NATIONAL DIRECTORS INSTITUTE

NDI Checkpoint Web Conference

2018 Proxy Season Preview

December 12, 2017

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Today's Presenters

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Peter Kimball
ISS Corporate Solutions
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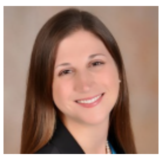

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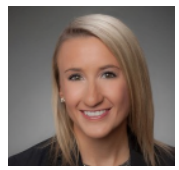

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Governance Trends from 2017 Proxy Season

Governance Themes from the 2017 U.S. Proxy Season

1. Shareholder proposals seeking more disclosure on **climate change** preparedness fared well in 2017, and three such proposals—at Exxon Mobil, Occidental, and PPL Corporation—received majority shareholder support.
2. The 2017 proxy season saw a spike in the number of **directors receiving low levels of support** from shareholders; 102 directors at S&P 500 companies, or 2.4 percent, received less than 80 percent shareholder support during proxy season, the highest figure since 2011 and a substantial increase from 57, or 1.3 percent, during the 2016 proxy season.
3. As in 2015 and 2016, **proxy access proposals** topped the chart of the most commonly filed shareholder proposals, and most of the proposals that went to a vote received majority support.
4. Taken as a group, **political contributions and lobbying proposals** were the second most frequently filed shareholder proposals in 2017, and saw a slight uptick in support from 2016.
5. Shareholder rights continue to receive focus. One example is companies' steady march from plurality vote standards in uncontested director elections to **majority vote standards**.

Shareholder Proposal Trends

2017 Top Shareholder Proposals Submitted

Source: D.F. King

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2017 Shareholder Proposal Trend: Decline in Traditional Governance Proposals

Proposal Types

- De-staggering the board, adopting majority voting in uncontested director elections, eliminating supermajority provisions, adopting special meeting rights.

Why?

- As best practices become more widely adopted, there are fewer large companies that have yet to adopt these provisions already. Smaller companies are following suit.

What This Means for Issuers:

- The focus shifts elsewhere (ESG, compensation, etc.), and companies that have not adopted governance best practices find it harder to provide effective rationale to investors.

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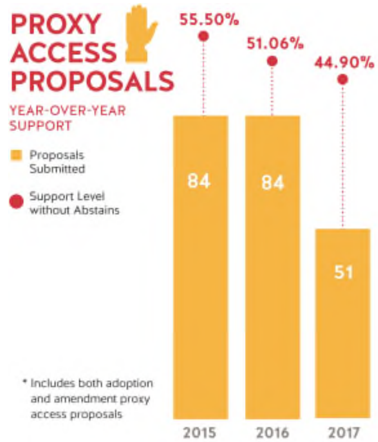
2017 Shareholder Proposals-Proxy Access Update

- Although over 100 proposals were filed, less than half went to a vote in 2017.
- 2017 marked a shift in type of proxy access proposal filed; almost 50% of proposals that went to a vote sought to ***amend*** pre-existing provisions (aggregation limits were typically targeted).
- Most amendment ('fix-it') proposals filed did not make it to a vote and were omitted. SEC staff has generally agreed with companies that they can exclude proposals based on substantial implementation, provided that the no-action request demonstrates how existing aggregation limits can achieve meaningful proxy access right.
- Over half of the S&P 500 have now adopted proxy access. Most bylaws follow the established 3/3/20/20 market practice.
- Momentum has now waned for this topic, and the focus shifts. Example: Board Accountability Project v. 2.0



Source: D.F. King

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New York City Comptroller's Board Accountability Project 2.0

- This summer, the Comptroller sent letters to 151 companies that it had targeted for proxy access in the past three years.
- The letters seek public disclosure of a company's board refreshment process and of a specific Board Matrix presenting certain boardroom characteristics:
  - Skills
  - Race
  - Gender
- The Comptroller's office may also seek dialog with nominating committee members at these companies.
- There is no specific targeting of companies in this process, other than that they enacted proxy access previously or received majority support for a proxy access proposal.

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2017 Shareholder Proposals: Environmental & Social Issues

Scope

- Over 40% of all proposals submitted were related to E&S; record number of filings for this category.
- A number of institutions have updated voting guidelines reinforcing this shift toward increased focus.
- Certain proposal types have received large spike in shareholder support. Climate change and board diversity attract increasing support and attention.

Why?

- As the current administration decreases environmental regulations, investors have increased their focus in this regard, calling for an increase in reporting.
- The newer generation of decision-makers at institutions are increasingly socially and environmentally-minded, and this is being reflected in this shift in focus.

Outlook for 2018:

- Investors are increasingly interested in learning about what boards are doing regarding these initiatives. As engagement season approaches, we recommend keeping boards informed and prepared to answer questions on board diversity, skillsets, environmental reporting, pay disparity and various industry-specific topics in this regard.
- Because there likely will not be a near-term rule making decision on climate change by the government, investors are increasingly focused on voluntary environmental reporting.

Environmental Proposals: Focus on Climate Change

- Notably, almost every large asset manager is now a signatory to the United Nations-supported Principles for Responsible Investment (PRI), which requires investors to incorporate sustainability into their investment practices.
- Shareholder proposals regarding climate change are becoming more nuanced & targeted toward specific industries and companies; this has led to a shift in 2017 to where long-term, governance-focused investors are now backing calls for increased disclosure around climate change.
- European companies & investors have long been proponents of increased sustainability reporting; according to a survey conducted by NIRI, 69 percent of non-U.S.-based IR professionals said that sustainability issues are either permanently or temporarily on their top management's agenda compared with 39 percent of U.S.-based IR respondents. As investor bases broaden, we expect this increased interest in voluntary reporting to further influence U.S. markets.
- Climate change proposals won majority support at three major energy companies during the spring 2017. The proposals requested companies to issue a report providing a 2-degree scenario analysis, a term that refers to the goal of the Paris Climate Accord of limiting global temperature increases to 2 degrees Celsius (3.6 degrees Fahrenheit). The report would assess the impact on the company's asset portfolio of long-term climate change.
- Success of these proposals is at least in part due to the shift in approach towards environmental proposals by certain institutional investors, including BlackRock, Vanguard and Fidelity.
- In light of the Trump administration's recent decision to withdraw the United States from the Paris Climate Agreement, Mindy Lubber, CEO and president of Ceres, a nonprofit sustainability advocacy organization, said in a statement, "In the face of the Trump administration's failure to lead on climate change at the national level, the business community will not back down. Investors and companies will redouble efforts to support and invest in solutions that will accelerate the transition to a sustainable, low-carbon economy."

Contrasting Definitions of Materiality

- **Global Reporting Initiative (GRI)**
  - Multi-stakeholder driven, stakeholder engagement, stakeholder-inclusive materiality process
- **Sustainability Accounting Standards Board (SASB)**
  - Investor driven industry specific using the SEC's definition of materiality
- **International Integrated Reporting Council (IIRC)**
  - Six capitals financial, manufactured, intellectual, human, social & relationship, and natural
- **RobecoSAM Corporate Sustainability Assessment (CSA, DJSI)**
  - Be-spoke materiality through 'weightings' of ESG criteria in the assessment for DJSI
- **CDP (formerly known as Carbon Disclosure Project)**
  - Focused on deep dives on particular issues (climate, water, forest, supply chain)

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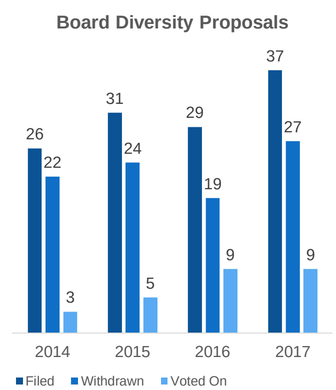
Board Diversity



Two proposals passed, receiving well above majority support

Diversity continues to make headlines

No women on the board? Companies warned they could face gender quotas

These eight major companies have no women on the board

Groups focused on increasing gender diversity:

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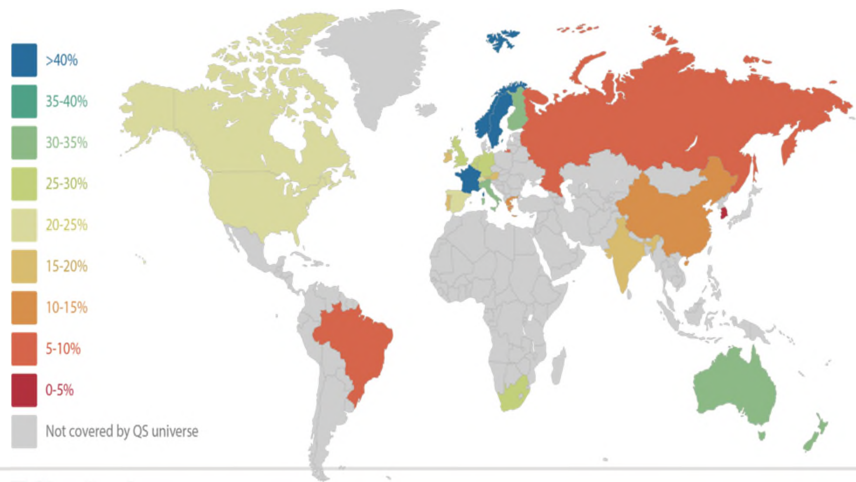
Source: ISS Voting Analytics, 2017
as of August 28, 2017

Focus on Gender Diversity: Global HeatMap

% of Women on Boards, ISS QualityScore universe, 2017



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Source: *ISS Analytics QualityScore data June 2017*

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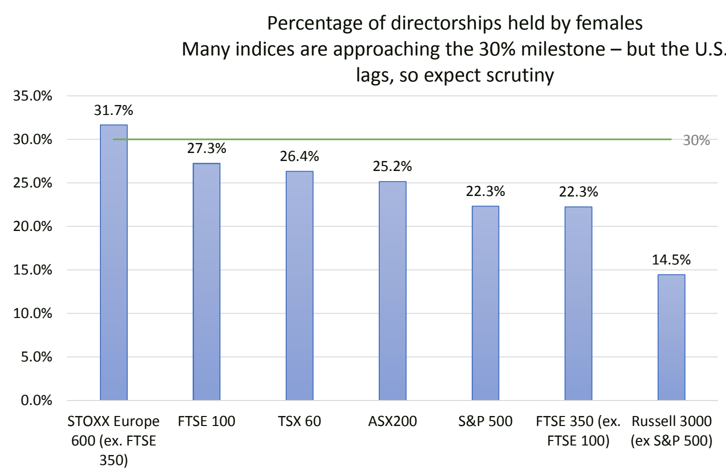
Focus on Gender Diversity

30% Women on Boards? Unrealistic or Reality?



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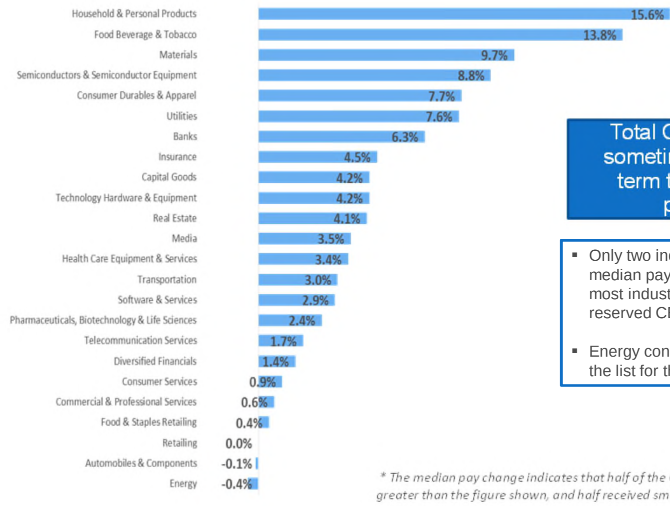
Executive Compensation Trends

Compensation Themes from the 2017 U.S. Proxy Season

1. **Median CEO pay** at S&P 500 companies increased significantly in 2016, after a relatively flat year in 2015.
2. **Performance-based compensation** continues to grow in popularity—a majority of CEO pay at the median mid-cap S&P 400 company is tied to performance goals.
3. This year's **say-on-pay frequency votes** underscore institutional investors' increased focus on compensation and engagement; whereas shareholders preferred annual say-on-pay votes at 80 percent of companies in 2011, they preferred annual votes at well above 90 percent of companies this year.
4. Despite the increased shareholder interest in annual say-on-pay votes, the median **say-on-pay vote result** at Russell 3000 companies remained quite high—96.4 percent, a slight uptick from 2016's median outcome of 96.1 percent.
5. Over 80 **compensation proposals** were filed by shareholders for 2017 meetings, but more than a third were withdrawn or omitted; shareholder support has been lackluster to date, topped by 24.2% support for a proposal asking Apple Inc. to adopt a share retention policy for senior executives.

CEO Pay Raises by Industry – Median Pay Changes*



Total CEO pay changes sometimes reflect longer-term trends in industry performance

- Only two industries had double-digit median pay gains year-over-year, while most industries showed much more reserved CEO pay gains
- Energy continues to be at the bottom of the list for the second year in a row

** The median pay change indicates that half of the CEOs in each industry received raises greater than the figure shown, and half received smaller raises. Excludes change in pension.*

Source: ISS Corporate Solutions' ExecComp Analytics. Data through June 19, 2017.

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2017 Say-on-Pay & Equity Plan Shareholder Support

- Public companies continue to receive strong say-on-pay and equity plan support. Support for say-on-pay this season was recorded as the highest in over 5 years. Less than 1% of companies did not receive requisite shareholder approval for an equity plan.
- Most companies during the 2017 season placed their second advisory vote on frequency of say-on-pay on the ballot this year; broad support for annual say-on-pay votes has further been solidified.
- As say-on-pay has evolved, investors are now far more comfortable taking their own approach versus following proxy advisory firm recs. Increased engagement has led to investors willing to give more leeway to companies; the increased shareholder support for say-on-pay supports this.
- ISS influence is waning; companies that received ISS against rec & received over 70% support has increased.
- E&S spotlight has made its way into compensation; pay disparity & gender pay equity proposals have increased.

Say-on-Pay Approval	2015	2016	2017
Over 90%	77%	76%	78.4%
Over 70%	92%	93%	93.2%
Less than 70%	7.7%	7.4%	6.8%
Less than 50%	2.6%	1.6%	1.3%

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The Dangerous Seven: Common Themes Behind Say-On-Pay Problems

Problematic disclosure theme	Examples of actions/disclosures that trigger say-on-pay problems
Unresponsive / ineffective compensation committee	Failure to intervene when pay formulas produce results that don't align with shareholder outcomes Failure to follow through on commitments made to shareholders Failure to address ongoing compensation issues / shareholder concerns Poor (or no) shareholder engagement disclosure, especially after poor say-on-pay vote results Failure to provide adequate disclosure (*e.g.*, Externally Managed Issuers)
Discretionary awards	Retention awards Replacement / "Make whole" awards Outsized inducement grants Significant discretionary grants not substantiated by company performance
Construction of incentive programs	Pay program primarily dependent on discretion / excessive "subjective" components Ineffective mix of time- and performance-based awards Characterizing several consecutive short-term incentives as an LTI program (e.g. annual LTIP goal setting) Programs with formulaic payouts tied directly to company results (e.g. percentage of pre-tax income) Programs that keep dollar value of grants whole during sharp declines in company stock price
Performance metric selection and disclosure	Limited discussion of metric selection rationale (e.g. linkage to long-term shareholder value creation) No disclosure of targets (even ex-post) LTI and STI sharing identical or substantially similar metrics, especially without disclosed rationale
Lack of rigor on performance goals	Maximum awards earned for two or more years running without adequate explanation Goals which trigger payouts based on achieving, but not necessarily sustaining, targets Limited disclosure on goal-setting methodology Re-granting or extending a performance period to allow more time to attain goals (even with higher goals) Opportunity for retesting/catch-up/make-up performance goal attainment Lowering goals below prior year target or actual results without reduction in pay opportunity
Escalatory pay benchmarking practices	Aspirational peer set (e.g. significantly larger median peer) Above-median benchmarking Failure to respond to declining company performance with reduced pay opportunity
Employment agreement / leadership transition issues	Change-in-control provisions and single or modified single-trigger provisions Severance multipliers in excess of 3x Excise tax gross-ups, even simply upon agreement renewal Guaranteed multi-year awards Large grants made prior to retirement / separation of service (especially with potential acceleration)

CEO Pay Ratio

CEO Pay Ratio - Background

- The SEC issued final CEO Pay Ratio rules on August 5, 2015
- Requires disclosure of ratio of median compensation of all employees to the compensation of the principal executive officer
- Timing
  - Disclosure required for compensation for full fiscal years beginning on and after January 1, 2017
  - For calendar year issuers, pay ratio disclosure will first be required in proxy or information statement for the 2018 annual meeting, based on 2017 compensation

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CEO Pay Ratio Predictions

- Very unlikely that the 2018 implementation date will be withdrawn, despite efforts by Congress to repeal or amend the rule.
- Some have speculated that pay ratio will be a 1-year requirement, and that the rule will likely be repealed in 2018; both treasury report & Choice Act call for repeal. However, if this happens, there will likely be an uptick in shareholder proposals requesting this information, and companies will likely face pressure & blowback from removing disclosure.
- Institutional investors have generally stated that pay ratios will not factor into voting decisions. As of yet, ISS/Glass Lewis have not stated that they will incorporate ratios in determining vote recommendations.
- Rather, problematic pay ratios will likely translate into PR/press coverage problems as well as problems with employee morale.
- General consensus on disclosure is that companies should keep this as simple as possible, in order to facilitate ease in year-over-year calculations.
- Guidance from the SEC Division of Corporation Finance can be translated as 'relax'. As long as companies exercise good faith, the staff will likely not bring enforcement actions.

Source: D.F. King

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CLE Code

ISS and Glass Lewis Voting Policy Updates

ISS Update: Poison Pills

New ISS Recommendation:

Vote against/withhold from all nominees if:

> The company has a poison pill that was not approved by shareholders. However, vote case-by-case on nominees if the board adopts an initial pill with a term of one year or less, depending on the disclosed rationale for the adoption, and other factors as relevant (such as a commitment to put any renewal to a shareholder vote).

> The board makes a material adverse modification to an existing pill, including, but not limited to, extension, renewal, or lowering the trigger, without shareholder approval.

- The updated policy will be applied at companies that have existing non-shareholder approved pills.
- There are approximately 90 previously-grandfathered companies that adopted or renewed 10-year pills.
- The removal of the distinction between annually elected and classified boards impacts approximately 50 companies with annually-elected boards.
- For short-term pills (with a term of one year or less), ISS will continue to conduct a case-by-case analysis, with special emphasis on the board's disclosed rationale for adopting the plan without a shareholder vote. A commitment by the board that, should it extend or renew the pill, it will put it to a shareholder vote, would provide reassurance to investors that their interests are being considered.
- Only four companies in the S&P 500 Index have a poison pill that that was not approved by public shareholders, compared to 89 companies in the Russell 3000 Index.

Other ISS Governance Policy Updates

- **Director independence** categorizations in both markets are now Executive Director, Non-Executive Non-Independent Director, and Independent Director. The Canada policy (TSX and TSX-V companies) now includes guidance on the nature of professional services relationships that is similar to that currently found in the U.S. policy.
- **Poor attendance** by new directors who serve on the board for only part of the year will no longer result in negative recommendations.
- **Pledging** of company shares is evaluated on a case-by-case basis, examining its magnitude and rationale, and efforts to wind it down.
- **Special purpose acquisition company** extension proposals are examined on the basis of the length of the request, any pending transactions, any equity kicker, and prior extension requests.
- **State laws that mandate classified boards** are a basis for perennial negative director recommendations unless the company has opted out of those laws.

Pay-for-Performance Quantitative Screening: Financial Performance Alignment

2017 process: The existing overall concern determination works as follows:

1. Quantitative Review: Run RDA, MOM, and PTA tests → receive Overall Concern Level

Overall Concern = Low | Overall Concern = Medium | Overall Concern = High

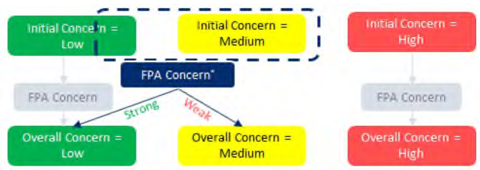
2. Qualitative Review: Perform qualitative review, where FPA metrics could impact the outcome

2018 process: The new overall concern determination will work as follows:

1A. Quantitative Review: Run RDA, MOM, and PTA tests → receive Initial Concern Level

Initial Concern = Low | Initial Concern = Medium | Initial Concern = High

1B. Quantitative Review: Apply the FPA metrics



Only *Medium* and upper *Low* initial concern companies apply the FPA Modifier to determine the Overall Concern

2. Qualitative Review: Perform qualitative review

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ISS Pay-for-Performance Quantitative Screening: TSR Calculations

For 2018, ISS is slightly modifying its TSR methodology. Instead of using a single date for TSR, ISS Research will average the stock prices for trading days in the month closest to the company's fiscal year end. For companies with a fiscal year end on/after the 15th of the month, that month will be used. For companies with a fiscal year end before the 15th, the previous month will be used. ISS will continue to use an annualized calculation and dividends and stock splits will still be averaged in.

Example:

- For companies with a December 31st fiscal year end, ISS will take the average of all the trading days in December
- For companies with a December 10th fiscal year end, ISS will take the average of all the trading days in November

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ISS Update: Director Pay

- **Following six years of say-on-pay for executive compensation**, shareholders and proxy advisors have begun to more closely scrutinize director pay magnitude.
- **Although NED pay varies by size and industry**, ISS has identified extreme outliers with director compensation sharply above the median of peer companies.
- **ISS policy will now explicitly provide for adverse vote recommendations** on boards/compensation committees approving relatively high NED pay levels on a recurring basis without a clearly disclosed rationale.
- **This policy update will not affect 2018 director elections**, but going forward, ***starting in 2019***, a pattern of excessive NED compensation in consecutive years ***will trigger adverse vote recommendations on board members***.

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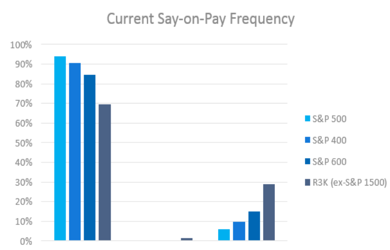
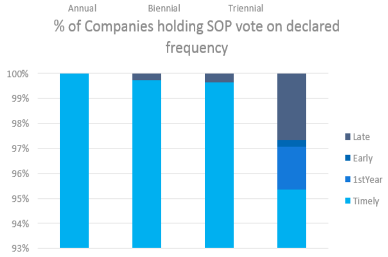
ISS Update: Say-on-Pay Frequency





- ISS Research reached out to companies that inadvertently omitted say-on-pay frequency
  - 30+ companies took action in response to add this item to the ballot
  - For companies that did not take action, if they were biennial or triennial, ISS recommended against their Say on Pay resolution or, in its absence, against members of their Comp Committee
  - If the company did not take action but maintained an annual frequency, ISS did not provide an adverse vote rec
- ISS Research has solidified this policy in 2018 and, accordingly, will vote case-by-case on Compensation Committee members (and potentially the entire board) if the board implements an advisory vote on executive compensation on a less frequent basis than shareholders approved

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ISS Equity Plan Scorecard Updates

Equity Plan Scorecard (EPSC) allows companies to make tradeoffs between the size of a new share request, and the company's historical use of equity and the governance it applies to new shares

ISS will evaluate an equity plan based on the cost to shareholders, the use of equity, and governance features inside the equity plan

ISS has not introduced any new factors to the Equity Plan Scorecard, but has announced a number of enhancements to existing factors in an effort to simplify the methodology. The most significant factor updates include:

- Minimum Passing Score
- CIC Vesting -- scoring changed to Y/N
- Discretionary Vesting Authority – remove change-in-control event as a permissible exception
- Holding Period Requirements – scoring changed to Y/N
- CEO Vesting – scoring changed to Y/N

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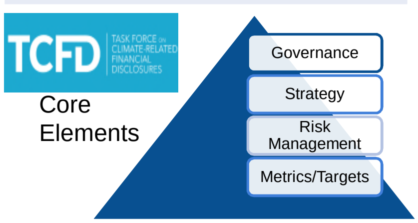
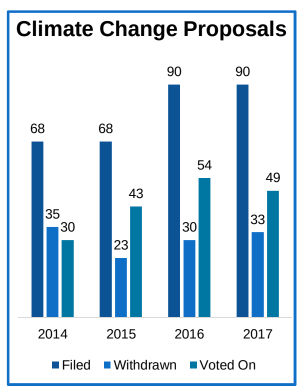
ISS Update: Climate Change Shareholder Proposals

New ISS Recommendation:

General Recommendation: Generally vote for resolutions requesting that a company disclose information on the financial, physical, or regulatory risks it faces related to climate change on its operations and investments or on how the company identifies, measures, and manages such risks, considering:

- Whether the company already provides current, publicly-available information on the impact that climate change may have on the company as well as associated company policies and procedures to address related risks and/or opportunities;
- The company's level of disclosure compared to industry peers; and
- Whether there are significant controversies, fines, penalties, or litigation association with the company's climate change-related





- Average shareholder support increased for the second year from 23.3 to 27.9 percent.
- 2017 saw three climate risk proposals receive majority support

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Source: https://www.issgovernance.com/file/policy/2018-Americas-Policy-Updates.pdf & ISS Voting Analytics, 2017 as of November 29, 2017

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Shareholder Proposals on Gender Pay Gap

New ISS Recommendation:

General Recommendation: Generally vote case-by-case on requests for reports on a company's pay data by gender, or a report on a company's policies and goals to reduce any gender pay gap, taking into account:

- The company's current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy and fair and equitable compensation practices;
- Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to gender pay gap issues; and
- Whether the company's reporting regarding gender pay gap policies or initiatives is lagging its peers.

Item 6. Report on Gender Pay Gap AGAINST

VOTE RECOMMENDATION

A vote AGAINST this resolution is warranted, due to the company's disclosure of its compensation program and its existing diversity and inclusion practices, and given that the company does not lag its peers in gender pay gap reporting.

Vote Requirement: Majority

Item 6. Gender Pay Gap FOR

VOTE RECOMMENDATION

A vote FOR this resolution is warranted, as Facebook lags its peers in addressing gender pay disparity at the company. By not keeping pace with its peers, Facebook is put at a competitive disadvantage in the recruitment and retention of employees.

Vote Requirement: Majority of the voting power of the shares of Class A common stock and Class B common stock (voting together as a single class), abstentions and broker non-votes not counted.

Status	Total
Proposed	22
Withdrawn	7
Not in proxy	1
Voted	14

Of the 14 proposals that made it to the proxy YTD in 2017, ISS Research has recommended 'For' on only 3 of these proposals, at **Alphabet**, **Facebook**, and **Oracle**, representing 21% of the proposals.

The most common reason for an 'Against' recommendation from ISS Research was '*due to the company's disclosure of its compensation program and its existing diversity and inclusion practices, and given that the company does not lag its peers in gender pay gap reporting*.'

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Source: https://www.issgovernance.com/file/policy/2018-Americas-Policy-Updates.pdf, ICS Voting Analytics & ICS Shareholder Proponent Data, https://login.isscorporatesolutions.com/votemetrics/prop/getResDoc/614906/10732109/1511323886155, & https://login.isscorporatesolutions.com/votemetrics/prop/getResDoc/50943/10547779/1511324055599

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Glass Lewis Updates: Board Gender Diversity

2018

- Glass Lewis will not make voting recommendations based solely on board diversity but it will be one of the considerations.

2019

- Generally, Glass Lewis will recommend voting against the Nominating Committee Chair of a board which has no female directors.
- There will be an extension of voting against other Nominating Committee members depending on other factors, such as the size of the company, the industry in which the company operates, and its governance profile.
- Against Vote Exemptions: Including a sufficient rationale for not having any female board member, or have disclosed a plan to address the lack of diversity on the board.

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Glass Lewis Updates: Board Responsiveness

The board generally has an imperative to respond to shareholder dissent from a proposal at an annual meeting of more than 20% of votes cast, especially with regard to compensation or director-related proposals. (For dual-class companies, Glass Lewis will examine unaffiliated shareholders when determining whether board responsiveness is warranted.)

An example—director elections:

Only 4 percent of directors receive less than 80% support

- Based on outcomes of uncontested director elections at Russell 3000 companies in 2017 (using For votes divided by For + Against votes):

  Median level of support: **98.4%**
  25th percentile: **96.0%**
  10th percentile: **89.2%**
  5th percentile: **81.9%**
  1st percentile: **65.0%**
- Only 0.2% of uncontested directors failed to receive majority support (33 of 18,485 YTD)

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Source: ISS Corporate Solutions' Voting Analytics database.

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Other Glass Lewis Updates

Virtual-Only Meetings: Starting in 2019, Glass Lewis will recommend against governance committee members at companies that hold virtual-only meetings without clear disclosure that shareholders would have the same rights as at a physical meeting.

Dual-Class Shares at IPO: Glass Lewis added a dual-class structure to the list of shareholder-unfriendly practices that it will consider in determining whether to issue negative recommendations on director elections at newly public companies.

Overboarding and Director Time Commitments: Although there is no change to Glass Lewis' overboarding policy, it will evaluate the specific duties and responsibilities of the executive role and the company's disclosure regarding the director's time commitments when determining whether to apply its limit of two total board membership for public executives.

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Q&A

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APPENDIX

New Rule 14a-8 Guidance on Shareholder Proposals

New Rule 14a-8 Guidance on Shareholder Proposals

- On November 1, 2017, the Division of Corporation Finance released new guidance regarding whether certain shareholder proposals can be excluded from a company's proxy statement under Rule 14a-8(i)(7), the "ordinary business exception," and Rule 14a-8(i)(5), the "economic relevance exception."
- **Ordinary Business Exception.** This exception allows companies to exclude a shareholder proposal that deals with the day-to-day operations of the business that typically should not be subject to direct shareholder oversight, unless the proposal focuses on a significant policy issue.
  - New guidance provides that a company's board of directors is typically in a better position than the SEC to judge whether a proposal relates to the ordinary business of the company or a significant policy issue. So, the guidance asks that companies include in their no-action requests a thorough discussion of the board's analysis of whether the proposal includes a policy issue that is significant to the company, which will "greatly assist" the staff with its review.
  - With respect to matters that the staff has, in the past, concluded to be "policy issues," the new guidance suggests that the staff will provide more deference to the board's conclusion than it has in the past if supported with sufficient analysis.

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New Rule 14a-8 Guidance on Shareholder Proposals

- **Economic Relevance Exception.** This exception generally allows a company to exclude a shareholder proposal that relates to operations that account for less than 5% of its assets, earnings and gross sales, and is not otherwise significantly related to the company's business.
  - In the past, this exception was infrequently used because any proposal that involved ethical or social issues would be deemed by the staff "otherwise significantly related to the company's business" no matter how small the issue.
  - Going forward, the staff has indicated that for proposals that are below the 5% threshold, the burden will generally shift to the proponent of the proposal to show that the matter has a significant effect on the company's business.
  - The Staff also indicated that the Board is in the best position to determine if a matter is "significantly related to the company's business," so companies should include in any no action letters the board's analysis as to why a matter is not significantly related to a company's business, and it appears that the staff will provide some deference to that determination.

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Additional Details on the CEO Pay Ratio

New Guidance Released September 2017

- On September 21, 2017, the SEC released several items that provide additional guidance on the CEO Pay Ratio Rule:
  1. SEC interpretive guidance;
  2. Revised pay ratio Compliance and Disclosure Interpretations ("C&DIs") reflecting the SEC's interpretive guidance; and
  3. Separate guidance released by the staff of the SEC's Division of Corporation Finance.

New Guidance

- Independent Contractors
  - Contrary to one of the SEC's C&DIs issued in October 2016, the new interpretive guidance provides that a company can determine whether a worker is an "employee" for purposes of the pay ratio rule by applying a widely recognized test used under another of area of law, such as tax law or employment law.
  - The C&DI issued in October 2016, which suggested that independent contractors could only be excluded if their pay was determined by an unaffiliated third party rather than the registrant itself, has now been withdrawn.

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New Guidance

- Use of Internal Pay Records
  - The interpretive guidance clarifies that registrants can use tax, payroll and other existing internal records as estimates in the following two circumstances:
    - *De minimis exemption* – can use internal records to determine whether the number of employees in a certain foreign jurisdiction is small enough to allow the company to exclude such employees under the 5 percent *de minimis* exemption.
    - *Median employee* – can use internal pay records as consistently applied compensation measure ("CACM") to identify median employee as long as the internal pay records reasonably reflect annual compensation, "even if those records do not include every element of compensation, such as equity awards widely distributed to employees." This provides public companies with more flexibility to use internal pay records than did the previously issued C&DI, which stated that total cash compensation could be a CACM *unless* the registrant also distributed equity awards widely among its employees. That C&DI has been amended to reflect the new interpretive guidance.

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New Guidance

- SEC Enforcement Actions
  - SEC interpretive guidance acknowledges that pay ratio disclosures will involve a degree of imprecision and that use of estimates will not provide the basis for enforcement action unless the disclosure lacks a reasonable basis or was provided other than in good faith.
  - New C&DI provides that the staff would not object if a company states that the ratio is a reasonable estimate in the disclosure itself.

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New Guidance

- Use of Reasonable Estimates and Statistical Sampling
  - New guidance from the staff at the Division of Corporation Finance clarifies that reasonable estimates can be used at all stages of the ratio calculation (other than for calculating CEO's compensation).
  - Also provides the following with respect to statistical sampling:
    - Statistical sampling methods may include, but are not limited to, simple random sampling, stratified sampling, cluster sampling, and systematic sampling
    - Company not required to use the same statistical sampling method for all geographic locations and/or business units, and may use statistical sampling for one location or business unit without having to use statistical sampling for all locations/business units
    - Public companies may use other statistical techniques in addition to sampling when determining the median employee, such as imputing or correcting missing data points and addressing outliers

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Pay Ratio Disclosure's Impact on Employees

- The disclosure of the CEO pay ratio will be the first time that median employee compensation will be included in a public document. Access to this new information may make employees of all levels, not just those below the median, question if they are being paid fairly, both compared to others within the company or compared to their counterparts at industry peer companies.
- General consensus that companies should not try to address these concerns in the proxy statement itself or by sending out additional materials to employees in advance of the proxy statement.
- But, be prepared to respond if employees have questions or concerns regarding the ratio. Specifically, think about what questions employees may ask, and be prepared with an answer. Also, think about who should answer these questions—whether an employee's direct supervisor, a designated person in the HR department, or someone else—and ensure that there is a consistent message among all individuals who will be involved in answering these questions.