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Comp Talks: The Latest re CD&A Disclosure

January 24, 2017

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Moderated by Amy Wood, Cooley

What Are We Talking About?

- Lessons from 2016 & outlook for 2017
- Hot topics
- Avoiding common pitfalls
- Addressing institutional investors' expectations and maximizing proxy advisory firm reactions
- Dodd-Frank Act SEC Rulemaking Update
- Other important (non-CD&A) compensation considerations for 2017 proxies

Lessons from 2016 & Outlook for 2017

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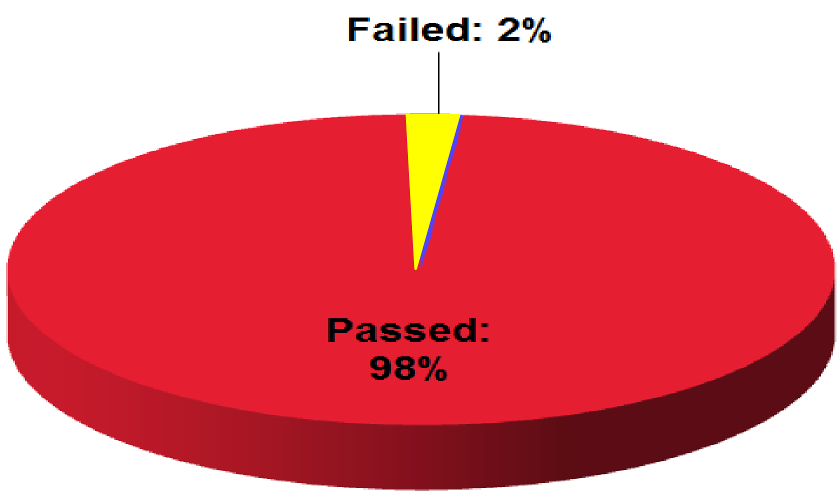
What Did We See in 2016?

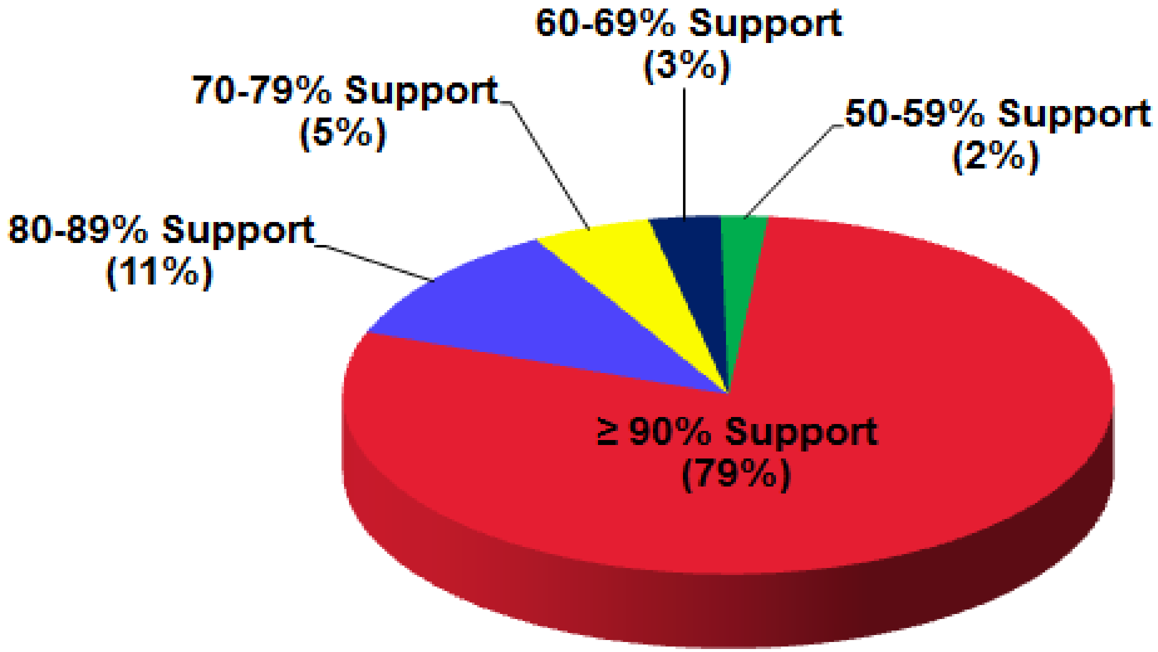
- Similar say on pay statistics to previous years
  - ISS recommended “for” roughly 89% of proposals
  - Successful vote does not guarantee success in following year
- (Even) more engagement and related disclosure
- Pay for performance disconnect was principal driver of votes against SOP
- Weak say on pay can result in weak support for board members

What Did We See in 2016?

Results of All SOP Proposals



Results of "Passed" SOP Proposals

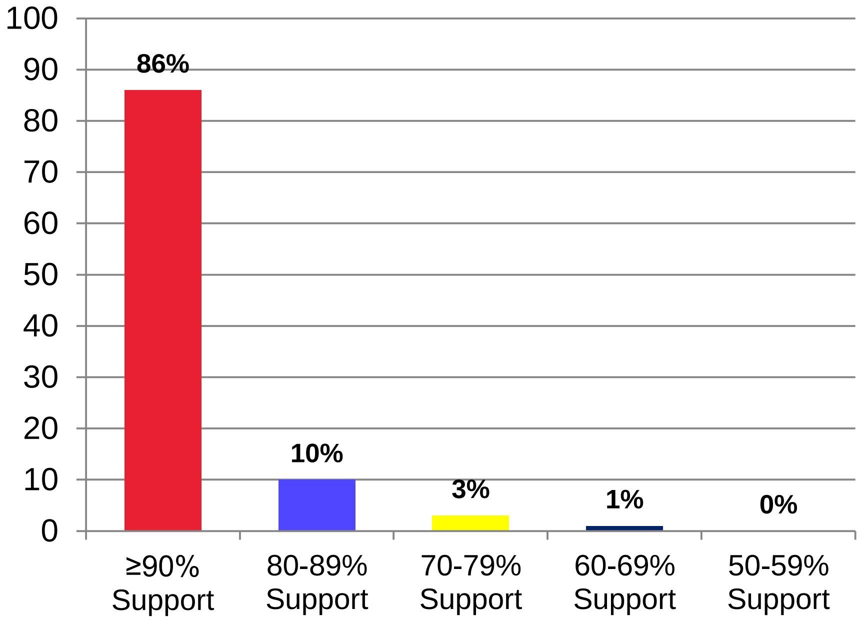


Data based on results from 1,972 meetings reported as of August 29, 2016; source: ISS Voting Analytics database

Results of 2016 Passed Say-on-Pay Proposals Following...

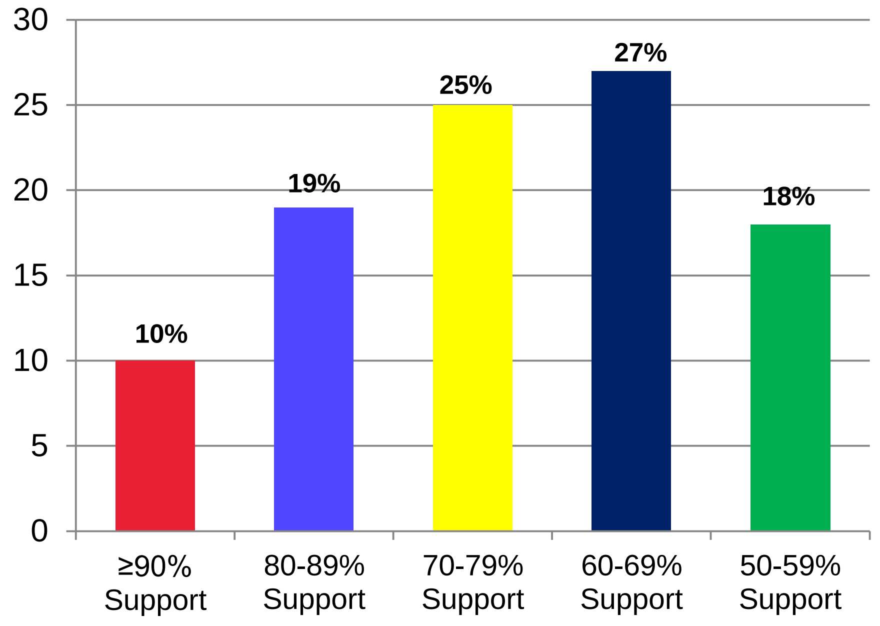
Positive ISS Recommendation

95% average support



Negative ISS Recommendation

72% average support



Data based on results from 1,972 meetings reported as of August 29, 2016; source: ISS Voting Analytics database

What Do We Expect for 2017?

- Continued pay-for-performance focus
- Further design enhancements and highlights
- Continued increase in engagement and disclosure
- Focus on peer groups, incentives and performance goals
- Say on frequency votes

Hot Topics

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Pay for Performance

- Voluntary disclosure of how pay is linked to company performance
  - Equilar: 95.7% of S&P 500 companies included disclosure in 2016 (largest year over year change)
  - The “performance” measure varies, as does how “compensation” is reported
  - SEC proposed rules – disclosure may be required in the future (not for 2017 proxy season)

Practice Tips:

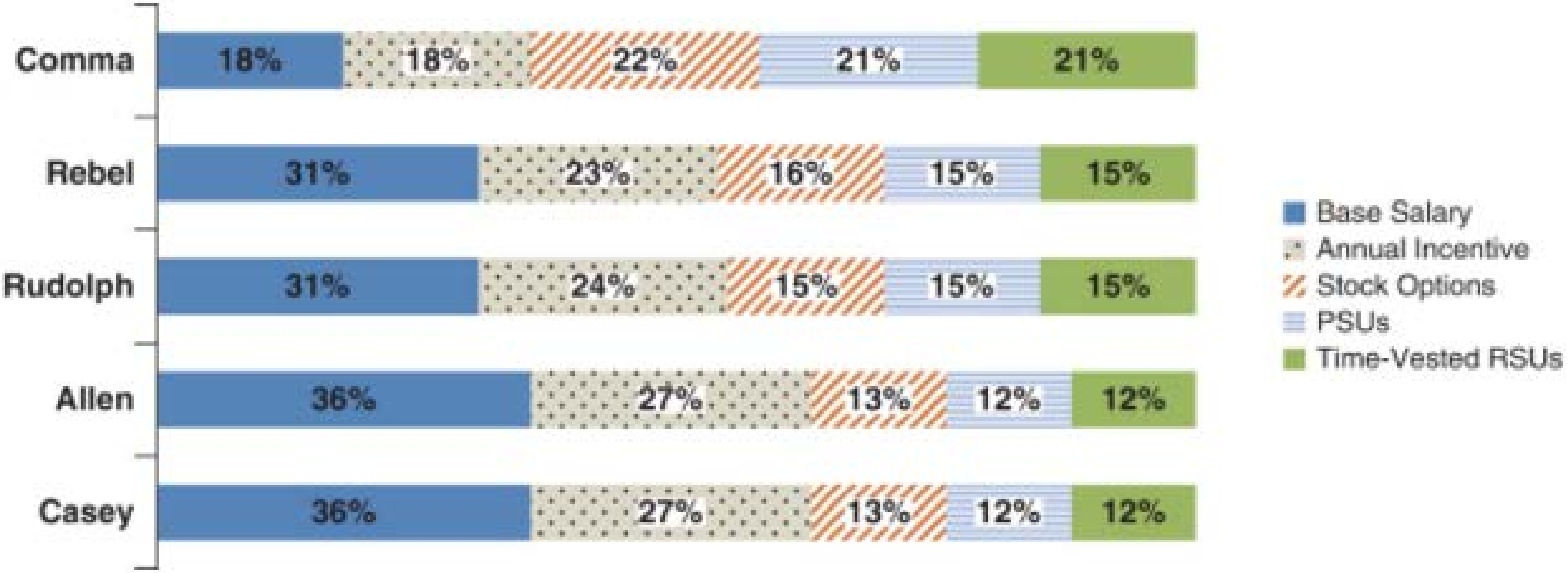
- No one size fits all (despite proposed SEC rules)
- Don’t let the tail wag the dog – beware of changes from year to year
- Avoid perception of “pay for failure” – address head on

Pay for Performance – Disclosure Example
Jack in the Box

[1] The graph above shows the cumulative return to holders of the Company's Common Stock at September 30th of each year assuming $100 was invested on September 30, 2010, and assumes reinvestment of dividends. The Company paid dividends beginning in fiscal 2014.

Jack in the Box – "At-Risk" Pay Disclosure

Fiscal 2015 Targeted Total Direct Compensation Mix.
The chart below shows the percentage breakdown of targeted total direct compensation ("TDC") (consisting of base salary, target annual incentive, and target long-term incentive) for each NEO in fiscal 2015. Consistent with our objective of pay for performance alignment (described in Section II of this CD&A), the largest portion of compensation is variable, at-risk pay in the form of annual and long-term incentives (including annual incentive, stock options and performance share units). In fiscal 2015, 61% of our CEO's pay was at risk, and 52%-54% of pay for our other NEOs.



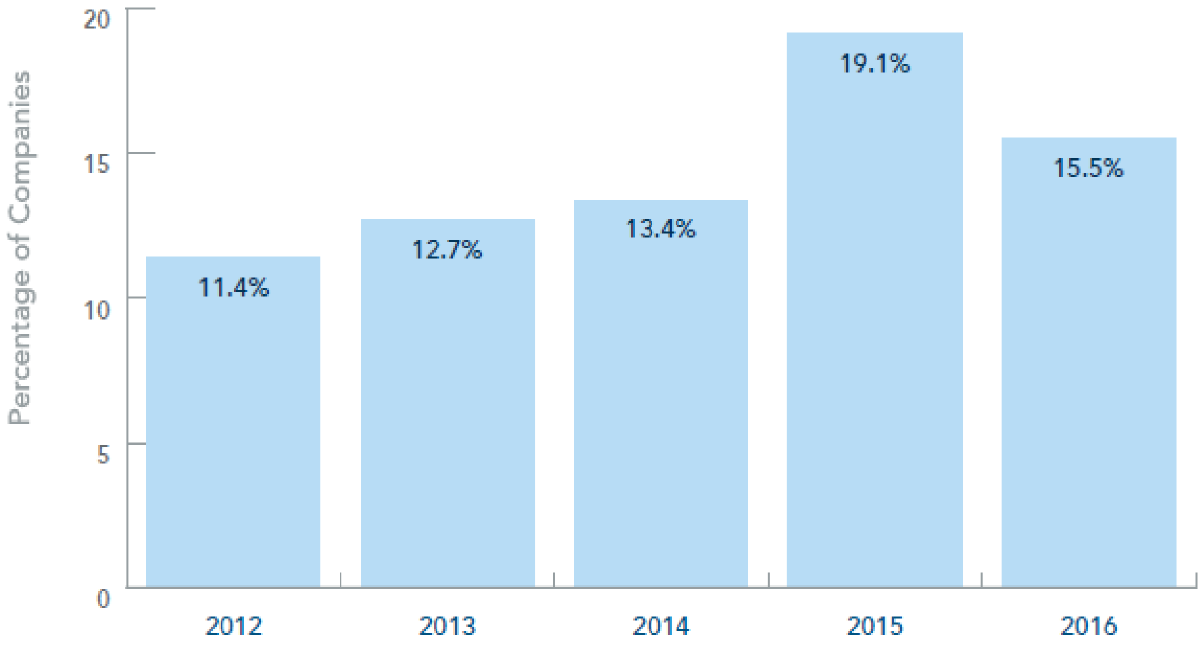
Pay for Performance – ISS Policy Change

- ISS is incorporating *additional financial measures* to supplement its legacy (and continued) use of TSR when assessing the alignment of CEO pay with company performance
- The new metrics and weightings vary based on each company's GICS industry group
  - Metrics may include relative evaluations of return on equity, return on invested capital, revenue growth, EBITDA growth and free cash flow from operations growth
- The new financial performance assessment is ***not*** part of ISS' ***quantitative*** pay-for-performance screen in 2017, but it will be considered in the ***qualitative*** analysis and may mitigate or heighten concerns identified in the quantitative screens

Alternative Pay Disclosure

- Company's opportunity to disclose "value" of what is paid
- Varying definitions of pay
  - Summary Comp Table pay
  - Realizable pay
  - Realized pay
  - Proposed SEC rules on "Compensation Actually Paid"
- Standardization versus flexibility

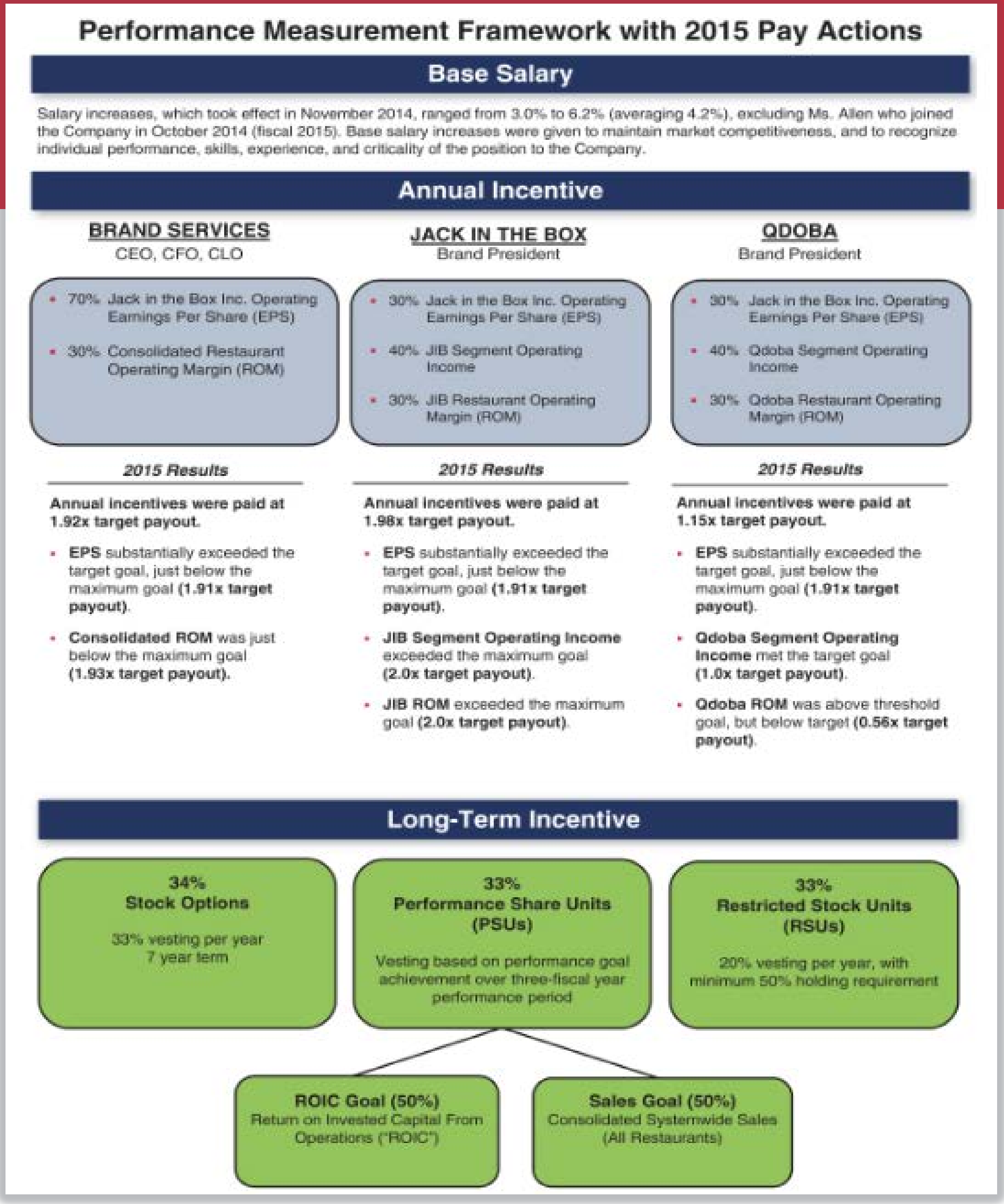
Equilar: S&P 500 Realized Pay Disclosure



Practice tips:
- ➢ Find the right measure that makes sense for you
- ➢ Explain the definitions used

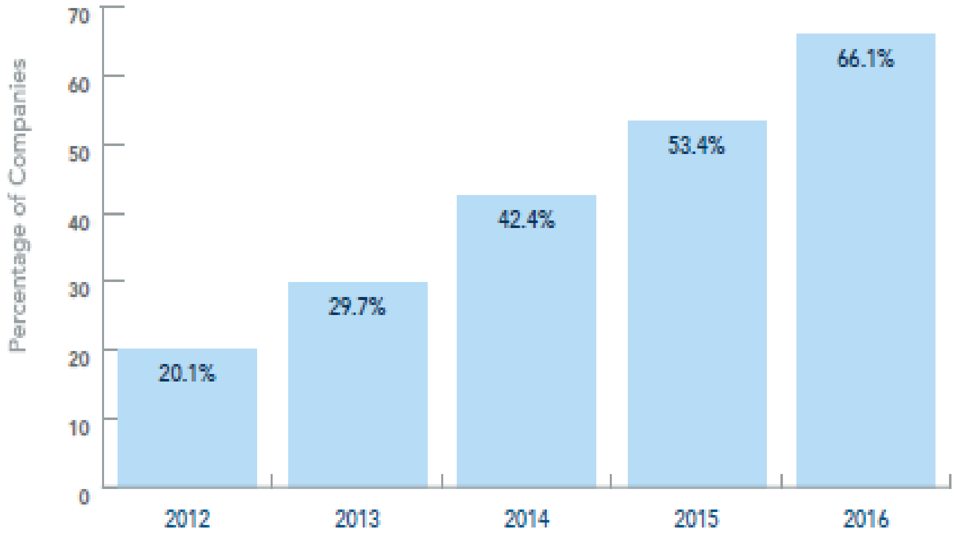
Design Enhancements

- CD&A table of contents / “quick reference guide”
- Proxy/CD&A summary
- Headers (bigger, brighter)
- Lists of positive practices (what we do, what we
  don’t do)
- Reduce narrative, increase charts, graphs and bullets

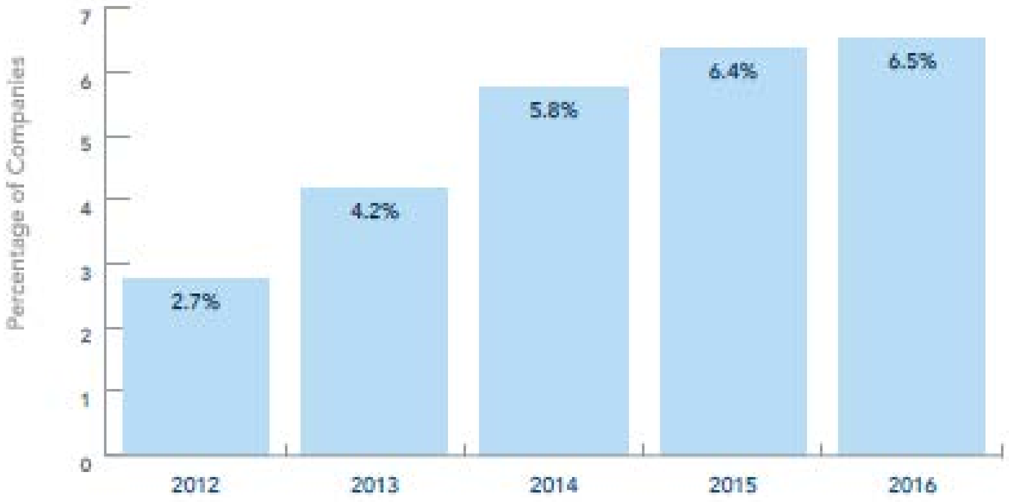


Engagement

Equilar: S&P 500 Shareholder Engagement Disclosure



Equilar: S&P 500 Proxy Advisor Engagement Disclosure



Practice tips for disclosure of engagement:

- Acknowledge past results
- Include scope of outreach and outcome of efforts
- Summarize investors' common concerns and how addressed (or why not)
- Consider describing general engagement process (if applicable)

Other Hot Topics

- Peer companies
- Short term incentive plan/bonus disclosure
- Performance metrics (rigor, disclosure, changes)
- Continued adoption of “risk mitigators” (stock ownership guidelines, holding periods, clawbacks)

Practice tips:

- Think carefully about each of these topics and consider how your disclosure could be improved
- Explain your rationale
- Don’t be reliant on past practice or lack of historical scrutiny
- Be mindful of possible future changes in practice

Avoiding Common Pitfalls

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What Can Go Wrong?

- Not starting early enough, not being organized
  - Review last year’s CD&A, remember prior commitments
  - Ensure appropriate records and personnel are available
  - Prepare a timeline and allocation or responsibility
  - Much can be written ahead of time
- Failing to explain the “why”
- More is not better
  - Avoid layering onto prior disclosure year after year; consider more efficient disclosure
- Trying to fit into the box
  - Many companies use a similar “format” and/or feel constrained to use the same format every year; consider the right format for disclosing these pay decisions, which may differ from year to year

Addressing Institutional Investors’ Expectations and Maximizing Proxy Advisory Firm Reactions

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Institutional Investors

- Understand what influences their votes and highlight/address head on
- Maximize proxy advisory firm reactions – understand their policies, proactively address anticipated issues, engage in the off season
- Beware of pet peeves – problematic practices, lack of transparency, boilerplate disclosure
- Consider proactive and reactive supplemental filings

Institutional Investors – “Hot-Button” Compensation Issues

- Pay-for-performance misalignment
- Problematic pay practices (*e.g*., gross ups, single trigger CIC payments, stock option repricing without shareholder approval)
- Discretionary bonuses/adjustments to performance metrics
- Lack of disclosure of performance metrics
- Lack of responsiveness to a low say on pay in prior year
- Lack of performance-vesting awards
- Above-median benchmarking without justifiable link to above-median performance and/or against aspirational peer group

Dodd-Frank Act SEC Rulemaking Update

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SEC Rulemaking – Dodd-Frank Act
Impact on CD&A

- Say on pay & frequency of say on pay (adopted/effective)
- Say on parachutes (adopted/effective)
- Compensation committee independence (adopted/effective)
- Compensation committee consultants/advisors (adopted/effective)
- **Pay ratio (adopted/effective for most 2018 proxies covering 2017 compensation)**
- **Pay versus performance (proposed rules; comment period closed)**
- **Clawback policy (proposed rules; comment period closed)**

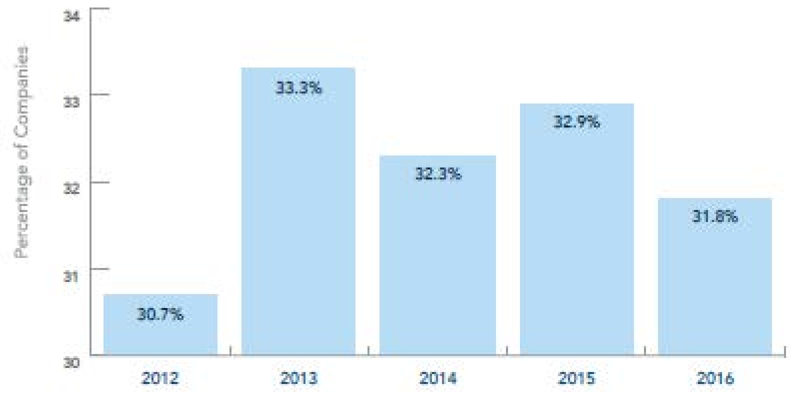
Pay Ratio

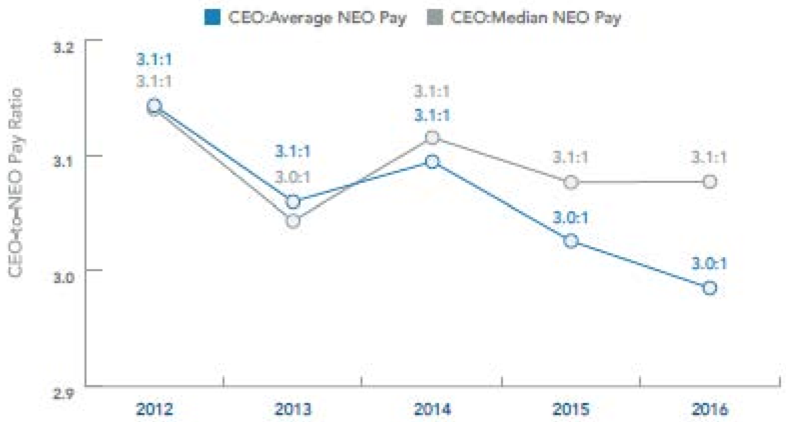
- Requires disclosure of:
  - the median of the annual total compensation of all employees of the company, except the CEO (that is, the point at which half the employees earn more and half earn less);
  - the annual total compensation of the CEO; and
  - the ratio of the two amounts above
- SEC adopted final rules August 5, 2015
- Disclosure <u>not</u> required in 2017 proxy statement
- Must disclose pay ratio for 2017 in 2018 proxy statement

Pay Ratio

- Few companies voluntarily disclosed CEO pay ratios in 2016 (one S&P 500 company)
- Equilar: in 2016, 30%+ of S&P 500 companies disclosed that they considered internal pay equity when designing pay packages

Equilar: S&P 500 Internal Pay Equity Disclosure





Pay Versus Performance

- Requires disclosure of the relationship between "compensation actually paid" and "company financial performance"
- "Compensation actually paid" relies on the measure of total compensation in the SCT, but with two adjustments to the amounts included for pension benefits and equity awards (shown for CEO and as an average for other NEOs)
- "Company financial performance" is TSR (new table must also show peer group TSR)
- SEC proposed rules April 2015
- Comment period closed July 2015
- <u>Not</u> required for 2017 proxy season

Clawback Policies

- The policy must provide that the company will recover from:
  - any current or former executive officer
  - an amount of incentive-based compensation
  - equal to the excess, if any, of the amount that was paid to the executive officer, in the three years preceding the date on which the company was required to prepare the restatement, over the amount that would have been paid to the executive officer based on the accurate financial data
- SEC proposed rules July 2015
- Comment period closed September 2015
- <u>Not</u> required for 2017 proxy season

Other Important Compensation Items for 2017 Proxies

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Other Important (Non-CD&A) Compensation Considerations for 2017 Proxy

- Director Compensation
  - Evaluation and disclosure of compensation practices
  - Litigation and “reasonable” limits on cash and equity compensation
- Equity Plan Proposals
  - Changes in ISS policy for general equity plan proposals, 162(m) proposals and director plan proposals
  - Expectation to go beyond the SEC requirements for proxy proposal disclosure