EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE ALERT

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2019 Proxy Season Best Practices and Trends

The adoption of Say-on-Pay has served as a catalyst for the evolution of proxy statements from a mandatory SEC reporting requirement into an investor relations tool. The proxy statement serves to directly communicate with shareholders on everything from compensation to corporate governance, company strategy and performance. Institutional investors (and proxy advisory firms[1]) are continuously increasing their demands on transparency and disclosure preferences, resulting in many public companies spending a substantial amount of time and resources to create state-of-the-art proxies. As the 2019 proxy season commences, public companies need to stay abreast of the most recent trends and developments when drafting their disclosure.

Proxy Best Practices and Trends

- **Ensure Effective Proxy Summary Messaging**
- **Reduce Text and Replace with More Visuals and Graphics**
- **Provide More Rationale Behind Compensation Decisions**
- **Improve Board Compensation Disclosure**
- **Enhance ESG Disclosure**

Proxy Statement Executive Summary Messaging

The average length of proxy statements has increased significantly over time, and investors often believe that a typical proxy is too long and difficult to read. In a 2015 Investor Survey[2], investors responded that, on average, they only read 32 percent of a proxy statement. If most investors are reading such a limited portion of proxy statements, the need for an effective proxy statement executive summary (found at the beginning of the document) cannot be overstated. It is the only way to realistically guarantee that a company's most important messages will be captured by their shareholders. Accordingly, more and more companies[3] have added a proxy statement executive summary.

The most effective proxy statement executive summaries are used as an opportunity to tell your story and are becoming an expectation of institutional shareholders. In order to take advantage of this opportunity to convey your company's story to the market, the proxy statement executive summary should:

- Be written in plain English and avoid the use of legalese

[1] Proxy advisors include Institutional Shareholder Services (or ISS) and GlassLewis
[2] 2015 Investor Survey Deconstructing Proxy Statements – What Matters to Investors sponsored by RR Donnelley, Equilar and the Rock Center for Corporate Governance
[3] Ernst and Young's 2018 Proxy Statement Report cited 65% of companies included a proxy statement executive summary

- Use graphics, tables and charts (just the use of bullets can be a significant improvement)
- Include as many of the following sections, as appropriate:
  - List of proposals to be voted on (including the Board's voting recommendation)
  - Strategic goals and business model/plan
  - Summary of company performance (financial, operational and total shareholder return)
  - Director nominee dashboard
  - Highlights of governance, compensation and environmental, social and governance (ESG) matters

Some examples of proxy statement executive summaries can be found below:

Shutterfly, Inc.	**Bank of America Corporation**

Increase Use of Visuals and Graphics

The use of visuals and graphics are essential to convey complex and robust information in a concise and easy to understand format, and they can also draw the reader's attention to key themes and takeaways. While the use of text is necessary and appropriate in many circumstances, it can also be cumbersome and less effective for investors. While compensation disclosure has incorporated graphs and charts for many years (such as pay-for-performance graphs, "what we do/don't do" charts, etc.), sections that have remained in paragraph form are increasingly shifting towards more impactful visual representations, including:

Board Qualifications	Director Bios	Voting Proposals	Governance Highlights
Use a matrix that list each director and their experience, skills and competencies	Summarize each director's bio separated into key sections and points of interest, including tenure, committee service, etc.	Use a visual graphic to recap all the important voting information including what is on the ballot	Use a chart or other visual graphic that recaps the company's key governance-related policies and structure
Board Matrix Example	**Director Bios Example**	**Voting Proposal Example**	**Governance Highlights Example**

Inclusion of the Rationale Behind Compensation Decisions

Investors and proxy advisory firms are generally not satisfied with disclosure that only addresses compensation decisions that were approved and implemented. The compensation transparency bar has been raised and requires companies to disclose the rationale behind why decisions were made and the factors/processes used to set compensation programs and levels for Named Executive Officers (NEOs). Given the stock price volatility faced by many companies in 2018, the need to disclose a rationale will be all the more important, especially at companies that are increasing compensation levels, despite negative total return performance.

Key areas that companies should consider enhancing disclosure on, with regard to the compensation process and rationale, include:

- Company performance factors considered outside of any metrics used in formulaic incentive compensation programs
- Explanation on why each performance metric was selected
- How the vesting/forfeiture of previously issued performance-based equity awards impact year-end compensation decisions
- Disclosure of individual performance factors used to determine award payouts
- Process used to select peer companies and the justification for any modifications from the prior year
- Rationale for any changes to base salaries or target compensation levels
- Visual graphics that illustrate the compensation review process
- Results of any benchmarking or peer group analyses
- Expanding CEO pay ratio disclosure to address any material changes from the prior year and/or material discrepancies to industry norms

Board Compensation Disclosure

Board compensation has become more heavily scrutinized in recent years with investors and proxy advisors paying closer attention to non-employee director compensation. A recent ISS director compensation policy update that targets “excess” director compensation, as well as board compensation-related lawsuits, suggests that board compensation will require more due diligence and enhanced transparency. Board compensation disclosure is expected to look more like a simplified version of executive compensation reporting and may include:

- Description of the company’s director compensation philosophy and review process, including the use of any benchmarking or peer group comparisons
- Description of the program in terms of both dollar values and structure in a more tabular/bulleted format
- Rationale for director compensation changes

An example of enhanced board compensation disclosure can be found by **selecting this link**.

ESG Disclosure

Large institutional investors continue to believe that long-term value is partially tied to ESG-related factors, and they have significantly increased their focus on sustainability and corporate responsibility issues. This increased emphasis on ESG is evidenced by firms creating new ESG-focused funds and the stated priorities of many large institutional investors, including BlackRock, State Street, Vanguard and T. Rowe Price.

Additionally, on October 2, 2018, a petition (signed by a number institutional investors and asset managers) was submitted to the SEC to mandate more standardized disclosure of ESG information.

> *"Integrating ESG considerations into our fundamental research has helped the firm identify well-managed companies that are leaders in their industries, more forward-thinking, better at anticipating and mitigating risk, and focused on the long term."*
>
> Bill Stromberg, President and CEO, T. Rowe Price

Companies should be reacting to this new investor priority by increasing the quality and robustness of ESG-related disclosure that may include:

- Links between ESG issues and corporate strategy and risk management
- Corporate social responsibility
- Quality and diversity of the board
- Environmental risk factors
- Corporate sustainability
- Human capital management

Examples of enhanced ESG disclosure can be found below:

Microsoft Corporation | **Allstate Corporation**

About FTI Consulting Executive Compensation and Corporate Governance Practice

The Executive Compensation and Corporate Governance practice at FTI Consulting has the unique capability to advise clients on both complex and routine compensation and other strategic matters. Our team of professionals has experience providing practical guidance on deal structuring, tax structuring, value-add governance changes and implementing compensation programs that are aligned with each company's strategic plan and reward employees for creating tangible value.

Our services include:

Competitive Compensation Review	Incentive Plan Design	Proxy-Related Services	Corporate Governance Services
Peer group development and benchmarking	Performance metric and goal setting to drive real performance	Draft proxy content and design graphics	Shareholder engagement and outreach
Pay magnitude and program structure	Pay mix	Calculate potential severance payments	Guidance on institutional investor and proxy advisor policies
Employment and severance agreements	Plan leverage and calibration	CEO pay ratio calculations	Board and executive evaluations
Salary banding and grading	Accounting and tax implications	Equity incentive plan design	Succession planning
Pay philosophy and objectives	Plan vehicle selection	Audit of compensation tables	Compensation risk assessments
Board of directors compensation	Payout calculations	Forecast pay-for-performance results under the ISS model	Corporate governance diagnostics

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