‘18 Holes of Governance
Board Governance at the Turn

The Agility of an Innovator. The Expertise of a Leader.
Today’s Foursome
Handicaps and Course Rules

► Playing from the Black Tees: S&P 500 Firms (Large Caps)
  ► Average Board Size in 2017 (YTD): 11.1 seats

► Playing from the Blue Tees: S&P 400 Firms (Middle Market)
  ► Average Board Size in 2017 (YTD): 9.7 seats

► Playing from the Red Tees: S&P 600 Firms (Small Caps)
  ► Average Board Size in 2017 (YTD): 8.5 seats

► Playing from WTDWP: Recent IPOs/Emerging Growth Companies
  ► Average Board Size (2016): 7.1 seats at time of closing

► Front Nine ISG Rules: Investor Stewardship Group
  ► ISG is a collective of some of the largest U.S.-based institutional investors and global asset managers (including Blackrock, State Street Global Advisers and Vanguard). The members are a group of 38 U.S. and international institutional investors that in aggregate invest over $20 trillion in the U.S. equity markets. The framework goes into effect Jan. 1, 2018.

► Back Nine Rules: Emerging Issues and Future Concerns
  ► Three near-term, three mid-term and three long-term
Hole 1 (Par 4) Average Board Independence
ISG 5.2—A majority of directors on the board should be independent.

Most Board Have Only One or Two Directors Who Are Not Independent

IPOs: 60-75% independent, but just 85% have majority independent boards at pricing.

Source: ISS Governance Analytics
Hazard: % with Independent Nominating/Governance Panels

ISG 5.3—Boards should establish committees to which they delegate certain tasks to fulfill their oversight responsibilities.

Prevalence of Independent Nominating Panels High, But Dropping

Hazard: % with Independent Nominating/Governance Panels

Source: Governance Analytics
Hole 2 (Par 4) Annual Elections of All Board Members

ISG 1.2—Requiring directors to stand for election annually helps increase their accountability to shareholders.

Hazard: Supermajority Vote Requirements to Amend Charters Slow Reform

Source: Governance Analytics

IPOs: >70% have classified boards
Hole 3 (Par 4): Majority Voting In Uncontested Elections

ISG 1.3—Individual directors who fail to receive a majority of the votes cast in an uncontested election should tender their resignation. The board should accept the resignation or provide a timely, robust, written rationale for not accepting the resignation.

Source: Governance Analytics

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ISG 1.4—Shareholders who own a meaningful stake in the company and have owned such stake for a sufficient period of time should have, in the form of proxy access, the ability to nominate directors to appear on the management ballot at shareholder meetings.

Rapid Rate of Adoption Leads to Big Governance Gap

Source: Governance Analytics
Small-Caps Lead the Way: Governance Gap Moves In the Opposite Direction

ISG 4.2—Some investor signatories believe that independent board leadership requires an independent chairperson, while others believe a credible independent lead director also achieves this objective.

Source: Governance Analytics
Combining Top Two Titles is No Longer The Norm

Hazard: Relay succession planning

Source: Governance Analytics
Hazard: Independent Lead Directors

ISG 4.3—The role of the independent board leader should be *clearly defined and sufficiently robust to ensure effective and constructive leadership*. The responsibilities of the independent board leader and the executive chairperson (if present) should be agreed upon *by the board, clearly established in writing and disclosed to shareholders*.

Source: Governance Analytics
Hole 6 (Par 4) Refreshment: Average Tenure (Director Level Data)

ISG 5.7—Boards should disclose mechanisms to ensure there is appropriate board refreshment.

Surge of New Directors Lowers Average Board Tenure

Source: Governance Analytics
Hole 7 (Par 4) Refreshment: Average Age (Director Level Data)

ISG 5.7—Boards should disclose mechanisms to ensure there is appropriate board refreshment.

Board Aging Process Slowed By Recent Refreshment

Source: Governance Analytics
Hole 8 (Par 3) % of Women on Boards (Average of company-level data)

ISG 5.1—Boards should be composed of directors having a mix of direct industry expertise and experience and skills relevant to the company’s current and future strategy. In addition, a well-composed board should also embody and encourage diversity, including diversity of thought and background.

Source: Governance Analytics
Hole 9 (Par 5) % of Minority Directors on Boards (Average company-level data)

ISG 5.1—A well-composed board should also embody and encourage diversity, including diversity of thought and background.

Glacial Progress on Racial and Ethnic Diversity

Source: Governance Analytics
Hole 10 (Par 4) Focus on Gender Diversity Will Grow in 2018
30 Percent Women on Boards? Unrealistic or Already Reality?

Percentage of Directorships Held by Women

<table>
<thead>
<tr>
<th>Index</th>
<th>Percentage of Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>STOXX Europe 600 (ex. FTSE 350)</td>
<td>31.7%</td>
</tr>
<tr>
<td>FTSE 100</td>
<td>27.3%</td>
</tr>
<tr>
<td>TSX 60</td>
<td>26.4%</td>
</tr>
<tr>
<td>ASX200</td>
<td>25.2%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>22.3%</td>
</tr>
<tr>
<td>FTSE 350 (ex. FTSE 100)</td>
<td>22.3%</td>
</tr>
<tr>
<td>Russell 3000 (ex. S&amp;P 500)</td>
<td>14.5%</td>
</tr>
</tbody>
</table>
ISS 2017-18 Survey: Gender Diversity

Does your organization consider it to be problematic if there are zero female directors on a public company board?

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Investors</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>43%</td>
<td>25%</td>
</tr>
<tr>
<td>Yes, but concerns may be mitigated by policy</td>
<td>26%</td>
<td>29%</td>
</tr>
<tr>
<td>No</td>
<td>8%</td>
<td>19%</td>
</tr>
<tr>
<td>Case-by-case determination</td>
<td>24%</td>
<td>27%</td>
</tr>
</tbody>
</table>

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ISS 2017-18 Survey: Gender Diversity

What actions do you consider may be appropriate for shareholders to take at a company that lacks any gender diversity on the board, and/or has not disclosed a policy on the issue? (Check all that apply)

<table>
<thead>
<tr>
<th>Action</th>
<th>Investors’ Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engage with board/management</td>
<td>#1 (71)</td>
</tr>
<tr>
<td>Consider supporting shareholder proposal</td>
<td>#2 (64)</td>
</tr>
<tr>
<td>Consider supporting a shareholder-nominated board candidate</td>
<td>#3 (46)</td>
</tr>
<tr>
<td>Consider vote against chair of the nominating/governance committee</td>
<td>#4 (41)</td>
</tr>
<tr>
<td>Consider votes against nominating/governance committee</td>
<td>#5 (34)</td>
</tr>
</tbody>
</table>
Hole 11 (Par 4) Enter the Board Matrix

- Boardroom Accountability Project campaign 2.0 wants to make boards more diverse, independent, and climate-competent.
- Comptroller Stringer/NYC Pension Funds called on >150 boards to disclose directors’ race, gender and skills in a standardized “matrix” format and to enter into a dialogue.
- In 2015, NYC Funds — along with eight other major U.S. pension systems — submitted a rulemaking petition to the SEC asking to make this type of disclosure mandatory market-wide.

Source:
Nearly two-thirds (63%) of investors indicated they plan to use the new CEO pay ratio
- Comparing ratios across companies/industry sectors
- Assessing year-over-year changes at an individual company

Investors said they will use the information for...
- Considering votes on compensation proposals
- Background when engaging with issuers
- Considering votes on directors

Only 16% of investors indicated that they have no plan to use the data
Hole 13 (Par 5) ESG Issues on Rise
Environmental Issues Emerge as Leading E&S Concern

Number of Resolutions Filed for Top 6 E&S Issues
2017 data as of August 28, 2017

Focus on Climate Change Risk
Recent Growth in Climate Change Proposals in US

Climate Change Resolutions 2013-2017
2017 Data as of August 28, 2017

- Filed
- Withdrawn
- Voted On
- Avg Support

<table>
<thead>
<tr>
<th>Year</th>
<th>Filed</th>
<th>Withdrawn</th>
<th>Voted On</th>
<th>Avg Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>17</td>
<td>5</td>
<td>11</td>
<td>22.8%</td>
</tr>
<tr>
<td>2014</td>
<td>35</td>
<td>30</td>
<td>23</td>
<td>23.8%</td>
</tr>
<tr>
<td>2015</td>
<td>68</td>
<td>68</td>
<td>43</td>
<td>20.9%</td>
</tr>
<tr>
<td>2016</td>
<td>91</td>
<td>54</td>
<td>30</td>
<td>23.3%</td>
</tr>
<tr>
<td>2017</td>
<td>88</td>
<td>31</td>
<td>49</td>
<td>27.9%</td>
</tr>
</tbody>
</table>

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Hole 14 (Par 3) Virtual Only Annual Meetings

ISS 2017-18 Survey: Please describe your organization's view on the use of remote means of communication for facilitating shareholder participation at general meetings, i.e., "hybrid" or "virtual-only" shareholder meetings.

- My organization generally considers the practice of holding "virtual-only" or "hybrid" shareholder meetings to be acceptable.
- My organization generally considers the practice of holding "hybrid" shareholder meetings to be acceptable, but not "virtual-only" shareholder meetings.
- My organization generally considers the practice of holding "hybrid" shareholder meetings to be acceptable, and would also be comfortable with "virtual-only" shareholder meetings if they provided the same shareholder rights as a physical meeting.
- My organization does not support the practice of holding "hybrid" or "virtual" shareholder meetings.
- Other (please specify)

Investors and Companies.
SNAP’s zero voting right IPO sparks major investor backlash
Stock exchanges race to the bottom in pursuit of high-profile listings
  - Hong Kong & Singapore consider relaxing bans on unequal voting rights
  - London wooing Saudi Aramco
Investors lobby index providers - with some success
  - Will index providers emerge as new governance arbiters?
Some investors appear open to unequal voting rights with a clear sunset
Other issues for post-IPO boards–staggered terms and supermajority votes
Issues for other boards–bylaw amendments and “placeholder” nominee bans
ISS 2017-18 Survey: One Share One Vote

Which of the following represents your organization’s view of multi-class capital structures with unequal voting rights?

<table>
<thead>
<tr>
<th>Option</th>
<th>Investors</th>
<th>Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies free to choose.</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Never appropriate for public company.</td>
<td>43%</td>
<td>43%</td>
</tr>
<tr>
<td>Sunset based on time elapsed since the IPO.</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>Sunset based on the market capitalization of the company.</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Require periodic reapproval low-vote shareholders.</td>
<td>18%</td>
<td>18%</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>13%</td>
<td>13%</td>
</tr>
</tbody>
</table>

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Hole 16 (Par 3) Risk Oversight

• Risk oversight failures drive large “no” votes against directors and opposition to say on pay
  • 2017: Wells Fargo (fake accounts), Mylan NV (EpiPen pricing) and McKesson (opioid crisis)
  • 2018: Equifax (cyber security), Insys Therapeutics (opioid scandal)...
• Key steps taken upon discovery of problem
  • Speedy disclosure (materiality)
  • Independent investigation by board or third party
• Actions taken by boards in wake of scandals
  • Executive turnover
  • Clawbacks implemented for senior executives (reputational damage)
  • Director exits and arrivals
  • Boardroom leadership and key committee membership changes
  • New committees focused on risk oversight
Hole 17 (Par 4) Performance Pay in the Spotlight

Increased scrutiny on goal setting and rigor

**Discretionary Bonus vs. Performance Cash***

<table>
<thead>
<tr>
<th></th>
<th>S&amp;P 500</th>
<th>R3K</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonus</td>
<td>10%</td>
<td>24%</td>
</tr>
<tr>
<td>Non-Equity Incentive Plan</td>
<td>86%</td>
<td>70%</td>
</tr>
</tbody>
</table>

*Source: ISS ExecComp Analytics

**Performance-Vested vs. Time-Vested Equity (S&P 500)**

- Performance-Based Equity
- Time-Vested Equity

*Source: ISS ExecComp Analytics*
Hole 18 (Par 5): Potential Refreshment Pitfalls

Fewer Boards Stand Pat

Power Shifting Towards Newer Board Members

Women, 50-somethings & Leaders Dominate “New” Director Demographics
S&P 1500: >50% of Boards Add “New” Members

More than one-half of boards refreshed in 2015 and 2016

The Agility of an Innovator. The Expertise of a Leader.
S&P 1500: Refreshment Rate Grows After Lull

“Rising” directors lose share to new/recent nominees and long-serving board members

IRRCi/ISS Board Refreshment Study
S&P 1500: Directors in 50s and 60s Dominate

Board members in 70s and 80s gain bigger shares of seats; sub-50 directors lose slots

IRRCi/ISS Board Refreshment Study
Refreshment Toolbox

Boards Have Limited Tools to Drive Refreshment

- RETIREMENT POLICIES
- TERM LIMITS
- BOARD/DIRECTOR EVALUATIONS

IRRCi/ISS Board Refreshment Study