

2017-18 Proxy Season Roundtable

October 5, 2017



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Agenda

- 2017 Proxy Season Review
- Disclosure Developments
- Panel Discussion: Key Themes and Trends
 - The New Investor Landscape
 - Director Diversity and Qualifications
 - Environmental and Social Issues
 - Effective Shareholder Engagement
- Other Governance Developments
- Key Takeaways/Action Items

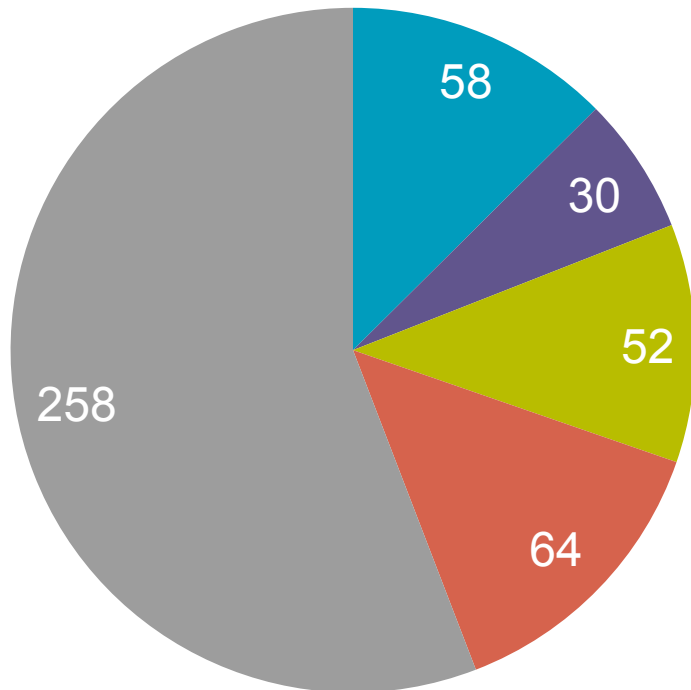
2017 Proxy Season Review

William P. Fiske
Senior Managing Director
Georgeson LLC



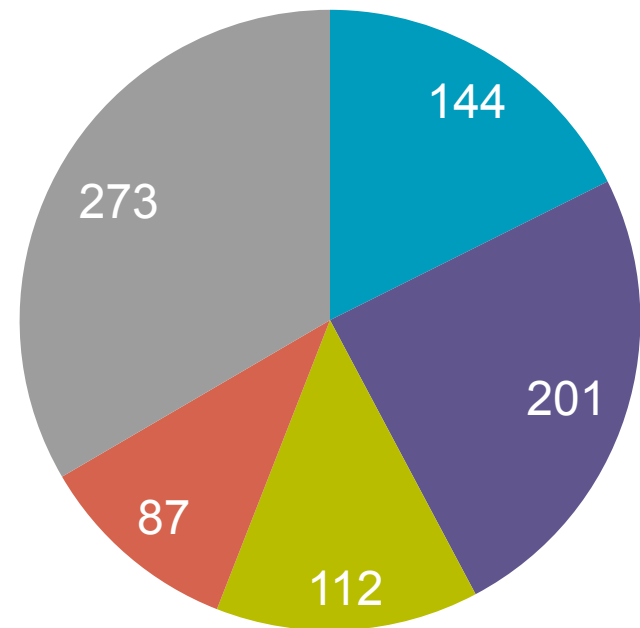
Overview: Shareholder Proposals in 2017

Proposals Voted in 2017



■ Environmental/Sustainability ■ Gender Diversity/ Pay Gap
■ Proxy Access ■ Political Activity
■ All Other

Estimated # of Proposals Submitted in 2017

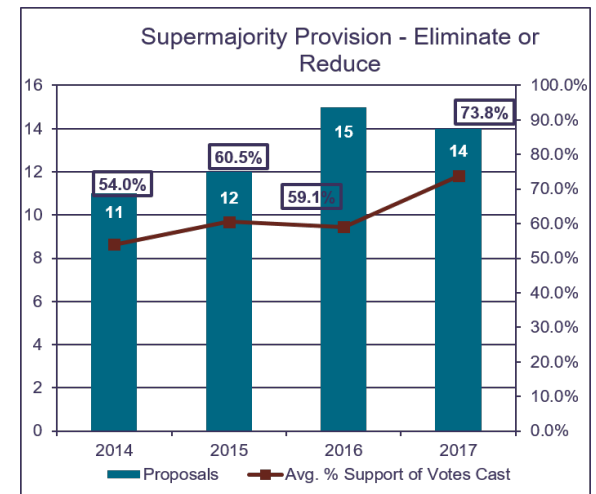
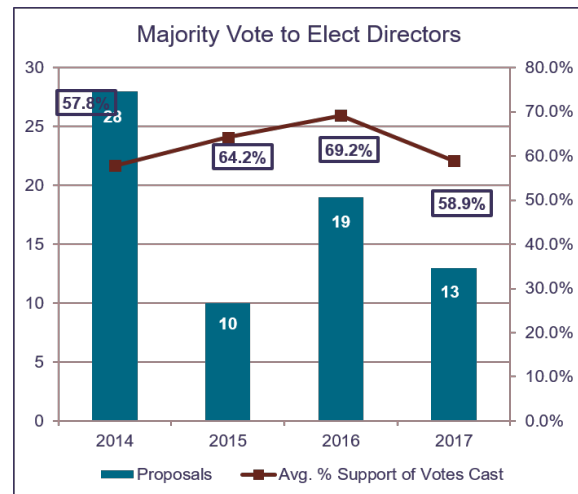
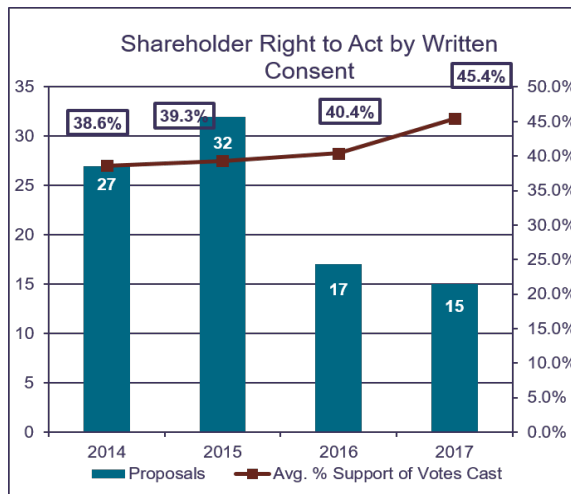
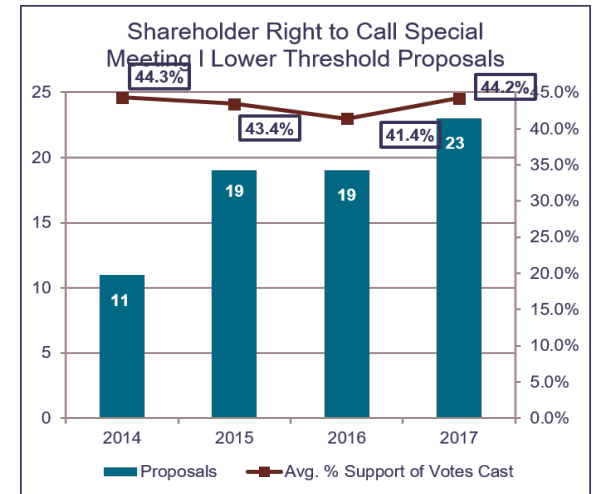
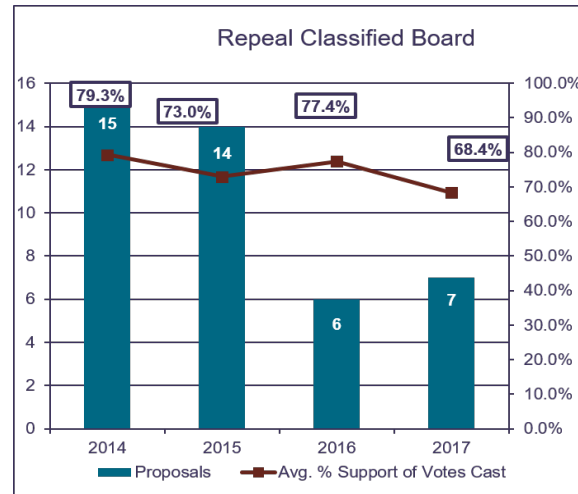
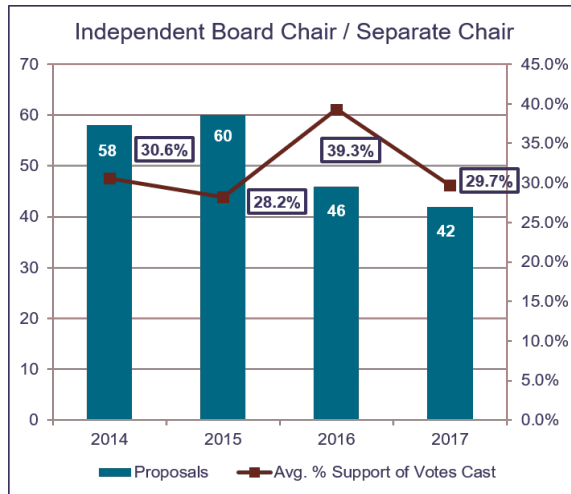


■ Environmental/Sustainability ■ Social
■ Proxy Access ■ Political Activity
■ All Other

Decline in Traditional Governance Proposals

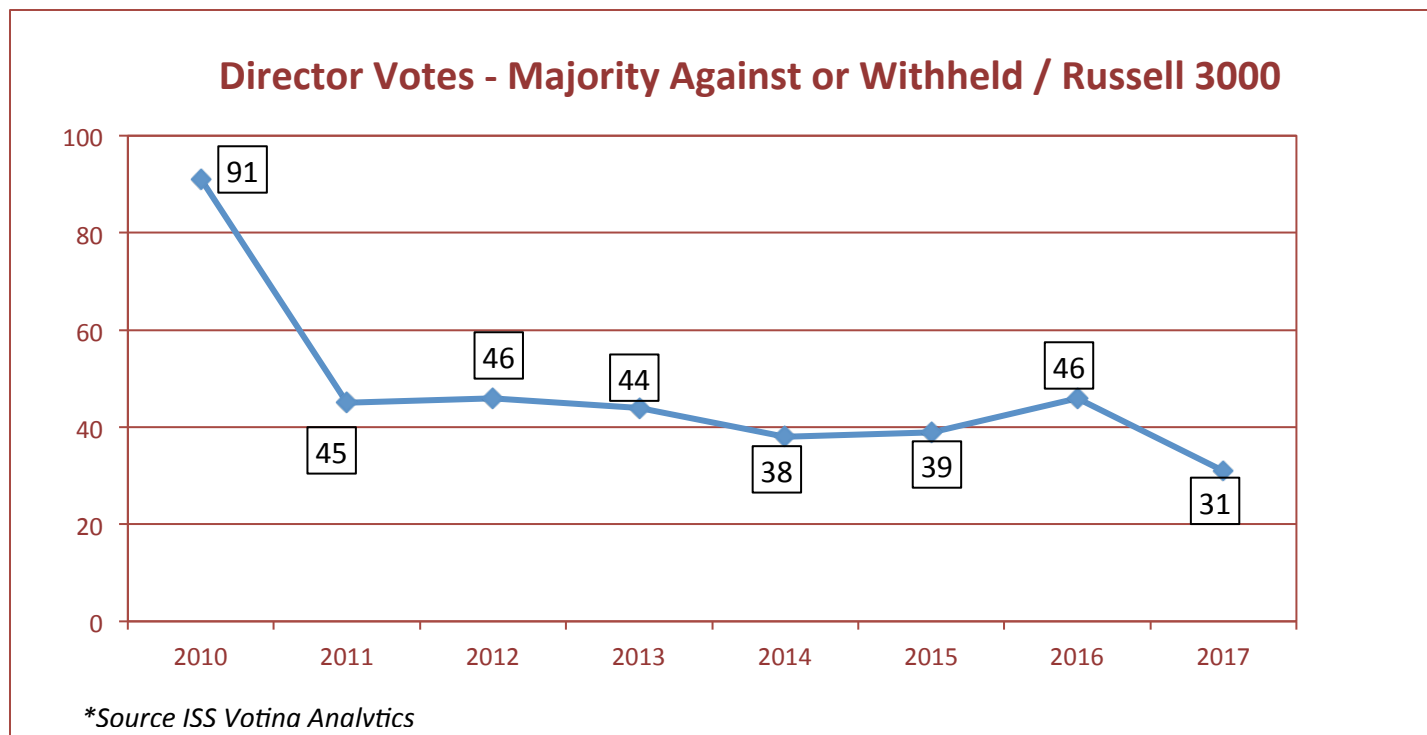
- Shareholder proposals on traditional governance issues (destagger the board, adopt majority voting, eliminate supermajority voting rights, adopt special meeting rights, etc.) continue downward trend
 - Most large companies have already adopted these practices
 - Small caps are also adopting certain features, especially majority voting
- Heightened focus on independent chair proposals
 - Average support remained high but none passed
 - Most shareholders are okay with an alternative structure of a strong, independent lead director

Governance Shareholder Proposals (Russell 3000)



Director Elections

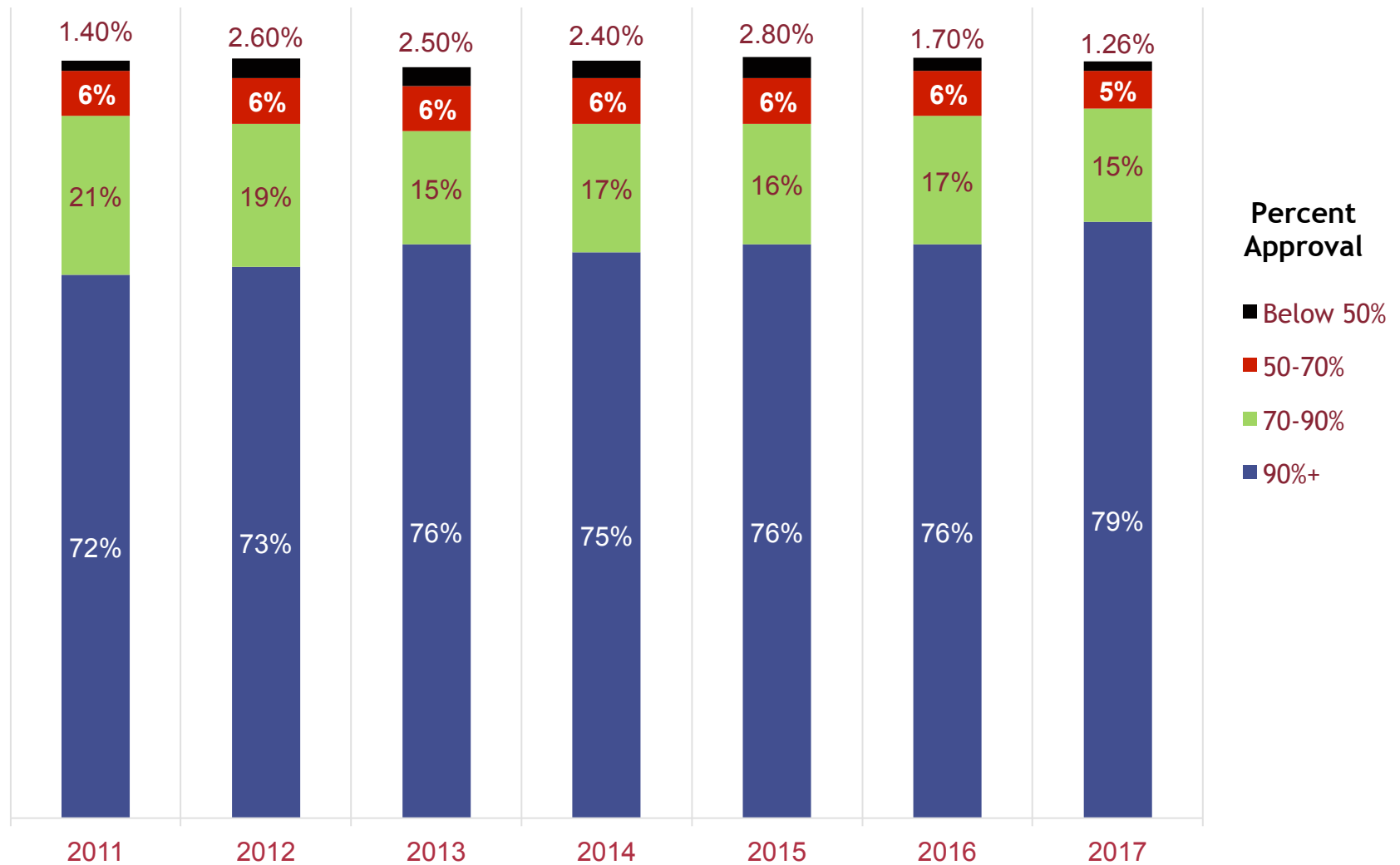
- Average support for directors was very high in 2017
 - Russell 3000 – 95.8% votes cast; S&P 500 – 96.9% votes cast



Say-on-Pay

- Results remain strong
 - Failure rate for 2017 say-on-pay proposals hit all time low of 1.3%
- However, since 2011 more than 2,000 companies have either received negative ISS recommendations or less than 70% support
 - Approximately 12-14% of companies run into problems every year with negative ISS recommendations
 - Engagement works!
 - Companies with negative ISS recommendations that achieved > 70% support have increased each of last three years
- Frequency votes strongly in favor of annual – 91% average vote
 - 2017 – 88% of boards recommended annual votes
 - 2011 – 53% of boards recommended annual votes

Say-on-Pay Proposals



Reasons for Problematic SOP Outcomes

1. Pay magnitude
2. TSR
3. Compensation Committee responsiveness
4. Discretionary or “one-off” awards
5. Incentive program design (poor mix of time/performance based awards, subjective/discretionary components, etc.)
6. Performance metric selection/disclosure (lack of)
7. Performance goal rigor
8. Aspirational peer group
9. Employment agreements (tax gross ups, single triggers)
10. Leadership transition issues

Disclosure Developments

Lily Brown, WilmerHale
Rebecca Chang, WilmerHale

2017 Form 10-K

What's New

- EGC cover page checkboxes
- Hyperlinked exhibits
- Impending adoption of new revenue recognition standard

Other Focus Areas

- MD&A: Known trends and uncertainties
 - Supreme Court review of *Leidos, Inc. v. Indiana Public Retirement System*
- Cybersecurity
- Brexit and Trump risk factors – one year later
- Non-GAAP financial measures
- Disclosure Effectiveness Initiative

Proxy Statement for 2018 Annual Meeting

What's New

- Pay ratio disclosure

Other Focus Areas

- Enhanced audit committee disclosures
- Continued enforcement interest in perquisites and related person transactions
- Evolution of proxy materials into an effective means of shareholder communication

Delayed

- Dodd-Frank compensation mandates other than pay ratio (clawbacks, pay-vs-performance, hedging) on regulatory back burner, but investors will continue to push for voluntary action

Pay Ratio Disclosure

- Proxy statements for 2018 annual meetings must generally include pay ratio disclosure based on 2017 compensation
 - Does not apply to EGCs, SRCs, FPIs
 - While the possibility of Congressional action to repeal or postpone remains, based on the new guidance provided by the SEC and SEC staff on September 21, 2017, it is likely the new disclosure will be required
- New Regulation S-K Item 402(u) requires disclosure of:
 - Median of the annual total compensation of all employees of the company, other than the CEO
 - Annual total compensation of the CEO
 - Ratio of these two amounts
 - Brief description of methodology and material assumptions, adjustments and estimates, including use of exceptions

Pay Ratio – Overview of Key Steps



Audit Committee Disclosures

- Trend to add enhanced voluntary disclosure continues

Disclosure Topic	2017	2016	2012
Directly responsible for appointment, compensation and oversight of auditor	87%	81%	45%
Selection of the auditor is in the best interests of the company/stockholders	73%	72%	3%
Involved in the selection of the lead audit partner	75%	69%	1%
Responsible for audit fee negotiations	32%	27%	0%
Length of the auditor's tenure	67%	65%	27%
Periodically considers if auditor should be rotated	60%	55%	3%

- In New England, Carpenters union has been active on this issue as part of their auditor independence project

Capital Markets Developments

- Normal settlement cycle is now T+2
- Revised SEC staff guidance on omission of financial statements from draft registration statements
- New non-public review process for certain registration statements that do not qualify for confidential submission under the JOBS Act
 - IPOs by non-EGCs
 - Follow-up offerings by companies public less than 12 months
- Financial statement waivers
 - Recent statements from SEC Chair Clayton and Division of Corporation Finance Chief Accountant suggest openness to requests for waivers under Rule 3-13 of Regulation S-X
 - Such waivers are also specifically mentioned in the Division's summer announcement regarding draft registration statements

Key Themes and Trends

Krystal Gaboury Berrini, Camberview

Meredith Cross, WilmerHale

Anne Meyer, Georgeson

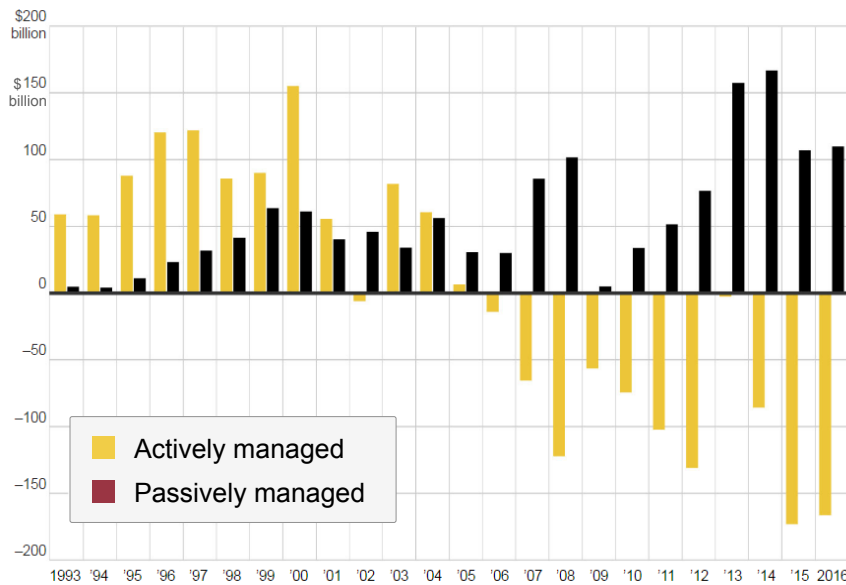
Jennifer Zepralka, WilmerHale



The New Investor Landscape

Ownership of US companies is increasingly concentrated in passive and index funds

Active vs. Passive: Net Flows of U.S. Stock Mutual Funds and ETFs (1993-2016)¹



"At some point in the next nine months ... more than half of managed equity assets in the U.S. will be run on a passive basis ... At the current rate we forecast that this will happen sometime in Jan. 2018"

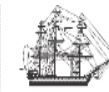
Inigo Fraser Jenkins, Head of Global Quantitative Strategy / European Equity Strategy, Bernstein Investment Research and Management (Apr. 2017)

Rise in S&P 500 Companies in which U.S. Passives Own More Stock than U.S. Actives¹

20 → 112
2010 2016

Significant Concentration of Ownership by Large Index Funds²

BLACKROCK



Vanguard®

STATE STREET
GLOBAL ADVISORS

Combined Assets Under Mgmt:

~\$11T

Over 3X the global hedge fund industry

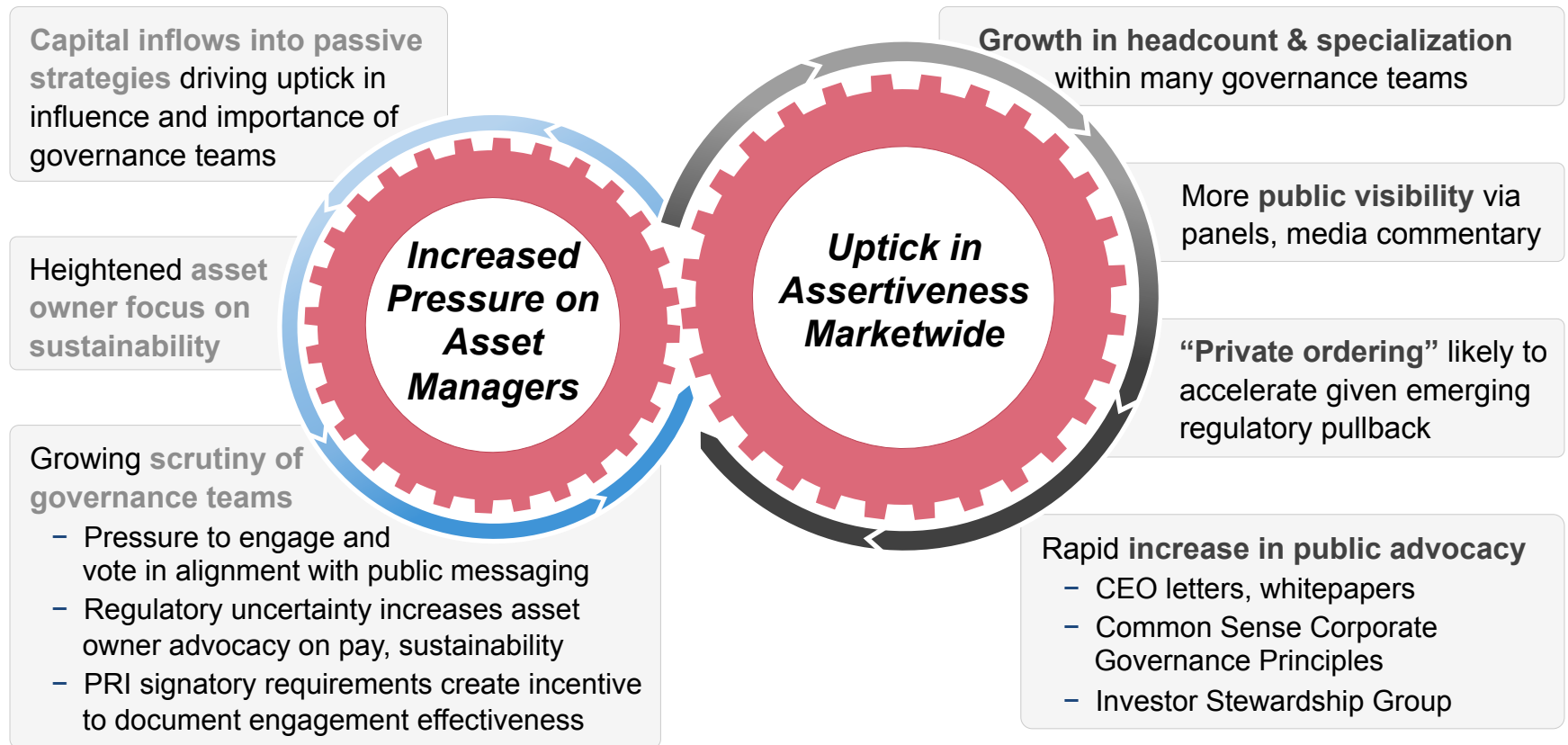
Largest Single Shareholder in:

88%

of S&P 500 companies

Governance Teams are Growing More Assertive

Investors are increasingly vocal on governance, diversity, pay and sustainability



Large Index Funds: In Their Own Words

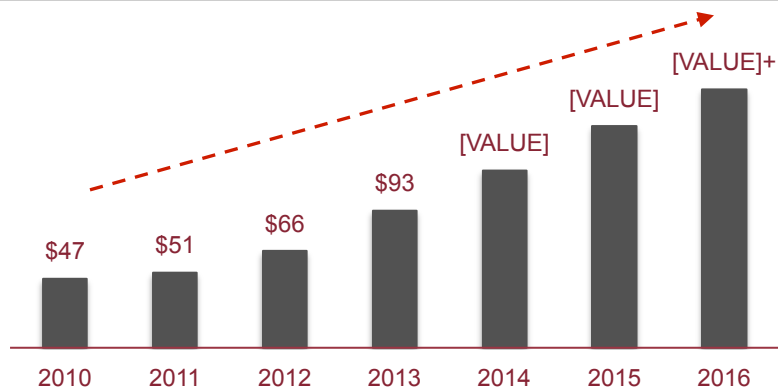
- **Vanguard:** “You can expect us to speak out when we detect threats to our shareholders’ economic interests. For example, you will see us address traditional governance issues such as misaligned executive compensation packages, unequal shareholder voting rights, and ineffective boards. Increasingly, you will also see us take more public positions on select governance topics such as climate risk disclosure and gender diversity on boards.”
- **Blackrock:** “As a significant number of our clients invest through index-based strategies, engagement is an important mechanism to provide feedback or signal concerns about factors affecting long-term performance, absent the option to sell.”
- **SSGA:** “We are encouraged by a growing focus on the long term by our clients and other industry stakeholders in a world filled with short-term pressures. Moreover, we were pleased to help lead key industry initiatives to codify best governance and stewardship practices for the long term.”

Shareholder Activism Overview & Trends

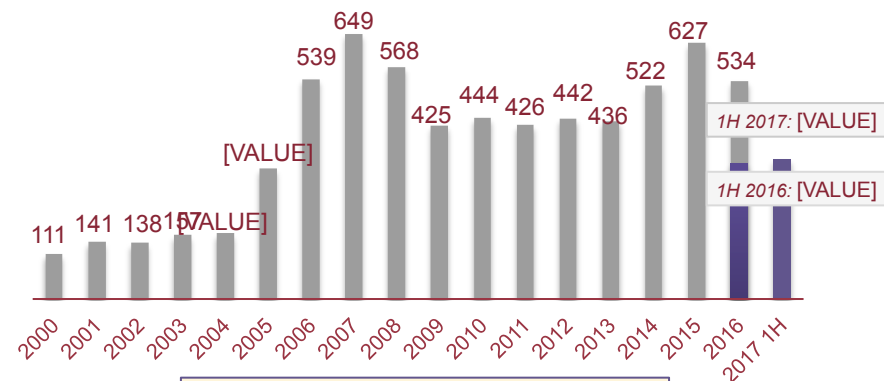
General Activism Observations

- **Activist activity remains elevated:** High success rates fuel continued interest in activist strategies by asset owners
- **Activist fund performance has been mixed:** Hedge funds broadly and activists specifically have had performance challenges over the past two years, although many have at least partially recovered after the 2016 US election
- **More campaigns resulting in board seats and settlements; long-term investors beginning to push back:** Boards are becoming more pragmatic towards activists and have shown an increased willingness to settle; however, unclear if this trend will continue, as some long-term investors are beginning to question whether the activists are representing long-term investors' viewpoints
- **Activist objectives have evolved beyond financial engineering:** Operational activism increasing; coupling economic thesis with governance argument remains key to success
- **Activists have generally outmaneuvered issuers:** Early engagement with governance teams is a central defense against activists, many of whom have cultivated relationships with governance teams
- **Path to victory for issuers is increasingly through the passive funds:** Increased fund flows to passive funds and their willingness to consider arguments from both sides typically results in passive funds representing the swing vote

Funds Dedicated to Activist Strategies (\$B)



of Shareholder Activist Campaigns¹ (U.S. Only)



Director Diversity and Qualifications

- Board diversity has emerged as an area of key focus for many institutional investors and others, with an initial focus on gender
 - New York City Comptroller's Board Accountability Project 2.0
 - BlackRock, SSGA and Vanguard policy changes
 - Letter writing campaigns (e.g., Thirty Percent Coalition)
 - Congressional interest, including letters from Representatives Maloney and Beyer to SEC Chair Clayton regarding required disclosures
- Proposals relating to diversity are increasing in number and support
 - During 2017, 35 board diversity proposals were submitted – 9 reached a vote, receiving 27.5% average support, with 2 passing
 - In contrast, in 2016, 28 board diversity proposals were submitted – 7 reached a vote, receiving 21.1% average support, with 1 passing
 - Companies negotiate withdrawal of diversity proposals by: agreeing to adopt related policies; taking affirmative action prior to the next shareholder meeting; and/or improving disclosure

Two Majority-Supported Diversity Proposals

- During 2017, board diversity proposals passed at Cognex Corporation (62.8%) and Hudson Pacific Properties (84.8%)
 - The proposal at Cognex, which had no women on its board, was submitted by the City of Philadelphia Public Employees Retirement System and requested that the company's board adopt a policy that would require that the initial list of candidates from which new management-supported director nominees are chosen include, but need not be limited to, qualified female candidates
 - The proposal at Hudson Pacific asked the company to prepare a report, at reasonable expense and omitting proprietary information, on steps the company is taking to foster board diversity
 - These companies were largely viewed as recidivists and as being unresponsive to shareholder engagement on diversity issues. Notably, Hudson Pacific added a woman to its board of directors in August 2017
- In contrast, similar proposals at Apple Inc. and Tyson Foods received less than 5% shareholder support

Director Qualifications

- Enhanced Disclosure
 - Investors are seeking enhanced disclosures about the qualifications of the company's board nominees and what expertise they bring to the board table
 - New York Comptroller seeks disclosure of skills and diversity matrix
- Tenure
 - Some investors question whether long-serving directors should continue to be considered independent
 - New Microsoft tenure policy focuses on average tenure of all independent directors, rather than on individual directors
- Board Independence
 - Recent research paper questions whether independence becomes too much of a good thing when boards are left with only one inside director

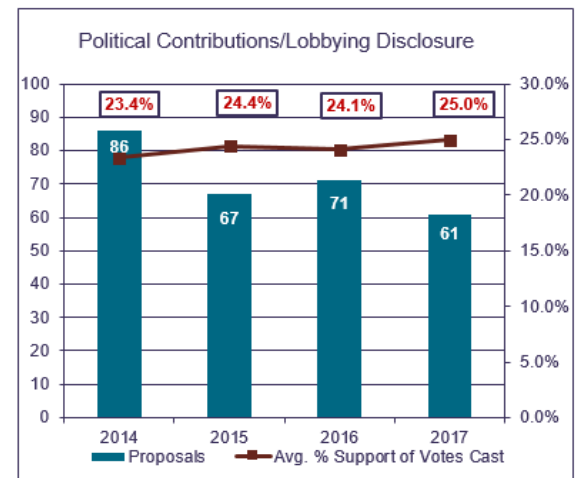
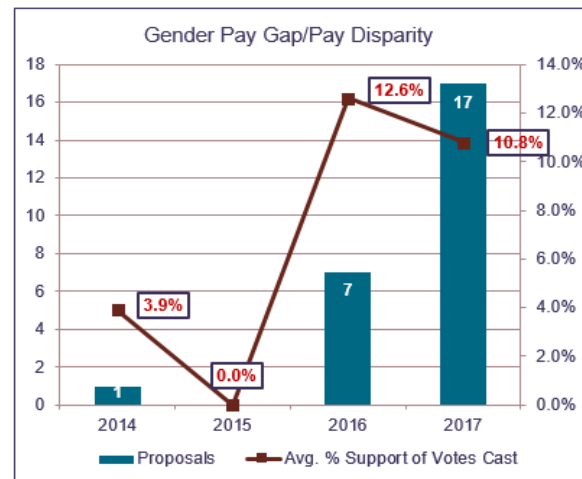
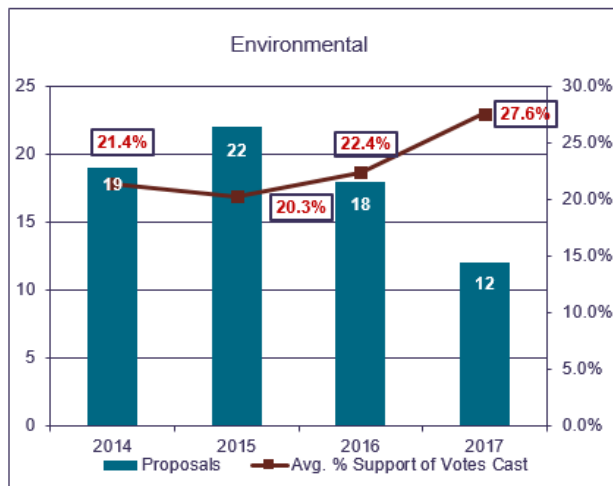
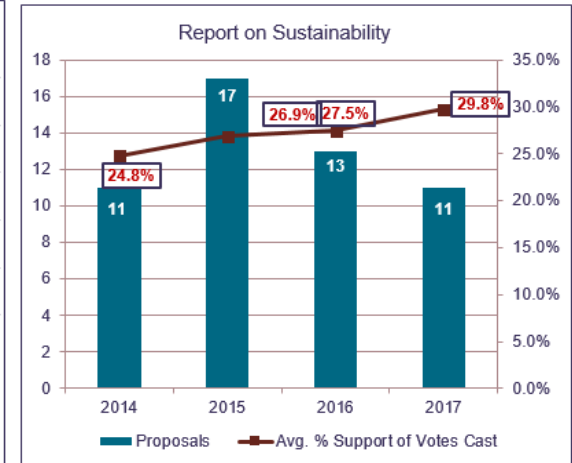
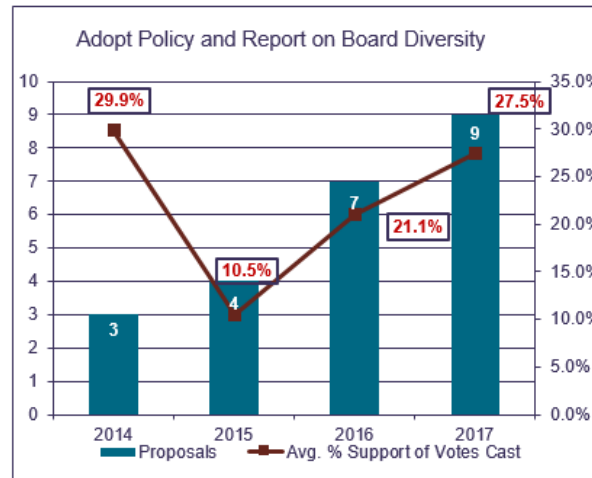
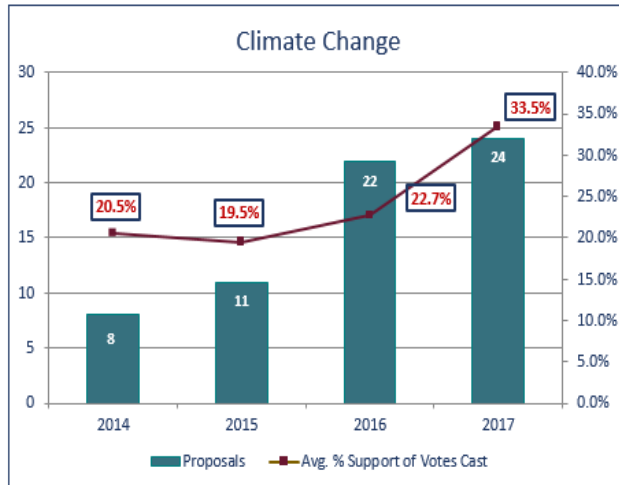
Why Do Investors Vote Against Directors?

- Poor attendance
- Overboarding
- Say-on-Pay issues in prior year(s) not addressed
- Perceived lack of response/shareholder engagement
 - 2017 – Factor in passage of 2 degree Celsius proposals
 - Board diversity
- Perceived lack of board oversight
 - Relating to issues such as financial misstatements, strategy, risk oversight, and events that create a reputational harm

Environmental and Social Issues

- 2017 was a watershed year for E&S initiatives
- Higher support for key environmental and social shareholder proposals, in particular climate change proposals, appears to be driven in part by large institutional investors' modified approach to E&S proposals
 - Perceived failure by companies to engage with investors or take demonstrable action to address investor concerns may drive votes against directors
- ISS voting recommendations on E&S matters had little impact on overall voting results
- “Socially responsible” investors continue to submit the vast majority of environmental proposals
- Environmental and diversity-related proposals must be analyzed on a case-by-case basis
- The topic and terms of E&S proposals will continue to evolve

ESG Shareholder Proposals (Russell 3000)



Climate Change

- Climate change dominated the spotlight this proxy season and was the most prevalent type of environmental proposal
 - At Russell 3000 companies, 24 climate change proposals went to a vote during the first half of 2017, receiving an average of 33.5% shareholder support in 2017 compared to 22 climate change proposals that went to a vote during the first half of 2016, receiving 22.7% average support
 - Notably, 16 of the 24 climate change proposals in 2017 (or 66.7%), received in excess of 30% shareholder support, including 13 proposals that received in excess of 40% support and three winning proposals
- The majority of climate change proposals were submitted at companies in the oil and gas and energy industries
 - Shareholder support for climate change was significantly higher at these companies than at companies in other industries
 - 6 proposals submitted at financial services firms received -less than 10% support

Employment Diversity

- In 2017, seven shareholder proposals relating to employment diversity went to a vote, receiving average support of 28.9%
 - These proposals received strong support across the board, with 4 receiving greater than 30% support and only one receiving less than 25% support

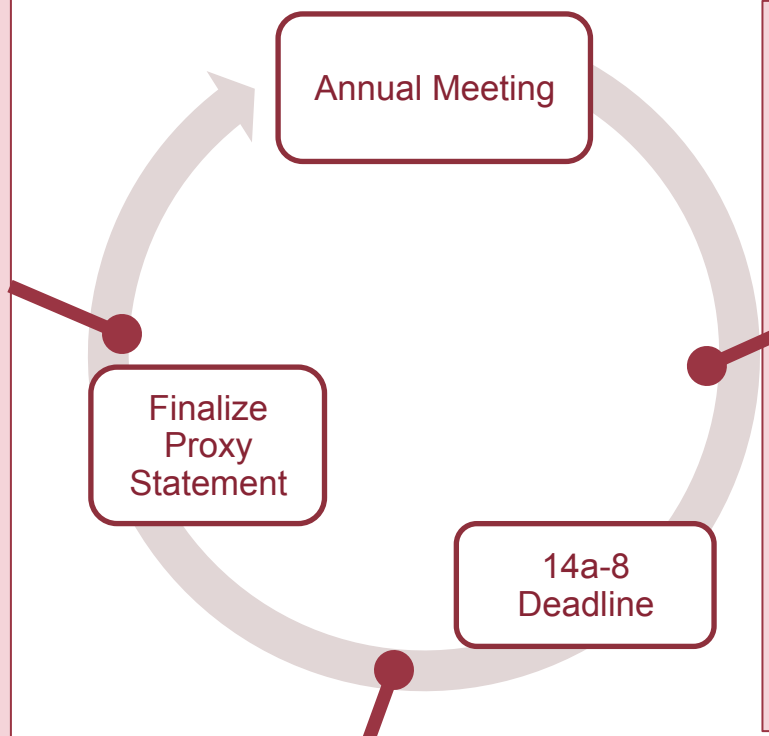
Effective Shareholder Engagement

- Historically, “engagement” consisted of earnings calls, the annual meeting and interactions by the CEO and CFO with portfolio investment managers; other forms of engagement were generally viewed as something companies did reactively and as quietly as possible when they were in trouble
- Today, engagement has become more proactive and widespread
 - Say-on-pay vote requirement (since 2011)
 - Voting policies on responsiveness to shareholder proposals
 - Increased levels of activism
 - Continued high level of activity by governance activists
 - Changing expectations of mainstream institutional investors

Engagement Is Now a Year-Round Process

Active Solicitation

- Engage to secure favorable votes, including follow-up contacts from pre-season meetings as appropriate
- File all written solicitation materials
- Monitor proxy advisory firm recommendations



Post-Meeting

- Review voting results at company, peers and more generally
- Identify any changes in response to votes
- Engage to understand vote outcomes, discuss potential changes and obtain general input on hot topics
- Consider proactive action prior to when 14a-8 proposals start arriving

Pre-Season

- Engage to educate on compensation and governance practices and changes under consideration and to learn what investors view as focus issues for upcoming proxy season
- Negotiate with proponents of any 14a-8 proposals

Questions for Boards to Consider

- How does the board stay informed about their largest shareholders' priorities for engagement and governance philosophies? Are we falling short of their expectations?
- How is the board making sure that director qualifications align with the company's long-term strategy and key risks? What about diversity? How can we best communicate this to investors?
- For less diverse boards, what are we doing to change that? How best can we communicate that message to investors?
- Are environmental and social considerations integrated into the company's long-term strategy—and is the company communicating that to investors?
- Is our proxy statement used as productively as it can be to deliver our key messages to investors?

Other Governance Developments

Krystal Gaboury Berrini, Camberview

Anne Meyer, Georgeson

Knute Salhus, WilmerHale



Special Governance Considerations for Smaller and Recently Public Companies

	IPO	R2000	S&P 500
Have a classified board of directors	77%	51%	10%
Have plurality voting standard for election of directors	Most	68%	9%
Have any supermajority vote standard	76%	61%	39%
Prohibit shareholders from calling special meetings	93%	53%	37%

- ISS now routinely recommends against the re-election of directors who, prior to an IPO, approved provisions considered adverse to shareholder rights
- Shareholder proposals are primarily, but not exclusively, submitted to S&P 500 companies
 - For smaller companies, changes are more often prompted by investor outreach and letters from institutional investors

Voting Standard in Uncontested Elections

- Many mid- and small-cap companies are being approached by institutional investors urging that the company alter its voting standard for electing directors in an uncontested election

Plurality

Whoever gets the most votes is elected

In an uncontested election, the company's nominees get elected no matter how few votes they receive

Default outcome under Delaware law

Plurality Plus

Retains plurality standard, but provides that any director who receives more "withhold" votes than "for" votes must offer to resign

Board follows process to determine whether to accept resignation

Majority

Changes standard in bylaw so nominee is only elected if he/she receives more votes "for" than "against"

An incumbent who receives more "against" votes is a "holdover director" and must offer to resign

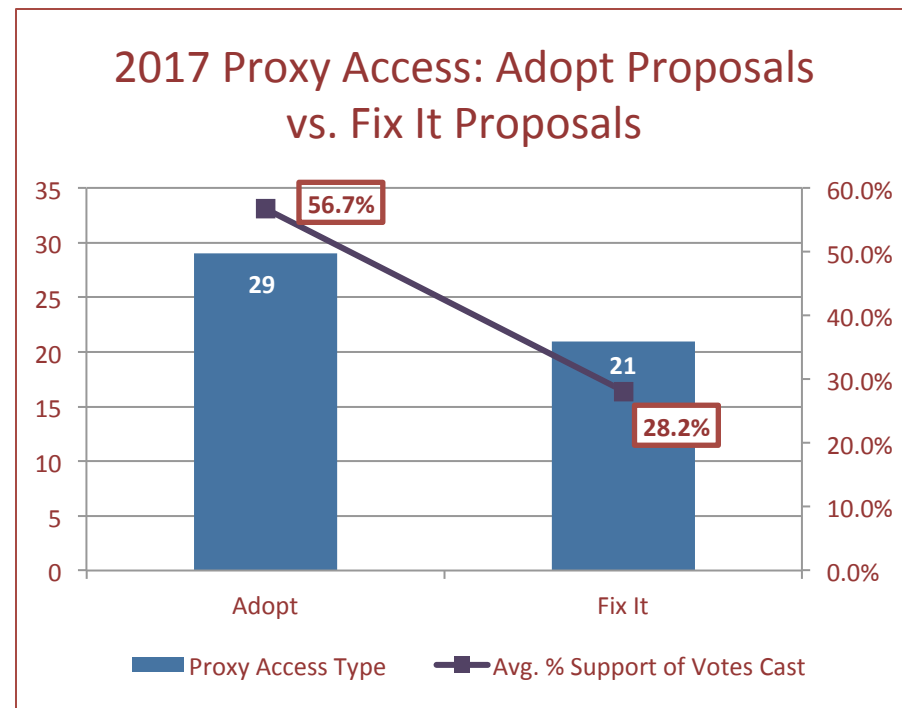
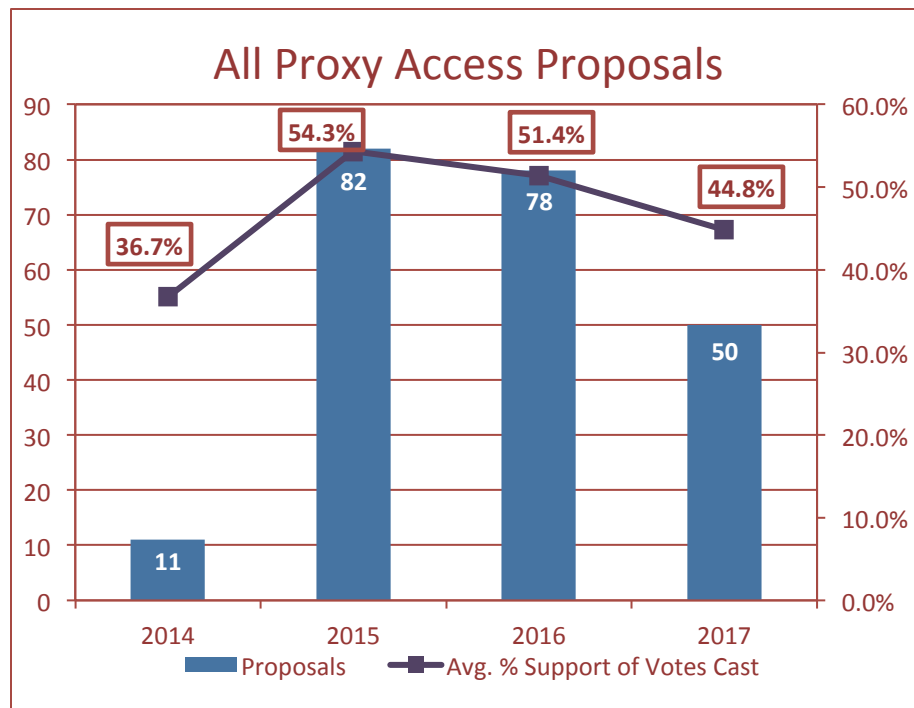
Board follows process to determine whether to accept holdover's resignation; but some investors have begun to seek "consequential majority voting," which takes away the Board's discretion

Plurality standard applies in a contested election

Proxy Access

- Over 60% of S&P 500 had adopted proxy access bylaws as of end of the 2017 proxy season, up from less than 1% in 2014
 - Most provisions adhere to 3/3/20/20 market norm
- Two types of proposals in 2017 proxy season
 - “Please adopt” proposals
 - Staff generally grants substantial implementation no-action relief where company adopts a “market” bylaw
 - Majority of proposals pass when taken to a shareholder vote
 - “Fix-it” proposals
 - Request one or more changes to an existing bylaw (e.g., to increase or eliminate the aggregation limit and/or to increase the percentage of the board subject to proxy access from 20% to 25%)
 - Generally not excludable on substantial implementation basis absent amendments to company bylaws, except in the case of proposals to increase the aggregation limit to a specified number (40 or 50) where companies provide detailed shareholder ownership data illustrating usability of proxy access bylaw
 - Have not passed to date when taken to a shareholder vote

Proxy Access Shareholder Proposals Russell 3000 (2017 Meetings through 8/31/17)



2017 proposals = 18 passed, 32 failed

- “Adopt” proxy access proposals = 18 passed, 11 failed
- “Fix It” proxy access proposals = 0 passed, 21 failed

2016 proposals = 41 passed, 37 failed

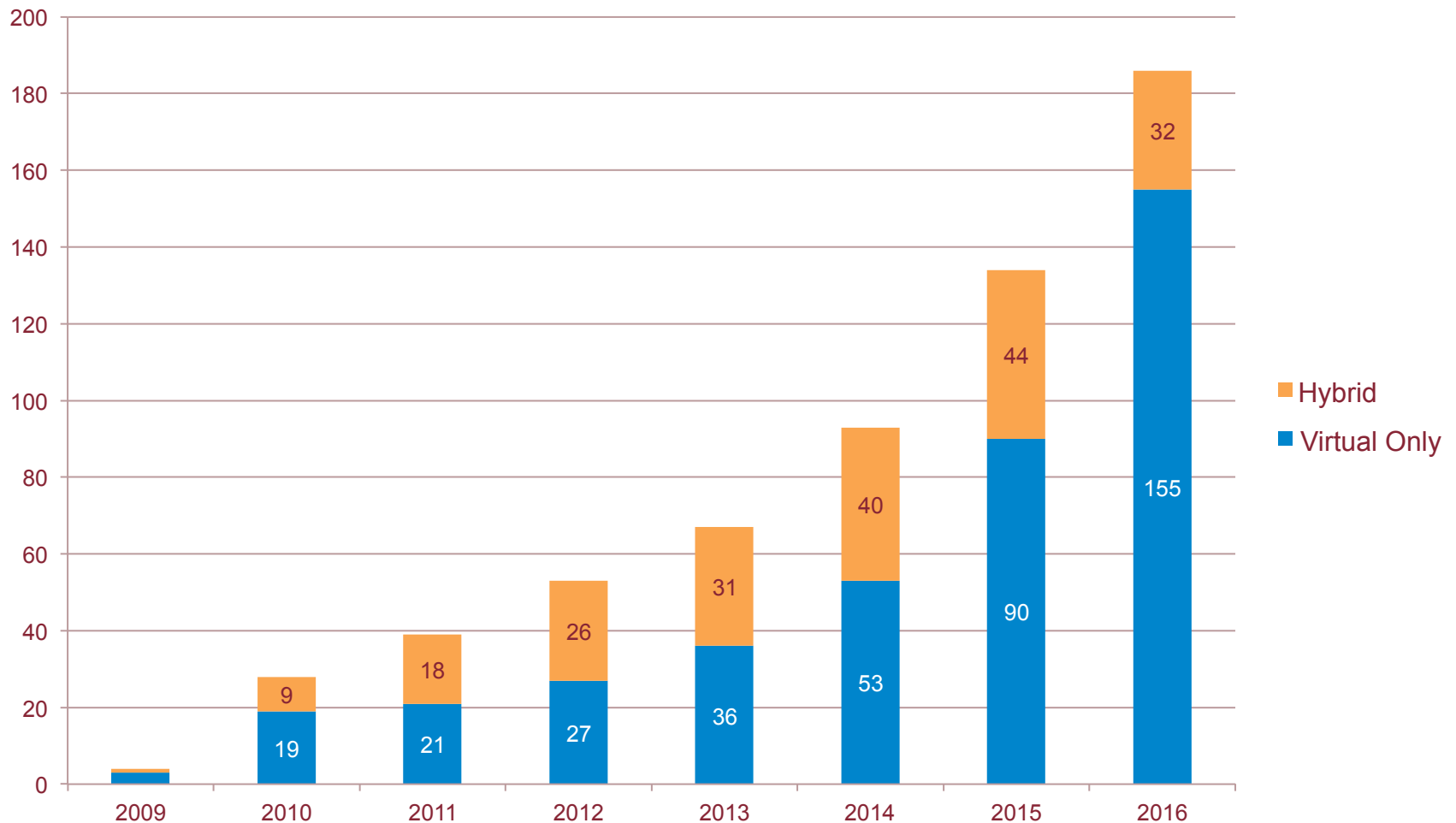
2015 proposals = 48 passed, 34 failed

2014 proposals = 4 passed, 7 failed

Virtual-Only Shareholder Meetings

- Increasing numbers of companies are moving to “virtual-only” shareholder meetings
 - 5% of S&P 500 companies held such meetings during 2017 proxy season, up from 3% in 2016
 - Generally audio-only format, with questions submitted by shareholders in advance of and/or during the meeting
- Many shareholders are concerned about this trend
 - Believe virtual-only meetings deny shareholders the ability to engage with company leadership in person
 - New York City Comptroller letter writing campaign and new proxy voting guidelines opposing virtual-only meetings
 - Small number of proposals submitted in 2017 proxy season, none of which went to a vote (excludable as “ordinary business”)

Virtual-Only Shareholder Meetings



Source: Broadridge Financial Solutions, Inc.

Multiple-Share-Class Structures

- In response to Snap's IPO of only non-voting shares, several institutional investors have more strongly voiced their preference for a "one share, one vote" model
- A number of indexes have recently announced changes in their inclusion criteria
 - S&P 500, 600 and 400: Will no longer add companies with multi-class structures; existing constituents are permanently grandfathered
 - FTSE Russell: Companies will be required to have greater than 5% of voting rights held by the public; 5 year grandfather period for existing constituents
- Nasdaq has stated its continued willingness to list companies with multiple-class structures

Shareholder Proposals

- Number of shareholder proposals down overall in 2017 proxy season – approximately 827 versus 916 in 2016
- Developments to watch
 - New willingness of SEC staff to allow exclusion under ordinary business on basis of “micromanagement”
 - Efforts to reform the shareholder proposal rule
 - The CHOICE Act would change the requirement for a proponent to hold 1% or \$2,000 in company shares for one year to 1% for 3 years, as well as raise the resubmission thresholds and eliminate the ability of persons to act as “proxies” for shareholders (which would limit John Chevedden’s ability to submit proposals)
 - Statements of SEC Chair Clayton suggest willingness to revisit Rule 14a-8
- New and/or notable topics include lead exposure, minimum wage and religious freedom (framed as “non-discrimination proposals”)
- New Staff Legal Bulletin expected shortly

ISS Policy Survey Focus Areas

- Governance Principles Survey – high-profile governance issues
 - One-Share, One-Vote Principle
 - Gender Diversity on Boards
 - Share Issuance and Buyback Proposals
 - Virtual/Hybrid Meetings
 - Pay Ratio between Senior Executives and Employees
- Policy Application Survey – more in-depth drill down of key issues
 - Outcomes-based Compensation Measures
 - Non-Employee Director Pay
 - Gender Pay Gap
 - Poison Pills

Key Takeaways and Action Items

Jonathan Wolfman, WilmerHale



Action Items

- Get ready to provide pay ratio disclosure
- Prune your exhibit list — candidates for deletion include:
 - Agreements not in the ordinary course of business that were entered into more than two years before the filing and which are no longer material (including because they have been fully performed)
 - Ordinary course agreements upon which the company is no longer “substantially dependent” in light of growth or changes in its business
 - Compensation plans that are not relevant to the last completed fiscal year or future compensation
 - Compensatory agreements for former named executive officers who were not NEOs as of the end of the fiscal year being reported in Form 10-K and who are not expected to be NEOs for the current fiscal year
 - Compensatory agreements with executive officers who are not NEOs where the agreements are immaterial in amount and significance
 - Acquisition agreements once the acquisition is no longer required to be discussed in the financial statements or MD&A
- Alert CFO to possibility of SEC Staff calling with oral comments

Action Items

- Evaluate whether to file a new shelf S-3 prior to your first 10-Q reporting on the basis of the new revenue recognition rule
- Consider providing enhanced voluntary disclosure about:
 - Long-term business strategy
 - Qualifications and diversity of your directors
 - Relationship of compensation programs to long-term strategy
 - Risk oversight
 - Sustainability and other social issues
 - Succession planning
 - Board evaluation processes
 - Audit committee oversight of independent auditor
- Update disclosure controls and procedures to address non-GAAP measures, performance metrics and pay ratio disclosures

Questions?

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