cyber Security Intelligence Index
3 “Premera, Anthem data breaches linked by similar hacking tactics,” Computenworld, March 18, 2015
What Caused the 2015 Mass Healthcare Breaches?
Although it is difficult to pinpoint all reasons for the 2015 surge in healthcare cyberattacks, the following played a part in the trend:

Lost and Stolen Devices
According to a report by Calyptix Security, 45.4% of breaches in 2015 were caused by lost and stolen assets such as laptops, tablets and removable drives.4

Healthcare Data was not Adequately Protected
According to the 2014 research by EMC and IDC, 90% of healthcare data needed more protection.7 Healthcare IT security is often lagging when compared with the security architectures built by financial organizations, for example.

Healthcare Data is Valuable
The patient data available in healthcare entities such as insurance companies, hospitals and pharmacies contain large amounts of sensitive client data that can be sold for high prices in the cyber-underground.5 As Calyptix Security notes, while a stolen credit card may provide a thief with several purchases before the theft is detected and the credit card blocked, stolen medical information and the medical identity it provides to a thief will result in longer-lasting payoffs.6

4 *Top 3 Causes of Health Data Breaches,* Calyptix Blog, December 22, 2015
5 *4 Reasons Why Healthcare Data Breaches are Rising,* Calyptix Blog, September 13, 2015
6 Id.
7 Id.
An Emerging Trend: How Data Breaches Are Discovered

Another trend to watch out for is how data breaches are discovered. More and more, firms are being notified about data breaches from external sources. This often means firms no longer have control over how the internal investigation is conducted or what timeline to follow in terms of how the media or regulators are notified of the incident. The fact that your organization was breached might already be getting attention in the media, customers will be looking for answers and law enforcement may request access to your data and systems as part of their investigation — all before your internal IT and information security teams have had a chance to fully vet what actually happened.

Breach Discovery Methods

The increased number of data breaches that are not detected internally, but are instead discovered by external sources, means it is increasingly critical to have an effective incident response plan in place that clearly spells out the roles and responsibilities of key stakeholders that might need to be engaged in the event of a data breach. The time pressures can be intense especially in the first few days after a data breach is discovered. Having a plan and knowing who will do what in those critical moments can save a lot of time and make the incident response that much more coordinated and effective.

Depending on the particular facts of the incident, the list of key data breach stakeholders could include the following:

![Changes in Data Breach Discovery Methods](image)

![Key Data Breach Stakeholders](image)
Cybersecurity as a Board-Level Concern

Understanding data breach risk and evaluating the organization’s approach to cybersecurity is increasingly becoming a board-level issue. Due to the recent high-profile breaches and the organizational and financial impact these incidents can have, not only senior management but also the board are beginning to ask for cybersecurity assessments to be included as part of the company’s overarching risk management process.

An increasing number of US and other governments seeking to regulate cybersecurity are also issuing regulations, standards and guidance on how cyber risks should be mitigated and data privacy is protected, further making the management and oversight duties more complex. To highlight this increased need for oversight, SEC Commissioner Luis A. Aguilar has said in a speech delivered at the New York Stock Exchange, “ensuring the adequacy of a company’s cybersecurity measures needs to be a part of a board of directors’ risk oversight responsibilities.” He added: “the boards that choose to ignore or minimize the importance of cybersecurity oversight responsibility do so at their own peril.”

“Ensuring the adequacy of a company’s cybersecurity measures needs to be a part of a board of directors’ risk oversight responsibilities.... The boards that choose to ignore or minimize the importance of cybersecurity oversight responsibility do so at their own peril.”
– SEC Commissioner Luis A. Aguilar

Best Practices to Help You Minimize the Chance of Suffering a Data Breach

Train Your People

One of the largest data breaches of all time may have been caused by employees opening seemingly innocuous work emails.\textsuperscript{8} Investing in data privacy and cybersecurity training for all staff coming into contact with your IT systems and sensitive information may prove itself worth the expense if employees know to think twice before clicking around the internet or being careless with their laptops and mobile devices.

\textsuperscript{8} Id.

Put Yourself in Your Adversaries’ Shoes

Conduct internal and external tests frequently, and hire a third party to do so. They may find weaknesses in your information systems that you are unable to see.

Have a Plan in Place

Unfortunately, cyberattacks and other methods of data breaches have only increased in sophistication and, in all likelihood, will continue to do so.\textsuperscript{9} Companies should have a plan of action for when their systems are compromised; the plan should detail how to contain and take down the threat, methods for quickly identifying the risk of exposure of personal information, and a process that allows the company to comply with data breach notification laws and any contractual requirements.

\textsuperscript{9} “Gartner’s Top 10 Security Predictions 2016,” June 15, 2016

Shearman & Sterling LLP

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THE SURVEY
## Size of Board

The size of the boards of directors of the Top 100 Companies ranged from eight to 17 members, with an average of 12 members. The board size of 81 of the Top 100 Companies ranged from 10 to 14 members.

<table>
<thead>
<tr>
<th>Size of Board</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>8 or fewer members</td>
<td>2</td>
</tr>
<tr>
<td>9 Members</td>
<td>2</td>
</tr>
<tr>
<td>10 Members</td>
<td>11</td>
</tr>
<tr>
<td>11 Members</td>
<td>23</td>
</tr>
<tr>
<td>12 Members</td>
<td>22</td>
</tr>
<tr>
<td>13 Members</td>
<td>13</td>
</tr>
<tr>
<td>14 Members</td>
<td>12</td>
</tr>
<tr>
<td>15 Members</td>
<td>3</td>
</tr>
<tr>
<td>16 or More Members</td>
<td>11</td>
</tr>
</tbody>
</table>
BOARD LEADERSHIP

Separation of the Offices of the CEO and Chair

Separating the offices of the Chief Executive and the chair of the board has been debated for years and is still among the top corporate governance issues facing companies today. Seventy-six Top 100 Companies give the board flexibility to separate or combine the offices of the CEO and chair of the board, depending on which leadership structure is in the company’s best interest at the time.

FAST FACTS

63

CEOs of Top 100 Companies serve as chair of the board.

37

CEOs of Top 100 Companies do not serve as chair of the board.

24

Board chairs are independent.

Public companies are required to disclose why the board leadership structure they have chosen is appropriate for the company. When the same person serves as both the CEO and chair, companies generally explain that the approach best serves their constituency because it provides unified leadership, clear accountability and the benefit of deep operational and industry experience. The rationale for splitting the two offices is that the roles have separate and distinct duties — the CEO is responsible for operational leadership and strategic direction of the company, while the chair facilitates independent oversight of management and leadership of the board.
BOARD REFRESHMENT

In today’s constantly evolving and complex global business environment, board composition is increasingly in the spotlight. “Board refreshment” includes issues facing nominating / governance committees related to director tenure, experience, diversity and performance, all of which contribute to board effectiveness. While director continuity provides many benefits, nominating / governance committees are tasked with the responsibility of balancing those benefits with the need for fresh perspectives, diverse views, specialized experience and independence. The average board tenure at the Top 100 Companies is 8.51 years.

Average Tenure of Directors

<table>
<thead>
<tr>
<th>Tenure</th>
<th>Number of Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 6</td>
<td>16</td>
</tr>
<tr>
<td>years of service</td>
<td>12</td>
</tr>
<tr>
<td>6 years</td>
<td>20</td>
</tr>
<tr>
<td>of service</td>
<td></td>
</tr>
<tr>
<td>7 years</td>
<td>17</td>
</tr>
<tr>
<td>of service</td>
<td></td>
</tr>
<tr>
<td>8 years</td>
<td>13</td>
</tr>
<tr>
<td>of service</td>
<td></td>
</tr>
<tr>
<td>9 years</td>
<td>8</td>
</tr>
<tr>
<td>of service</td>
<td></td>
</tr>
<tr>
<td>10 years</td>
<td>12</td>
</tr>
<tr>
<td>of service</td>
<td></td>
</tr>
<tr>
<td>11-15 years</td>
<td>2</td>
</tr>
<tr>
<td>of service</td>
<td></td>
</tr>
</tbody>
</table>

Director Independence

Independent directors constituted 75% or more of the directors on the boards of most of the Top 100 Companies. Over the last 10 years, the number of companies at which the CEO is the only non-independent director has increased significantly. COOs served on the boards of four companies and a CFO served on the board of two companies.

- 80 companies have boards composed of 75% or more independent directors.
- 52 companies have the CEO as the only non-independent director.
- 36 companies have non-management directors who are not independent.
Mechanisms to Encourage Board Refreshment

Refreshing the board is often accomplished by adopting a mandatory retirement age for non-employee directors or, less frequently, by imposing mandatory term limits on service. Bright-line standards can eliminate the need to make difficult decisions about the continued service of an individual director, but they often do not take into account whether the directors are functioning effectively and can prolong the tenure of under-performing directors or cut short the tenure of directors who continue to make a contribution. The NYSE mandates board self-evaluations, and many companies rely on them as a more effective means for ensuring board composition is appropriate and the board is functioning effectively.

Retirement Age

Although not required by either the NYSE or NASDAQ listing standards, 78 of the Top 100 Companies have disclosed a mandatory retirement age for their non-management directors. Of these, 37 companies expressly permit the board or a committee of the board to make exceptions to the retirement age policy. Age 72 continues to be the most commonly selected age for mandatory retirement of non-management directors. Common practice requires management directors (other than chairs in certain instances) to retire from the board when they retire from employment with the company.

Term Limits

Only five of the Top 100 Companies have adopted mandatory term limits for their directors. The mandatory term limits apply only to non-management directors at three of these companies. Fifty-five of the Top 100 Companies specifically state that term limits have not been adopted, most citing the value of the insight and knowledge that directors who have served for an extended period of time can provide about the company’s business. Many of these companies also state that periodic reviews by the board or a board committee of each director’s performance serve as an appropriate alternative to mandatory term limits. One company has a 20-year term limit.
WOMEN IN LEADERSHIP

Women in the C-Suite

A woman served as the CEO at 13 of the Top 100 Companies and as both CEO and chair of the board at nine of those companies.

A woman served as the CFO at 12 of the Top 100 Companies.

Only 1 Top 100 Company has a woman serving as both CEO and CFO.

Women held approximately 23% of the total number of board seats at the Top 100 Companies in 2016. Only 15 of the Top 100 Companies have boards composed of 30% or more women members, and only three of these companies have a board of 40% or more women members.

Board Gender Diversity (% of Women on the Board)

- Less than 10%
- 10% – 15%
- 16% – 20%
- 21% – 25%
- 26% – 29%
- 30% – 39%
- 40% or More

FAST FACTS

Average Board Tenure

The average board tenure of male and female directors is about the same.

Men
(Average Age: 63.8)
8.54 Years

Women
(Average Age: 61.3)
8.36 Years
Recent years have seen the development and implementation by US-listed companies of new bylaw provisions. Some, such as advance notice bylaws, have been, at least in part, a reaction to increased levels of shareholder activism. US-listed companies are also considering forum selection bylaws, intended to facilitate the management of shareholder litigation, and proxy access bylaws, intended to facilitate the nomination of director candidates by large shareholders.

Certain Bylaw Trends

Proxy Access Bylaws
A proxy access bylaw permits shareholders satisfying certain ownership criteria to include board nominees in the company’s proxy statement. As described in the article on page 22, proxy access is a rapidly evolving area of focus among shareholders. Our survey data shows a 9-fold increase in proxy access bylaws at the Top 100 Companies, and many other US public companies have adopted proxy access bylaws in the past year.

7 Top 100 Companies had proxy access bylaw provisions in 2015, and this number increased more than 900% over the past year.

Forum Selection Bylaws
A forum selection bylaw generally requires that litigation commenced by shareholders against the company be adjudicated in courts located in the company’s state of incorporation. More companies have adopted this type of bylaw since the Delaware Chancery Court upheld its validity in 2013.

75 Top 100 Companies have this bylaw provision.
25 Top 100 Companies do not have this bylaw provision.
It has been over a year since the SEC proposed long-awaited rules to implement Section 954 of the Dodd-Frank Act, and final rules have yet to be promulgated. Proposed Exchange Act Rule 10D-1 would prohibit the national securities associations and exchanges from listing any securities of an issuer that does not develop, implement and disclose a policy requiring the recovery of excess incentive-based compensation received by an executive officer when the issuer needs to correct erroneous financial data by preparing an accounting restatement.

Even without being required to do so, many of the largest US public companies voluntarily maintain clawback policies. Proxy advisory groups strongly encourage public companies to adopt clawbacks as an element of sound corporate governance and risk mitigation. Issuer policies, however, are not uniform, and their application varies as to the events that trigger recovery, culpability standards, the individuals covered, the types of compensation subject to recovery, the level of board discretion as to whether to seek enforcement and the time period covered by the recovery policy.

The Clawback Proposal:

1. applies without regard to whether misconduct was a cause of the restatement.
2. applies to almost all listed issuers, including smaller reporting companies, emerging growth companies, controlled companies, foreign private issuers and issuers that only list debt.
3. covers any current or former employee who was an “officer” under Section 16 of the Exchange Act during the relevant period.
4. applies to incentive compensation based on, or derived from, financial information that must be reported under the securities laws, as well as on total shareholder return and stock price.
5. exempts awards that vest solely on the basis of time, including time-vested options.
6. recovers incentive-based compensation paid in excess of what would have been received had it been determined based on the restated financials.
7. prohibits the indemnification of covered officers against the loss of any recovered compensation.
8. requires the recovery policy be filed as an exhibit to the issuer’s annual report.
9. requires disclosure of actions taken pursuant to the policy in the issuer’s proxy statement (or annual report if no proxy statement is required).
10. mandates delisting in the event an issuer fails to implement, disclose or adhere to its policy.
of the Top 100 Companies publicly disclosed that they maintain a financial-related clawback policy in 2016, up from 87 in 2015.

Covered Persons

The threshold issue is determining whose compensation is subject to a clawback. Clawbacks mandated under Dodd-Frank will apply to all current and former Section 16 officers. The following individuals are subject to the voluntary financial-related clawbacks at the Top 100 Companies:

- 56 Named Executive Officers (NEOs) Only
- 16 All Executive Officers
- 17 Senior Employees
- 6 All Officers
- 17 All Employees (or all participants in the plans or programs subject to the clawback policy)
- 5 Not Disclosed

Top 100 Companies expressly disclose that the clawback policy applies to former employees or executives.
Triggers
Dodd-Frank requires recoupment of compensation upon an accounting restatement due to material noncompliance with any financial reporting requirement. The SEC’s proposed rules interpret material noncompliance to mean any error that is material to previously filed financial statements. The restatement need not result from fraud or misconduct by the issuer or any of its employees.

Triggers at the Top 100 Companies include:*

- **Financial Restatement**: 79
- **Fraud or Misconduct Relating to Financials (no restatement)**: 13
- **Materially Inaccurate Financials (no restatement)**: 15
- **Dodd-Frank Compliant**: 4
- **Not Specified**: 47

Employee Subject to the Recoupment Engaged in Fraud or Misconduct

- 49 require fraud or misconduct related to the financial restatement
- 30 do not require fraud or misconduct

*The policies at 20 Top 100 Companies use multiple triggering events.

Compensation Subject to Clawback
Dodd-Frank compliant clawback policies will require companies to recover “certain incentive-based compensation (including stock options).” The SEC’s proposed rules define incentive-based compensation as compensation that is granted, earned or vested based upon the attainment of financial reporting measures that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements and any measures that are derived wholly or in part from such measures, as well as stock price and total shareholder return. Time-vested awards are not covered. While voluntary clawback policies generally permit a company to recoup “incentive compensation,” the forms of incentive compensation that may be recouped vary.

Of the 90 Top 100 Companies that maintain a clawback policy, they may recoup:

- **Both Cash and Equity**: 75
- **Cash Only**: 8
- **Equity Only**: 5
- **Not Specified**: 2
Enforcement

The proposed rules provide boards with almost no discretion to determine whether to pursue recovery of erroneously awarded compensation. As a result, an issuer must recover erroneously awarded compensation except to the extent it would be impracticable to do so. Recovery would be impracticable if the direct expense paid to a third party to assist in enforcement would exceed the amount to be recovered, or if recovery would violate a home country law that was adopted prior to the proposed rule being published in the Federal Register. Prior to concluding that recovery would be too expensive, an issuer must make a reasonable attempt to recover the erroneously awarded compensation and document that attempt to the exchange or association. In addition, before concluding that recovery would violate a home country law, the issuer must obtain and provide to the exchange or association an opinion of home country counsel.

Of the 90 Top 100 Companies that maintain a clawback policy:

- 66 companies retain discretion as to whether to seek enforcement
- 15 companies appear to provide for mandatory enforcement
- 6 companies provide for both mandatory and discretionary enforcement, depending on the triggering event
- 3 companies do not specify who maintains the enforcement discretion

Who maintains the enforcement discretion under the voluntary policies currently in place?

- 25 companies: Compensation Committee
- 21 companies: Board of Directors
- 8 companies: Both the Board of Directors and the Compensation Committee
- 2 companies: Audit Committee
- 12 companies: Not Specified

*At one Top 100 Company, the board of directors of the parent retains the discretion.
Time Period

The clawback provisions under Dodd-Frank will apply to amounts received during the three-year period preceding the date on which the issuer is required to prepare a restatement. The date on which an issuer is required to prepare an accounting statement under the proposed rules is the earlier of:

- the date on which the issuer’s board of directors or authorized officer or officers concludes, or reasonably should have concluded, that the issuer’s previously issued financial statements contain a material error; or
- the date on which a court, regulator or other legally authorized body directs the issuer to restate its previously issued financial statements to correct a material error.

In providing that the trigger would be the date the issuer reasonably should have concluded that the financial statements contained a material error, the proposal may introduce additional complexity in its application. For example, issuers that initially disagree with a letter from an independent auditor suggesting that a restatement may be required, and therefore choose a later date as the trigger, may run the risk of a later determination that receipt of the letter was the date it reasonably should have concluded that its financial statements required restatement.

Of the 90 Top 100 Companies:

- Not Specified: 63
- Three Years: 12
- Applies to all Gains During the 12-Month Period Following the Filing of Incorrect Financial Statements: 7
- One Year: 3
- Entire Restatement Period: 3

70% of the clawback policies in place at the Top 100 Companies do not specify a time period for the application of the clawback. In addition, for many of the companies where a time period is specified, there is limited explanation as to exactly how the time period will be calculated.
Documentation

Of the 90 Top 100 Companies that maintain a clawback policy:

53
do not specify where their clawback policy is documented.

37
specify where their clawback policy is documented.*

These documents include:

- Incentive Award Plan or Agreement
- Corporate Governance Guidelines
- Publicly Available Compensation or Corporate Governance Policy
- Compensation Committee Charter
- Company Governance Website

*Five Top 100 Companies formalize their policies in more than one document.

Determination of Recovery Amount

The SEC’s proposed rules provide that the recoverable amount is the amount of incentive-based compensation that exceeds the amount that otherwise would have been received had it been determined based on the accounting restatement. This amount is determined on a pre-tax basis. With respect to cash awards, the recoverable amount is the difference between the amount that was received and the amount that should have been received by applying the restated financials. Special considerations would apply, however, under the following circumstances:

- **The Performance Metric is Total Shareholder Return or Stock Price.** Issuers may use reasonable estimates as long as they publicly disclose the estimates.

- **Equity.** If the equity awards or underlying shares are still held at the time of recovery, the recoverable amount would be the excess number of shares. If options have been exercised, but the underlying shares are still held, the recoverable amount would be the excess number of shares (less any exercise price paid). If the shares have been sold, the sale proceeds would be recoverable.

- **Incentive-Based Compensation Based Only in Part on a Financial Reporting Measure.** The recoverable amount is prorated.

The proposed rules also contain detailed provisions regarding bonus pools.

The clawback policies at the Top 100 Companies generally do not provide details as to how the excess recoverable amount should be calculated.
Clawback Disclosure Policies

Although not required by Dodd-Frank, the proposed rules would require that, if at any time during a fiscal year an issuer completed a restatement that required recovery of erroneously awarded incentive-based compensation pursuant to the listed issuer’s compensation recovery policy, or there was an outstanding balance of excess incentive-based compensation from the application of the policy in a previous year, it must disclose:

1. the date on which the issuer was required to prepare an accounting restatement;
2. the aggregate dollar amount of excess incentive-based compensation attributable to the accounting restatement, or an explanation as to the reasons why the amount has not yet been determined;
3. the estimates that were used in determining the excess incentive-based compensation attributable to the accounting restatement, if the financial reporting measure related to a stock price or total shareholder return metric; and
4. the aggregate dollar amount of excess incentive-based compensation that remained outstanding at the end of the last fiscal year.

If an issuer decided not to pursue recovery from an individual, it must disclose the individual’s name, the amount forgone and a brief description of the reason the listed registrant decided not to pursue recovery. Further, the issuer must disclose the name of any individual who, as of the end of the last fiscal year, had erroneously been awarded compensation outstanding for a period of 180 days or longer, as well as the dollar amount of the outstanding erroneously awarded compensation.

Top 100 Companies received shareholder proposals to amend or enhance clawback policies in 2016.
DET RIMENTAL CONDUCT
CLAWBACK POLICIES

Top 100 Companies maintain “detrimental conduct” clawback policies that apply when an employee commits a bad act that is not necessarily related to the issuer’s financials.

While many companies do not specify which acts trigger the detrimental conduct clawback, common triggering events for the policies at the Top 100 Companies include:

- Violation of Restrictive Covenants (e.g., noncompetes, nonsolicitation and confidentiality agreements)
- Violation of Law (including embezzlement, theft and bribery)
- Violation of Company Policy (including code of conduct and code of ethics)
- Acts Resulting in Reputational, Financial or Other Harm to the Company
- Failure of Risk Management
- Failure to Supervise
- General Fraud or Misconduct
- Termination for Cause or Misconduct
- Other Detrimental Activities
**SAY-ON-PAY**

The year 2016 represented the seventh proxy season under Dodd-Frank’s mandatory say-on-pay regime. Five of the Top 100 Companies have opted for triennial voting and thus did not hold a say-on-pay vote in 2016.

- **95** Top 100 Companies held a say-on-pay vote in 2016.
- **94** companies holding a say-on-pay vote received approval.
- **1** company failed to receive approval.

**FAST FACTS**

- The company that failed its 2016 vote also failed its votes in 2014 and 2015.
- Interestingly, four companies that received approval rates in excess of 90% in 2015 received approval rates below 65% in 2016.

**Say-on-Pay Approval Rates in 2016**

Of the 94 Top 100 Companies that held a say-on-pay vote in 2016 (and reported results), 78% received approval rates in excess of 90% and 6% received approval rates below 70%.

![Bar chart showing say-on-pay approval rates by percentage range for years 2014, 2015, and 2016.](chart_image)

*Approval rates are calculated on the ratio of votes “for” over the sum of votes cast plus abstentions, as reported in SEC filings.*
Say-on-Pay Proxy Disclosures

Dodd-Frank requires companies to disclose whether and how the prior year’s say-on-pay voting results were considered in making compensation decisions. Many companies went beyond this requirement.

Of the Top 100 Companies:

- 41 noted that the company reviewed the results and elected not to significantly change the compensation program.
- 89 disclosed the approval rate for the 2015 say-on-pay vote.
- 20 noted changes made to the compensation program in response to the say-on-pay vote.
- 6 provided no say-on-pay disclosures.
Top 100 Companies included an executive summary in their CD&A highlighting company performance, pay-for-performance and good corporate governance features, down from 87 in 2015.

Common Components of CD&A Executive Summaries include:

- Year-Over-Year Compensation and Performance: 30
- Significant Changes to the Compensation and Compensation Governance Practices Made During Calendar Year 2014: 34
- Significant Changes to Calendar Year 2015 Compensation: 3
- Shareholder Engagement Efforts: 47
- 2015 Say-on-Pay Results: 59
- Compensation Elements (often including the reasons for paying each element): 48
- CEO and / or NEO Pay Mix: 46
- A Summary of Good Compensation Governance Practices (often provided through a “what we do” and “what we don’t do” chart): 61
- Company Performance Highlights: 72
- Alternative Pay Disclosures (e.g., realized pay, realizable pay, total direct compensation or an alternate summary compensation table): 8
- Summary of Compensation Philosophy: 8
 Proxy Summaries

Common Compensation Highlights Included in the Proxy Summary Consist of:

- Significant Changes to the Compensation Governance Practices Made During Calendar Year 2014
- Significant Changes to Compensation in Calendar Years 2014 and 2015
- Shareholder Engagement Efforts
- 2015 Say-on-Pay Results
- CEO and / or NEO Pay Mix
- A Summary of Good Compensation Governance Practices (often provided through a “what we do” and “what we don’t do” chart)
- Company Performance Highlights
- An Abbreviated Summary Compensation Table
- Compensation Elements (often including the reasons for paying each element)
- Summary of the Compensation Philosophy
- Alternative Pay Disclosures (e.g., realized pay, realizable pay, total direct compensation or an alternate summary compensation table)
- Pay-for-Performance Analysis
- Compensation Highlights

Since 2014, proxy summaries have increased more than 25%.

76 of the Top 100 Companies provided an up-front "proxy summary" highlighting key points of the entire proxy, including executive compensation disclosures.
Alternative Pay Disclosures

Top 100 Companies have included some form of alternative pay disclosures in their CD&A.

Commonly, these include “realized pay” (i.e., the amounts executives actually received), “realizable pay” (i.e., amounts received plus the value of in-the-money stock options and full-value equity awards), total direct compensation and alternative summary compensation tables.

Of the Top 100 Companies:

- Provided total direct compensation and similar disclosure
- Provided no additional numerical disclosures
- Provided comparisons of compensation (often total compensation) and one or more performance metrics, (often total shareholder return)
- Presented “realized” pay disclosure
- Presented “realizable” pay disclosure
- Provided an Alternate Summary Compensation Table (generally excluding pension values)

The Proposed Dodd-Frank Pay-for-Performance Rules

There has been a long-standing debate on the merits of helpful and clear pay-for-performance disclosures. Despite the increasing trend to include “realizable pay,” “realized pay” and other alternative pay disclosures in proxy statements as a means of comparing pay and performance, no uniform practice or presentation of that information has emerged.

In April 2015, the SEC proposed rules to implement the Dodd-Frank pay-for-performance rules. Dodd-Frank Section 953(a) directs the SEC to promulgate rules to require public companies to provide a clear description of any compensation required to be disclosed under Item 402 of Regulation S-K, including information that shows the relationship between executive compensation “actually paid” to the NEOs and the registrant’s financial performance, taking into account any change in the value of the shares of stock and dividends and any distributions.

The proposed pay-for-performance rules would require tabular disclosure of:

- the compensation “actually paid” to the principal executive officer (“PEO”);
- an average of the compensation “actually paid” to the other NEOs;
- the corresponding “total compensation” amount as shown in the summary compensation table;
- the registrant’s total shareholder return (“TSR”); and
- the registrant’s peer group’s TSR.

In addition, a narrative or graphical format would be required to disclose the relationship between compensation “actually paid” and the registrant’s TSR on an annual basis and the registrant’s TSR and the peer group TSR on an annual basis.
Compensation “actually paid” would be determined by reference to the “total compensation” measure included in the summary compensation table, with certain modifications relating to changes in actuarial pension value and equity awards.

Under the proposed rule, registrants are permitted to use the same index or peer group used for purposes of its “performance graph” or the peer group used for the purposes of benchmarking disclosures in the CD&A (identifying such companies).

Registrants would be permitted, as they currently are with other mandated disclosures, to disclose other measures of financial performance as long as that additional disclosure is clearly identified, not misleading and not presented with greater prominence than the required disclosure.

The comment period for the proposed rules ended in July 2015 and, as of this writing, final rules have not been adopted.

Supporters of pay-for-performance disclosure hope that the formulaic approach prescribed by the proposed rule will provide useful and comparable data to shareholders. In cases where a registrant believes that the requirements risk presenting a skewed or misleading picture, supporters maintain that registrants have the flexibility to opt to supplement the new required disclosure.

Critics counter that the pay-for-performance disclosure is overly simplistic (specifically, in its use of the single total shareholder return metric), could be misleading to investors, may lead to unintended effects on equity program design and exacerbates “the current overemphasis on short-term performance at the expense of long-term shareholder value creation.”
Pay Ratio Rules

On August 5, 2015, the SEC issued final rules implementing Section 953(b) of the Dodd-Frank Act.

The final rules require companies to disclose:
- the median of the annual total compensation of all employees;
- the annual total compensation of the principal executive officer ("PEO"); and
- the ratio of these two numbers.

Identifying the Median Employee

The median employee must be identified once every three years, unless there has been a change in the employee population or compensation arrangements that the company reasonably believes would result in a significant change in the pay ratio disclosure. In all cases, the median employee's total compensation must be calculated annually. The company must:

- Choose any day within the last three months of the relevant fiscal year to determine the median employee (the “determination date”).
- Include all US and non-US employees, and those of any consolidated subsidiaries, who are employed on the determination date. This includes part-time, seasonal and temporary employees. Statistical sampling may be used.
- Choose any consistently applied compensation measure, such as information derived from tax and / or payroll records. However, once the median employee is identified, his or her total compensation must be calculated using the methodology for determining total compensation for purposes of the summary compensation table.
- Determine whether or not to make cost-of-living adjustments for employees in countries outside of the PEO’s country.
- Annualize compensation for permanent employees, but not seasonal or temporary employees. Full-time equivalents are not available for any employee.

Identifying the Median Employee

The median employee must be identified once every three years, unless there has been a change in the employee population or compensation arrangements that the company reasonably believes would result in a significant change in the pay ratio disclosure. In all cases, the median employee's total compensation must be calculated annually. The company must:

- Choose any day within the last three months of the relevant fiscal year to determine the median employee (the “determination date”).
- Include all US and non-US employees, and those of any consolidated subsidiaries, who are employed on the determination date. This includes part-time, seasonal and temporary employees. Statistical sampling may be used.
- Choose any consistently applied compensation measure, such as information derived from tax and / or payroll records. However, once the median employee is identified, his or her total compensation must be calculated using the methodology for determining total compensation for purposes of the summary compensation table.
- Determine whether or not to make cost-of-living adjustments for employees in countries outside of the PEO’s country.
- Annualize compensation for permanent employees, but not seasonal or temporary employees. Full-time equivalents are not available for any employee.

Presenting the Pay Ratio

Companies are required to provide the following:

- A ratio of the PEO’s compensation to the median compensation, with the median compensation equaling one (e.g., 50:1); or
- A narrative describing the multiple that the PEO’s compensation bears to the median compensation (e.g., “PEO compensation is 50 times the median compensation”).
- The median compensation may not be presented as a percentage of the PEO’s compensation.

Exemptions for Non-US Employees

Data Privacy Exemption

Companies may exclude non-US employees if the company obtains a letter from counsel that states the company cannot obtain the required information without violating a non-US jurisdiction’s data privacy laws.

De Minimis Exemption

Companies may exclude non-US employees up to 5% of the company’s total employees. If less than 5% of the total employees are non-US employees, the company must exclude all of them if it wants to exclude any of them. If the company excludes employees from any country, it must exclude all employees from that country. Any employees excluded under the data privacy exemption are also excluded under the de minimis exemption.
Proxy advisers and many institutional shareholders expect companies that receive low say-on-pay approval rates to engage with their shareholders and provide detailed disclosures of both the engagement efforts and resulting changes made to their compensation programs and governance policies. There was a clear correlation between the level of shareholder engagement disclosures in a company’s 2016 proxy statement and the company’s 2015 say-on-pay results, with companies that received below 70% approval in 2015 providing the most detailed disclosures on shareholder outreach.

**FAST FACTS**

Six of the eight Top 100 Companies that received approval ratings below 80% in 2015 provided detailed disclosures regarding shareholder engagement and changes to the compensation program. In their 2016 proxy statements, these companies each received a greater than 80% say-on-pay approval rate in 2016 (in many instances above 90%). With respect to the two companies that did not provide shareholder engagement disclosures in their 2016 proxies, one failed its say-on-pay vote for the second year in a row and the other had a nearly 22% decrease in its say-on-pay approval rating.
CHANGE IN CONTROL ARRANGEMENTS

Severance Benefits

☑️ 45
Top 100 Companies provide enhanced change in control severance benefits to one or more NEOs.

☑️ 2
companies have adopted a policy prohibiting future change in control severance benefits; existing arrangements are grandfathered.

What are the change in control severance benefits triggers?

Top 100 Companies require both a change in control and the NEO’s termination of employment (“double trigger”).

company permits the NEO to voluntarily resign during the 30-day period following the first anniversary of the change in control and receive severance benefits (“walkaway right”). This walkaway right has been eliminated for future agreements.

Top 100 Companies provide for payments solely upon a change in control (“single trigger”) without the need for a termination, down from two companies in 2015.

Which NEOs receive severance benefits?

36 All NEOs

5 CEO

4 CFO

9 Other NEOs

1
Top 100 Company has adopted a policy prohibiting single-trigger change in control severance benefits.
How are the change in control severance benefits documented?*

<table>
<thead>
<tr>
<th></th>
<th>Senior Executive Plan</th>
<th>Broad-Based Plan</th>
<th>Individual Agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>21</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>22</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Two Top 100 Companies document their change in control severance benefits in both a senior executive plan and individual agreements, depending on the executive.

Equity Change in Control Vesting Provisions*

Of the Top 100 Companies:

- 12: Provide for accelerated vesting of some or all of their equity awards in connection with a change in control
- 4: Do not maintain equity change in control vesting provisions
- 4: Make accelerated vesting discretionary
- 80: Did not provide disclosure

*Data is based on the provisions applicable to the most recent equity grants. In many instances, the vesting provisions differ for older awards.

FAST FACTS

In 2016, shareholders at 3 companies proposed that a policy prohibiting accelerated vesting upon a change in control, other than prorated vesting, be adopted. None of these proposals were approved.

8 companies have modified their equity change in control policies beginning in calendar year 2016. In most instances, the changes adopt a double trigger or single trigger unless assumed by the acquiring company.
Time-Vested Equity Awards

What are the time-vested equity award triggers?*

Double Trigger**

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>44</td>
<td>44</td>
</tr>
</tbody>
</table>

Single Trigger**

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>50%</td>
<td>12</td>
<td>6</td>
</tr>
</tbody>
</table>

*One Top 100 Company does not grant time-vested equity awards.
**Two Top 100 Companies provided for both single- and double-trigger vesting in 2015 depending on the award. In 2014, three companies varied the trigger by award.

What portion of the time-vested equity award will vest?

78
Full Vesting

2
Pro Rata Vesting Based on Years of Service

1
Not Specified

Twenty-one of these companies provide that the awards will vest if the employee is terminated within a specified time period following the change in control. The relevant time periods are as follows:

13
2 Years†

4
Not Specified

3
1 Year

1
As of the date of the transaction

†One Top 100 Company will also accelerate vesting if the executive is terminated six months prior to the change in control.
Performance-Based Equity Awards

Depending on the performance criteria and the acquirer’s integration strategy, it is often not possible to continue performance-based equity awards following a change in control. In addition to electing between single-trigger and double-trigger vesting, companies must determine how to treat the performance criteria applicable to these awards at the time of the transaction. Provisions can vary significantly from company to company and among grants at the same company.

What are the performance-based equity award triggers?

<table>
<thead>
<tr>
<th>Trigger Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Double Trigger*</td>
<td>40%</td>
</tr>
<tr>
<td>Single Trigger*</td>
<td>10%</td>
</tr>
<tr>
<td>Forfeited, Unless Successor or Surviving Entity Assumes the Award</td>
<td>1%</td>
</tr>
<tr>
<td>No Acceleration / Not Specified / No Performance-Based Awards</td>
<td>7%</td>
</tr>
<tr>
<td>Single Trigger, Unless Successor or Surviving Entity Assumes the Award</td>
<td>20%</td>
</tr>
</tbody>
</table>

*Three Top 100 Companies provide for both single- and double-trigger vesting depending on the award.

What portion of the performance-based equity award will vest?

<table>
<thead>
<tr>
<th>Vesting Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full Vesting**</td>
<td>48%</td>
</tr>
<tr>
<td>Pro Rata Vesting Based on Years of Service**</td>
<td>16%</td>
</tr>
<tr>
<td>Not Specified</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
</tr>
</tbody>
</table>

**At two Top 100 Companies, the portion of the award that vests differs based on when the employee is terminated or the change in control occurs.

How are performance-based equity awards valued?

- **Target Performance**
- **Maximum Performance**
- **Actual Performance**
- **Combination of Target Performance and Actual Performance (Based on Closing Date)**
- **Greater of Actual Performance and Target Performance**
- **Not Specified**
- **Other**

Fifteen of these companies provide that the awards will vest if the employee is terminated within a specified period following the change in control. The relevant time periods are as follows:

- **13** 2 years†
- **1** 3 years
- **1** As of the date of the CIC
- **3** Not Specified

†One Top 100 Company will also accelerate vesting if the executive is terminated six months prior to the change in control.
Change in Control Excise Tax Provisions

Description of Golden Parachute Provisions under the Code

Section 4999 of the Internal Revenue Code (the “Code”) imposes a 20% excise tax on the amount of any “excess parachute payments” received by certain executives, and Section 280G of the Code disallows an employer deduction for those payments. Any gross-up payment made in connection with the excise tax will also be subject to the excise tax and will be non-deductible. If the aggregate present value of all parachute payments paid to an executive (including cash and accelerated equity awards) equals or exceeds three times the executive’s base amount, then the executive will be considered to have received an excess parachute payment.

Excess Parachute Payment

Code Sections 280G and 4999 are triggered if all parachute payments equal or exceed three times the executive’s base amount. The amount of the excess parachute payment that is not deductible under Section 280G, and subject to the excise tax under Section 4999 is any payment in excess of one times the executive’s base amount.

Safe Harbor

The safe harbor is three times the executive’s base amount, less one dollar. Many companies use a 2.99 multiple in making their calculations to avoid an inadvertent trigger.

Base Amount

An executive’s base amount is the average of his or her compensation from the employer that was includible in his or her gross income for the most recent five calendar years ended prior to the year in which the change in control occurs.

Excise Tax Reduction Provisions

Companies are increasingly adopting measures to protect executives from the excise tax without providing tax gross-ups. The two most common measures include a “cut-back” provision and a “better-of” provision.


Under a “cut-back” provision, the change in control payments are automatically reduced to the safe harbor amount (or, in many instances, 2.99 times the base amount) so that no excise tax applies.

8

of the Top 100 Companies maintain a “cut-back” provision.


Under a “better-of” provision, employees will receive change in control payments equal to the greater of (1) the after-tax amount they would have received after the imposition of the Section 4999 excise tax and (2) the “cut-back” amount (i.e., the safe harbor).

17

of the Top 100 Companies maintain a “better-of” provision.
Golden Parachute Excise Tax Gross-Ups

For the fourth year in a row, there has been a significant decrease in the number of companies providing some level of “golden parachute” excise tax gross-up protection.

16 Top 100 Companies provide a full or modified gross-up to one or more of their NEOs.

Full Gross-Ups

1 Company amended its executive severance plan in 2015 to provide for a full gross-up.

<table>
<thead>
<tr>
<th>Year</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>9</td>
</tr>
<tr>
<td>2016</td>
<td>12</td>
</tr>
</tbody>
</table>

Modified Gross-Up

Under a modified gross-up, payment is only made if the change in control payments exceed a specified amount over the safe harbor. For instance, a company may provide that it will only pay a gross-up if the aggregate amount of the change in control payments exceeds the safe harbor amount, generally, by 10% or more. At some companies, if the change in control payments are below this percentage, they will be cut back to the safe harbor amount. Each of the Top 100 Companies that maintains a “modified” gross-up provides for a cut-back.

As was the case in 2015, four companies provide the modified gross-up under existing arrangements only, and the gross-up is eliminated for new arrangements.

<table>
<thead>
<tr>
<th>Year</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>4</td>
</tr>
<tr>
<td>2016</td>
<td>4</td>
</tr>
</tbody>
</table>

Who is subject to the full gross-up?

Full Gross-Up

<table>
<thead>
<tr>
<th>Category</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>All NEOs</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>CEO</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>CFO</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Other NEO</td>
<td>7</td>
<td>0</td>
</tr>
</tbody>
</table>

Who is subject to the modified gross-up?

Modified Gross-Up

<table>
<thead>
<tr>
<th>Category</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>All NEOs</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>CEO</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>CFO</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Other NEO</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
SEVERANCE ARRANGEMENTS

63
Top 100 Companies provide severance benefits to one or more of their NEOs.

29
of these 63 companies provide severance benefits through individual agreements.*

16
of the Top 100 Companies have adopted policies capping the severance multiple paid to NEOs without shareholder approval. In all but three instances, the severance is limited to 2.99 times the NEO’s base salary and annual bonus. In one instance the multiple is 2.99 for the CEO and 1x base and bonus for all the other NEOs. Two companies utilize a 2x multiple, with one of those companies averaging the annual bonus to the three previous years.

1
of the Top 100 Companies expressly prohibits employment agreements. Many others note that while they do not provide employment agreements to their executives, they do not expressly prohibit employment agreements.

12
of the Top 100 Companies amended or entered into employment agreements with one or more NEOs in calendar year 2016.

The executives that are party to the individual agreements are as follows:

<table>
<thead>
<tr>
<th>All NEOs</th>
<th>CEO</th>
<th>CFO</th>
<th>Other NEOs</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>12</td>
<td>3</td>
<td>6</td>
</tr>
</tbody>
</table>

At least one NEO (but not all)
of these 63 companies provide severance benefits through a stand-alone severance plan or arrangement.*

The executives that participate in the severance arrangements are as follows:

- **All NEOs**: 38
- **At least one NEO (but not all)**: 3 CFO, 6 Other NEOs

1 company has frozen its severance plan to future participants. All current NEOs remain eligible to receive severance benefits under the plan.

3 companies modified their severance plan in calendar year 2016.

*Twelve companies provide benefits through both individual agreements and a stand-alone severance plan, depending on the executive and/or the type of termination. At 13 companies, the severance plans are broad-based and are not limited to senior executives.

**FAST FACTS**

**Treatment of Equity in Connection with a Termination of Employment**

The treatment of equity awards varies significantly by company based on the type of award, the reason for termination and the applicable employee. Few Top 100 Companies provide for immediate and full accelerated vesting of equity awards. The most common treatments for time-based awards (e.g., stock options and restricted stock awards) are (1) continued vesting over a specified period generally subject to compliance with restrictive covenants and (2) forfeiture of unvested awards. In many instances, performance-based awards vest on a pro rata basis based on the period of service and actual performance.
COMPENSATION-RELATED SHAREHOLDER PROPOSALS

The most common proposal in 2014 related to limitations on equity change in control vesting, with shareholders at 12 Top 100 Companies requesting the adoption of such a policy in 2015, compared to seven companies in 2014.

32 shareholder proposals were submitted at 27 of the Top 100 Companies in the 2016 proxy season.

None of the 2015 compensation-related proposals were approved.

This represents a 67% reduction from the 12 companies that received share retention proposals in 2015.
Types of Compensation-Related Shareholder Proposals

**Diversity Reports**
Request that the company prepare and disclose reports on gender diversity in its workforce. One proposal also requests disclosure on the company’s policies and goals to reduce the gender pay gap.

**Incentive Compensation**
Includes: (1) using multiple weighted metrics that correctly reflect both individual and business accomplishments over an established multi-year period in setting performance measures for top executives, (2) requiring shareholder approval of quantifiable performance metrics, numerical formulas and payout schedules for at least a majority of awards to the named executive officers, (3) requiring an annual report on incentive compensation and (4) eliminating the use of certain performance metrics.

**Government Service Golden Parachutes**
Request that the Company prepare a report to shareholders regarding the vesting of equity-based awards for senior executives due to voluntary resignation to enter governmental service. This proposal was aimed only at financial services companies.

**Share Retention Requirements**
Request that the company adopt a policy requiring senior executives to retain 75% of the net after-tax shares underlying equity awards until normal retirement (generally, age 60). These proposals were coupled with a request to limit an executive’s ability to engage in certain hedging activities with respect to the shares held pursuant to share retention requirements.

**Clawback Policies**
Request that the company adopt a policy requiring annual disclosure of any recoupment or forfeiture of executive officer compensation and the circumstances resulting in the recoupment or forfeiture. Certain proposals also request disclosure of the decision not to pursue recoupment. Three of these proposals also request the adoption of an enhanced policy that would permit recoupment if there has been misconduct resulting in a violation of law or company policy that causes significant financial or reputational harm to the company and a senior executive either committed the misconduct or failed in his or her responsibility to manage or monitor conduct or risks.

**Limitations on Change in Control Equity Vesting**
Request that the company adopt a policy that would prohibit accelerated vesting of equity awards upon a termination or change in control, allowing pro rata vesting for time served.

**Other**
There are various other compensation-related shareholder proposals, including prohibiting hedging and pledging of equity award shares, requiring shareholder approval of future severance arrangements in excess of 2.99 times compensation and eliminating tax gross-ups.
STOCK OWNERSHIP GUIDELINES

Ninety-five of the Top 100 Companies maintain stock ownership guidelines for their directors and executives.

87
Both Director and Executive Stock Ownership Guidelines.

7
Executive Stock Ownership Guidelines Only.

1
Director Stock Ownership Guidelines Only.

Are executives and directors in compliance with the guidelines?
Ninety percent of the companies that maintain executive stock ownership guidelines (81 companies) and 70% of the companies that maintain director stock ownership guidelines (63 companies) disclose that all executives and directors were in compliance with the guidelines or on their way to compliance within the required time period.

Which executives are subject to the stock ownership guidelines?

11
NEOs Only

51
All Executive Officers

31
Senior Employees

2
All Officers
Executive Stock Ownership Guidelines

At the 94 Top 100 Companies that maintain executive stock ownership guidelines, the guidelines are expressed as:

**CEO and Executive Chair Base Salary Multiples**

- 4x: 1
- 5x: 17
- 6x: 38
- 7x: 9
- 8x: 9
- 10x: 9
- 12x: 1
- 15x: 2

**Other NEO Base Salary Multiples**

- 1x - 2.5x: 14
- 3x: 47
- 4x: 32
- 5x: 13
- 6x: 5
- 9x - 12x: 3

*Three Top 100 Companies set different types of ownership requirements depending on the executive’s position.

**At many of these companies, the multiple will vary depending on position.

‡ Two Top 100 Companies do not specify the Other NEO multiple. At one company, the base salary multiple is not applicable to the Other NEOs.
**Director Stock Ownership Guidelines**

At the 88 Top 100 Companies that maintain director stock ownership guidelines, the guidelines are expressed as:

*At one of the three Top 100 Companies where stock ownership guidelines are expressed as a multiple of the equity retainer, the multiple was five. The remaining companies used multiples of 3 and 1.5, respectively.*

---

**Director Annual Cash Retainer Multiples**

At the 66 Top 100 Companies where directors are required to hold shares with a value equal to a multiple of their annual cash retainer, the multiples range from three to seven times the annual retainer.
Years to Satisfy Stock Ownership Guidelines

**Executives**

Of the 94 Top 100 Companies that maintain executive stock ownership guidelines, 66 specify the number of years the executive has to meet the requirements:

- 3 Years: 61
- 1 Year: 28
- 1 Year: 1
- 3 Years: 6
- 4 Years*: 5
- 5 Years*: 3
- 6 Years: 2
- Not Specified: 3

*One company provides for 4 or 5 years depending on position.

**Directors**

Of the 88 Top 100 Companies that maintain director stock ownership guidelines, 81 specify the number of years the director has to meet the requirements:

- 3 Years: 69
- 1 Year: 3
- 5 Years: 3
- 6 Years: 3
- Not Specified: 7

**6** companies require executives to meet interim ownership requirements.

**5** companies require directors to meet interim ownership requirements.

**7** companies shorten the applicable timeline if an executive’s ownership requirements increase in connection with a change in position.
Executives

Which Equity Interests Count?

Of the 94 Top 100 Companies that maintain executive stock ownership guidelines, 74% (70 companies) disclose which shares are counted toward meeting the guidelines. The following categories represent the most commonly counted and, where applicable, the percentage of any award counted:

- **46** Vested Full Value Awards or Deferred Shares or Units
- **43** 401(k) or Other Plan Shares
- **34** Immediate Family or Estate Planning Vehicle Shares
- **37** Unvested Full Value Awards
- **7** Vested Options
- **11** Performance Awards

Which Equity Interests Do Not Count?

Of the 94 Top 100 Companies that maintain executive stock ownership guidelines, 48% (45 companies) specify which shares are not counted towards meeting the guidelines:

- **30** Options
- **16** Unvested Full Value Awards
- **20** Performance Awards (generally unearned)
- **5** Pledge Shares
- **4** Other
Directors

**Which Equity Interests Count?**

Of the 88 Top 100 Companies that maintain director stock ownership guidelines, 69% (61 companies) disclose which shares are counted. The following categories represent the most commonly counted and, where applicable, the percentage of any awards counted:

- **52** Vested Full Value Awards or Deferred Shares or Units
- **19** Immediate Family or Estate Planning Vehicle Shares
- **15** Unvested Full Value Awards (100% Counted)
- **13** 401(k) or Other Plan Shares
- **1** Vested Options (Entire Award Counted)

**Which Equity Interests Do Not Count?**

Of the 88 Top 100 Companies that maintain director stock ownership guidelines, 27% (24 companies) specify which shares are not counted towards meeting the guidelines:

- Options
- Unvested Options
- Unvested Full Value Awards
- Performance Awards (generally unearned)
- Pledge Shares
- Other
STOCK RETENTION REQUIREMENTS

Unlike stock ownership guidelines, which require executives and directors to hold a specified number of shares during their tenure, stock retention requirements direct executives and directors to retain all or a portion of the shares acquired from awards of equity-based compensation for a specified time period.

71 Top 100 Companies maintain stock retention requirements:

37 Executive Stock Retention Requirements Only
28 Both Director and Executive Stock Retention Requirements
6 Director Stock Retention Requirements Only

Executive Stock Retention Requirements
Sixty-five companies maintain executive stock retention requirements.

Who is subject to the retention requirements?

35 All Executive Officers
9 NEOs Only
19 Senior Executives
2 Other
Shares Subject to Executive Stock Retention Requirements*

- **2** Vested Full-Value Awards
- **4** All Equity Awards
- **27** 100% of Net Shares
- **10** 75% of Net Shares
- **22** 50% of Net Shares
- **2** 25% of Net Shares
- **4** Shares Subject to the Stock Ownership Guidelines
- **3** All Shares
- **2** 50% of Shares Owned
- **13** Other

Length of Executive Stock Retention Period**

- **11** 1 Year Following Exercise / Settlement
- **6** Retirement / Termination
- **2** 6 Months Following Retirement / Termination
- **7‡** 1 Year Following Retirement / Termination
- **45** Until Stock Ownership Guidelines Are Satisfied
- **10** Other

Top 100 Companies state that the stock retention requirements may extend beyond an executive’s retirement or termination of employment.

*At 20 Top 100 Companies, the number of shares subject to the executive stock retention guidelines varies by position or type of retention requirement. One company does not specify the shares subject to the stock retention requirements.

**At 14 companies, the retention period varies by position or type of retention requirement.

‡ At one company, only 50% of the required 75% of net shares need to be retained following retirement.
**Director Stock Retention Requirements**

Thirty-four Top 100 Companies maintain director stock retention requirements, the same as in 2014.

**Shares Subject to the Director Stock Retention Requirements***

- **8** All Equity Awards
- **9** 100% of Net Shares
- **1** 75% of Net Shares
- **7** 50% of Net Shares
- **4** Shares Subject to the Stock Ownership Guidelines
- **2** Other
- **4** All Shares

*Five Top 100 Companies have multiple director stock retention requirements.

**Length of Director Stock Retention Period**

- **17** Retirement / Termination
- **15** 6 Months Following Retirement / Termination
- **1** 1 Year Following Retirement / Termination
- **1** Until Stock Ownership Guidelines Are Satisfied

**43** Top 100 Companies grant deferred stock units as a component of director compensation. Deferred stock units serve as an additional retention requirement.

**1** Top 100 Company provides for a specific number of shares that must be retained by each director.
PLEDGING POLICIES

84
Top 100 Companies maintain pledging policies.

This is a 62% increase since 2013.

Who is subject to the pledging policy?

67
Both Directors and Employees

49
All Employees (or all equity plan participants)

20
All Executive Officers

9
Senior Employees

1
Individuals Subject to Insider Trading Policy

1
NEOs

3
Not Specified

Which employees are subject to the pledging policy?

5
companies provide a financial capacity exemption to their pledging policies that would allow the individual to pledge shares if he or she can demonstrate the ability to repay the loan without requiring the sale of the shares.

15
Employees Only

2
Directors Only

What are the terms of the pledging policy?

72
Outright Prohibition

9
Require Approval

8
companies limit the shares subject to the pledging policy; for example, only shares subject to the stock ownership guidelines or shares subject to vesting or transfer restrictions.

3
companies limit pledging restrictions to margin loans.
HEDGING POLICIES

In February 2015, the SEC proposed long-awaited equity hedging disclosure rules under the Dodd-Frank Act, and final rules have yet to be implemented. The proposed rules would require issuers to disclose whether any employee, officer or director is permitted to purchase financial instruments or otherwise engage in transactions that are designed to hedge or offset any decrease in the market value of equity securities (1) granted to the employee or director as compensation, or (2) held directly or indirectly by the employee or director.

What are the terms of the hedging policy?
The proposed rules would not require an issuer to prohibit hedging transactions or to otherwise adopt a policy addressing hedging. Moreover, the proposed rules do not require disclosure of actual hedging activities.

Who is subject to the hedging policy?
The SEC’s proposed disclosure rules apply with respect to all employees, officers and directors (including their designees). Hedging policies at the Top 100 Companies vary as to the covered persons. Certain Top 100 Companies, particularly in the financial services industry, will vary the policy based on position, with stricter requirements in place for directors and executive officers.

Which employees are subject to the hedging policy?

- **Top 100 Companies Require Approval of Hedging Transactions**
- **Top 100 Companies Prohibit Hedging Outright**
- **Individuals Subject to Insider Trading Policy**
- **Related Persons**
- **Not Specified**
- **All Employees (or all equity plan participants)**
- **All Executive Officers**
- **NEOs Only**
- **Key Senior Employees**

Top 100 Companies maintain hedging policies, a slight increase from 95 companies in 2014.
**RELATIONSHIP OF COMPENSATION AND RISK**

Under SEC rules, companies must disclose the relationship between the compensation practices that are applicable to all employees — not only those applicable to the NEOs — and the company’s risk management philosophy if the risks arising from the company’s compensation programs are “reasonably likely to have a material adverse effect” on the company.

Of the Top 100 Companies:

- **72** affirmatively stated that risks arising from compensation policies and practices are not reasonably likely to have a material adverse effect on the company.
- **28** provided compensation-related risk disclosure, but did not provide an affirmative statement. A majority of these companies noted that their programs do not encourage excessive or inappropriate risk-taking.
- **0** concluded that compensation-related risks are reasonably likely to have a material adverse effect on the company.
EXECUTIVE PERKS

94
Top 100 Companies provide executive perks. Personal use of corporate aircraft continues to be the most commonly offered perk.

15
Top 100 Companies disclosed that they provide tax gross-ups on some or on all perks provided to executives. 15 Companies disclosed above-market or preferential earnings on non-qualified deferred compensation.

Who is entitled to personal use of corporate aircraft?

- At 23 companies, the executives are required to reimburse the company for all or a portion of their personal aircraft usage.
- Certain companies note that aircraft usage is permitted but no executive officers actually used the aircraft in 2015.
- In many instances, personal usage is limited to availability and requires approval by the CEO.
- One Top 100 Company eliminated the personal use of corporate aircraft for its chairman beginning in calendar year 2016.
Top 100 Companies disclosed that the compensation committee retained independent legal counsel.

Top 100 Companies disclosed that management retained a separate compensation consultant.

companies provided conflicts of interest disclosures for management’s compensation consultant.

companies provided independence disclosures for management’s compensation consultant.

Eighty-one of the 94 Top 100 Companies that retained a compensation consultant affirmatively stated that the consultant is independent.

Common Independence Disclosures include:

- Consulting Firm Provides Services Only to the Compensation Committee
- Compensation Consultant Deemed Independent After Consideration of the SEC / NASDAQ / NYSE Factors
- An Affiliate of the Consulting Firm Provides Other Services to the Company
- Individual Consultant Provides No Other Services to the Company or Its Affiliates
- Consulting Firm Provides Both Director / Executive Compensation Services to the Compensation Committee and Other Services to the Company
Compensation Consultant Independence Policies

Terms of the consultant independence policies at the Top 100 Companies:

- Twenty-three companies require a periodic independence review by the compensation committee. Eleven of these companies require an annual review, three require a review at the time the consultant is selected and nine do not specify the frequency of the review.
- Eleven companies prohibit the consultant and its affiliates from providing any other services to the company.
- Seven companies require pre-approval (by the compensation committee or the committee chair) of services other than compensation services provided to the board.
- Four of the companies provide that a consultant (or firm) will not be deemed independent if it receives fees for other services in excess of a specified amount (generally, $120,000) or a percentage of the firm’s gross revenues (generally 1–2%).

Top 100 Companies disclosed that they maintain a compensation consultant independence policy, down from 33 in 2015 and 48 in 2014.

Compensation Consultant Conflicts Disclosure

Pursuant to the SEC’s final rules under Dodd-Frank, a company must disclose whether the work of its compensation consultant raised any conflicts of interest and, if so, the nature of the conflict and how it is being addressed. None of the Top 100 Companies disclosed a conflict.

Of the Top 100 Companies:

- 2016: 67
- 2015: 74

Seven of the Top 100 Companies mandate an annual conflicts review in their compensation committee charter.

made an affirmative statement of no conflicts.
Overall Director Compensation

Director compensation continues to be composed of a mix of cash, equity and perquisites. The 2016 results reflect that the compensation mix has been relatively stable over the last several years.

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
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<tbody>
<tr>
<td>Annual Cash Retainers</td>
<td>98</td>
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<td>98</td>
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<tr>
<td>Deferred Stock Units*</td>
<td>43</td>
<td>43</td>
<td>47</td>
</tr>
<tr>
<td>Restricted Stock or Units</td>
<td>41</td>
<td>43</td>
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<tr>
<td>Non-Restricted Stock or Units</td>
<td>17</td>
<td>19</td>
<td>17</td>
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<tr>
<td>Stock Options or SARs</td>
<td>13</td>
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<tr>
<td>Committee or Committee Chair Retainers</td>
<td>76</td>
<td>75</td>
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<tr>
<td>Perquisites and Benefits</td>
<td>22</td>
<td>18</td>
<td>16</td>
</tr>
</tbody>
</table>

*Deferred Stock Units are vested stock units that are not paid until the director ceases to serve on the board.
Director Equity Compensation

Ninety-nine of the Top 100 Companies grant equity compensation to their directors. The equity mix has remained fairly consistent over the past few years.

Types of Director Equity Compensation

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restricted Stock or Units:</td>
<td>43</td>
<td>47</td>
</tr>
<tr>
<td>Stock Options:</td>
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<td>45</td>
</tr>
<tr>
<td>Non-Restricted Stock or Units:</td>
<td>19</td>
<td>17</td>
</tr>
</tbody>
</table>

What are the deferred stock unit deferral periods?

Deferred stock units are vested stock units that are not settled until a later date. At the 45 Top 100 Companies that grant director deferred stock units, the deferral periods are as follows:

- Retirement or Termination
- A Specific Number of Years
- Year Following Termination
- Earlier of Five Years after Grant and Termination / Resignation
- Other

*Time period varies up to one year following termination.

FAST FACTS

21

The dollar value of director equity awards increased at 21 Top 100 Companies and decreased at one company. The increases ranged from $5,000 to $40,000.

13

companies announced changes to their director equity awards in calendar year 2016.

6

Top 100 Companies permit directors to select the form in which their equity grants are made.

Companies vary how they determine the size of director equity awards:

- 88 Top 100 Companies use a specified dollar value.
- 7 companies grant awards over a fixed number of shares.
- 1 company uses both a dollar value and a fixed number of shares.
- 2 companies grant discretionary equity awards.
**Board Committee and Committee Chair Retainers**

Ninety-six of the Top 100 Companies pay committee retainers to members and/or chairs of some or all of the board committees, the same as 2014.

*Data not collected prior to 2015.*

---

**41**

Top 100 Companies provide committee member retainers.

**94**

companies provide committee chair retainers.

**6**

companies pay all or a portion of the committee fees in equity.

**2**

companies provide a committee retainer only if the director serves on multiple committees.

**15**

companies modified their committee retainers in 2016 and 9 will do so on a going-forward basis.
**Director Non-Executive Chair Retainers**

Thirty-eight of the Top 100 Companies have separated the role of chair and CEO, with 24 companies retaining a non-executive chair. Twenty-four of these companies pay additional compensation to the non-executive chair. The non-executive chair retainers range from $200,000 to $1,093,195, which is substantially similar to 2015.

*The amounts set forth in the chart reflect the aggregate value of all cash retainers and equity awards paid to the non-executive chair, exclusive of meeting fees and other perquisites and benefits.

**FAST FACTS**

5

Top 100 Companies added or increased the amount of the non-executive chair retainer in 2016 and two have done so on a going-forward basis.

7

Top 100 Companies pay all or a portion of the lead director fees in equity.

14

companies added or increased the amount of the lead director retainer in 2015.

8

companies have done so on a going-forward basis.
**Director Annual Cash Retainer**

Ninety-eight Top 100 Companies paid annual cash retainers to directors. The annual cash retainer amounts ranged from $30,000 to $150,000 in 2016, the same as in 2015.

**FAST FACTS**

**16**

The annual retainer at 16 Top 100 Companies increased from 2015. The increases ranged from $5,000 to $50,000 with an average increase of $13,000.

**7**

companies announced that the annual retainer will increase in calendar year 2016 or later.

**Director Meeting Attendance Fees**

Only 16 of the Top 100 Companies paid board and/or committee meeting attendance fees in 2016, compared to 18 in 2015 and 22 in 2014. This low number evidences the consensus that director attendance at meetings is mandatory, not optional.
**Director Perquisites and Benefits**

Seventy-nine Top 100 Companies provide some form of perquisites and benefits to their directors. As with executive perks, this practice has sparked significant debate among investors. The level of common types of director perquisites and benefits has remained fairly consistent over recent years.*

* Data only reflects current programs that are available to all directors; frozen and grandfathered programs are excluded.

** The most common perquisites are company products and services and tickets to entertainment events.

† Director matching charitable contribution programs are generally consistent with similar benefits provided to all employees.

†† Includes special and excess meeting fees and fees for service on special committees.

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**Perquisites**

- **Life / Travel / Accident Insurance**: 23 (2015), 24 (2016)
- **Participation in Matching or Other Charitable Contribution Programs†**: 50 (2015), 59 (2016)
- **Fees for Special or Extraordinary Services††**: 8 (2015), 8 (2016)
- **Reimbursement of Taxes Incurred with Respect to Some or All of the Benefits**: 4 (2015), 5 (2016)
- **Medical and Dental Benefits**: 4 (2015), 6 (2016)
- **Personal Use of Aircraft**: 27 (2015), 30 (2016)
We reviewed the corporate governance and compensation practices of 100 of the largest US public, non-controlled companies that have equity securities listed on the NYSE or NASDAQ. These companies, which we selected based on a combination of their latest annual revenues and market capitalizations, are referred to as the “Top 100 Companies.” Generally, we derived the data in this Survey from the annual proxy statements, compensation committee charters and corporate governance guidelines posted on the companies’ websites available as of June 1, 2016 (except where otherwise noted).

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Top 100 Companies included in the 2016 Survey:

3M Company
Abbott Laboratories
AbbVie Inc.
Aetna Inc.
Alphabet Inc.
Altria Group Inc.
Amazon.com Inc.
American Airlines Group Inc.*
American Express Company
American International Group, Inc.
Amgen Inc.
Anthem, Inc.
Apple Inc.
Archer-Daniels-Midland Company
AT&T, Inc.
Bank of America Corporation
Berkshire Hathaway Inc.
Biogen Inc.
Boeing Company, The
Bristol-Myers Squibb Company
Cardinal Health, Inc.
Caterpillar Inc.
Celgene Corporation
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Comcast Corporation
ConocoPhillips
Costco Wholesale Corporation
CVS Health Corporation
Danaher Corp.
Delta Air Lines, Inc.
Dow Chemical Company, The
Duke Energy Corporation
E. I. du Pont de Nemours and Company
Eli Lilly and Company
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FedEx Corporation
Ford Motor Co.
General Dynamics Corporation
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General Motors Company
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Hewlett Packard Enterprise Company*
Home Depot, Inc., The
Honeywell International Inc.
HP Inc.
Intel Corporation
International Business Machines Corporation
Johnson & Johnson
JPMorgan Chase & Co.
Kraft Heinz Company, The*
 Kroger Co., The
Lockheed Martin Corporation
Lowe’s Companies Inc.
Marathon Petroleum
MasterCard Incorporated
McDonald’s Corporation
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NIKE, Inc.
Occidental Petroleum Corporation
Oracle Corporation
PepsiCo, Inc.
Pfizer Inc.
Philip Morris International Inc.
Phillips 66
Procter & Gamble Company, The
Prudential Financial, Inc.
QUALCOMM Incorporated
Reynolds American Inc.*
Starbucks Corporation
Sysco Corporation
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Twenty-First Century Fox, Inc.
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Union Pacific Corporation
United Parcel Service, Inc.
United Technologies Corporation
UnitedHealth Group Incorporated
Valero Energy Corporation
Verizon Communications Inc.
Visa Inc.
Walgreens Boots Alliance, Inc.
Wal-Mart Stores, Inc.
Walt Disney Company, The
Wells Fargo & Company

*New to the 2016 Survey
Seventy-nine of the Top 100 Companies are listed on the NYSE and 21 companies are listed on the NASDAQ.

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