

Lessons from the 2017 Proxy Season

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*Janet Geldzahler
Glen Schleyer*

Overview of Presentation

- Summary of proxy access proposals for 2017; further confirmation of market terms for proxy access
- Proxy access amendment proposals fail; how to prepare for 2018
- The types of investors that most often submit proposals
- Other common and successful shareholder proposals in 2017
- Greater focus on board diversity
- Drivers of results of 2017 say-on-pay votes
- Even stronger endorsement for annual say-on-pay votes
- Near elimination of compensation-related proposals; broad shareholder support for equity compensation plans
- Common reasons for director “against” votes

Proxy Access – Main Proponents

- NYC Comptroller “Boardroom Accountability Project”
 - 2017 was third year of initiative. Issuers selected on 3 criteria: climate change, board diversity and excessive CEO pay, as well as at issuers which were funds’ largest holdings
 - Once again, over 70 proposals made by NYC Comptroller
 - At least 50 withdrawn upon adoption of a proxy access bylaw
 - Most proposals that went to a vote were approved
 - Did not make amendment proposals in 2017
- Individual proponents (McRitchie/Chevedden)
 - Unlikely to withdraw, but issuers that adopted at 3% were able to exclude as “substantially implemented”
 - Over 50 exclusions total (including both proposals to adopt and proposals to amend)

Proxy Access – 2017 Results

- Overall – only 27 proposals to adopt proxy access went to a vote, down from 81 in 2016
 - ISS supported 100% of the proposals
 - One issuer proposed a competing binding by-law (3/3/20/20), which passed; the shareholder proposal did not
 - Two issuers announced intent to adopt proxy access within next year—both shareholder proposals were nonetheless successful
 - Two issuers supported the shareholder proposal, and two took no position; the shareholder proposal passed in all cases
 - In 21 cases, the issuer simply opposed the shareholder proposal
 - In 12 cases, the shareholder proposals passed
 - In 9 cases, the proposal failed; for most of these, the issuer had large insider or friendly holdings

All shareholder proposal data in this presentation is for meetings at U.S. Russell 3000 companies through August 31, 2017, and is based on S&C's analysis of ISS and Shark Repellent data as well as public filings. A proposal is described as "passing" if it receives the support of more than 50% of votes cast.

Proxy Access – Market Terms

What are market terms?

- NYC Controller proposals – 3% ownership/3-year holding period /25% of board (did not address size of group in proposal, did in negotiations)
- Provisions adopted to date*
 - 99% at 3% ownership threshold
 - 100% at 3-year holding period
 - 100% require full voting and economic ownership
 - 85% at 20% of board (13% at 25%); 81% of those provide minimum of two access nominees
 - 92% limit group to 20
 - 94% count funds under common management as a single holder
 - 83% count incumbent access nominees against the current-year maximum
 - 73% provide a nomination window of 120 to 150 days before the prior year's proxy mailing date
 - 94% prohibit or limit the availability of proxy access in the event of a concurrent proxy contest

* These percentages cover bylaws adopted from April 2015 on.

Proxy Access – Market Terms

Continued

- 82% prevent resubmission of a failed candidate who received less than a specified vote percentage (usually 25%) in the past few years
- 95% specifically include loaned stock for purposes of meeting the ownership threshold and holding period, with 53% of all by-laws requiring the loaned stock to be recalled at some point in time prior to the annual meeting and 34% requiring stock to be “promptly” recallable
- 71% do not address post-meeting holding of the stock, 8% require a representation of an intent to hold post-meeting for one year, and 21% require a description of the holder's intent to hold post-meeting
- 79% require disclosure of (but do not prohibit) third-party compensation arrangements, and 12% prohibit third-party compensation for service as a director, and in some cases also as a nominee

Proxy Access – Amendments

- All amendment proposals in 2017 were made by individual proponents (McRitchie, Chevedden, Steiner)
 - None by Comptroller in 2017
- Most were made at issuers where there had been a proxy access proposal voted on in the past, but three issuers this year received amendment proposals despite having proactively adopted proxy access
- Proposals generally either:
 - raise number of directors to greater of 25% and two, no limit on aggregation and no limit on renominations based on prior vote received or
 - remove or raise (generally to 50) group limitation of 20

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Proxy Access – Amendments

- 22 amendment proposals went to a vote in 2017 (only 8 in 2016)
 - All were precatory. ISS recommended for all.
 - All failed in 2017. In 2016, only two passed, both lowering 5% to 3%.
- Many more were excluded through SEC no-action process as “substantially implemented” by existing provision
 - Proposals to raise group size limit to 50 were deemed excludable as substantially implemented, even though no amendment was made
 - Burden is on issuer to provide data on duration and size of holdings of shareholder base, showing that the change would not significantly affect availability of proxy access.
 - Exclusion denied where company did not provide data on duration of holdings
 - Proposal to remove group size limit deemed not excludable (H&R Block letter)

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No Use of Proxy Access to Date

- Unattractive to activists – traditional proxy contests more likely to be successful
- Greater expense/effort than shareholder proposals
 - Must file Schedule 14N
 - Must comply with advance notice bylaw requirements
 - Director nominees likely to seek indemnification/nomination fees – grounds for exclusion in some proxy-access bylaws
 - Complicated legal framework
- Less attractive to potential nominees?
 - More limited solicitation means lower likelihood of success
 - Will group agree to indemnify, pay nomination fee; is it allowed under bylaw?

Proxy Access – What to Do Now

- Prepare form of proxy access bylaw
 - <https://www.sullcrom.com/proxy-access-bylaw-developments-and-trends>. Updates included in PLI Public Company Deskbook, written by S&C partners
- Analyze shareholders' positions – but assume absent unusual holdings receipt of proposal will result in adoption of proxy access in some form
- Stay apprised of new formats of proposals, SEC no-action positions
- Keep board updated

Should Issuers Adopt Proxy Access Proactively?

- **Pros**

- Less likely to receive proposal to amend
- Gets the issue behind the board
- Proxy access nominations as of yet have not been made
- Avoids increasingly extensive withdrawal negotiations with NYC Comptroller
- May avoid getting on radar for initiatives like Board Accountability 2.0 (discussed below)

- **Cons**

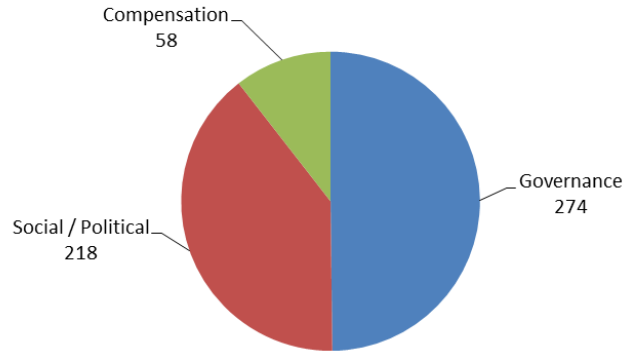
- Makes proxy access nominees possible sooner
- Issuer might not get a proposal for some time, and little pressure on mid-cap and small-cap companies to adopt proactively
- Currently, adopting after receiving proposal or losing a vote yields the same terms as proactive adoption (ISS has not recommended against directors at companies that adopted 3/3/20/20 bylaw after proposal passed, even where proposal provided group size be unrestricted)
- May still get a proposal to amend even following proactive adoption (for example, to remove group size limit)

Proxy Access – Actions on Receipt of Proposal

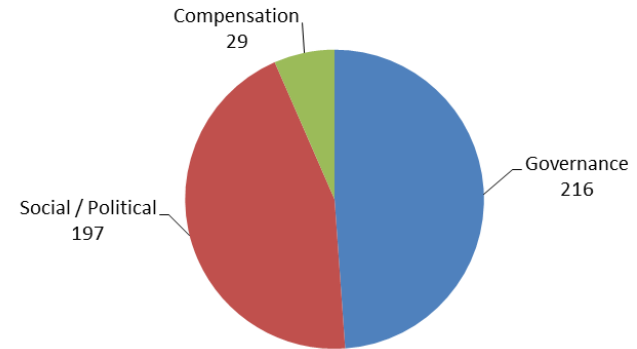
- **Simply putting to a vote probably still least attractive option**
 - Highly likely to lose, but terms adopted following lost vote are as favorable as those adopted proactively, and could be better than if negotiate with NYC Comptroller
 - Adopting following receipt of proposal puts issuer on same timing as to availability of proxy access as simply putting to a vote and losing, but appears more responsive
 - “Need for study, evolving landscape” arguments not very credible at this point in light of consistency of market practice
- **Adopting 3/3/20/20 in advance of vote is most common response**
 - NYC Comptroller should withdraw, but negotiations are becoming more protracted
 - Individual proponents generally won’t withdraw, but should be excludable as substantially implemented (as would NYCC proposal if not withdrawn). Successful exclusions in 2016 did not seem to increase risk of receiving an amendment proposal in 2017
 - For proposals that make it to a vote, prior adoption by company has been successful in defeating proposal in all instances unless 5% ownership required
- **Put forward competing management proposal for vote**
 - Less common than adopting in advance of vote, but similar success

Shareholder Proposals by Category

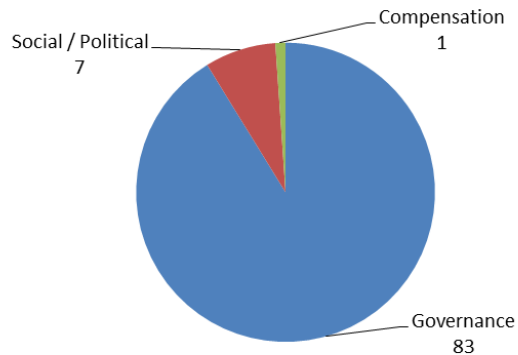
2016 Proposals Voted On



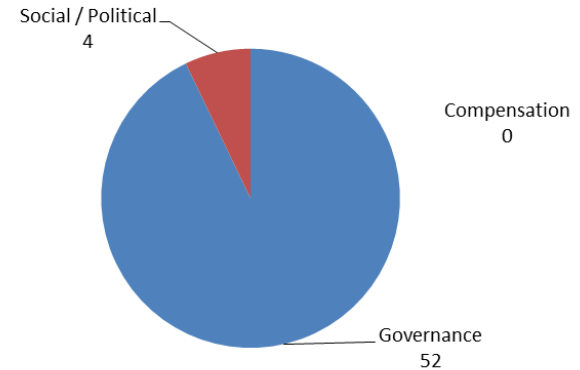
2017 YTD Proposals Voted On



2016 Proposals Passed



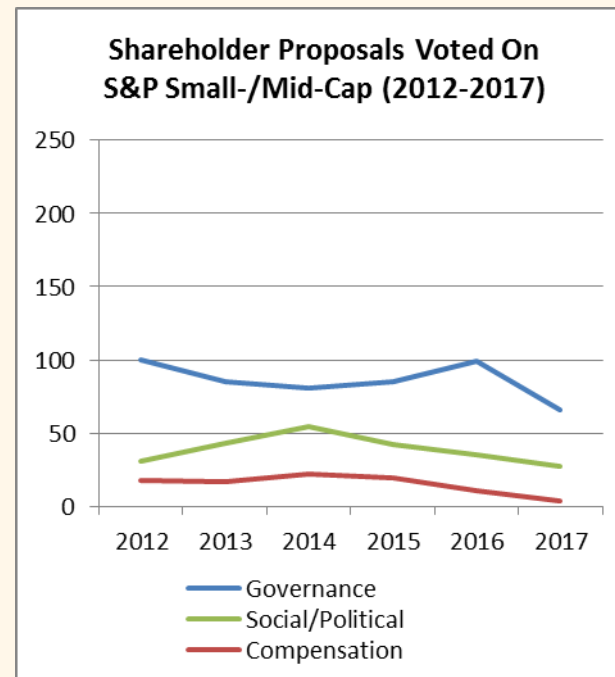
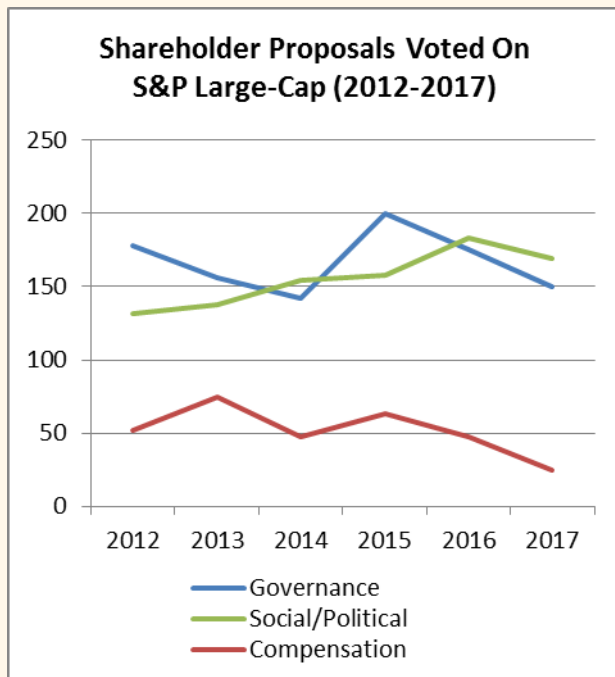
2017 YTD Proposals Passed



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Who Gets Shareholder Proposals?

- Shareholder proposals remain much more common at larger companies.
- The following chart shows the number of shareholder proposals by market cap (note that the small/mid-cap chart covers 3x as many companies):



Data derived from ISS and Shark Repellent information. Data is for meetings through August 31, 2017.

Who Makes Shareholder Proposals?

- *Individuals.* Chevedden, McRitchie and William Steiner and family members made over 200 proposals (220 in 2016), close to 25% of all proposals and more than half of all governance proposals
- *Public Pension Funds and Entities.* Over 140 (165 in 2016) proposals, including the 70 proxy access proposals by NYC Comptroller. Of other proposals, key focuses include board diversity, disclosure of political contributions, environmental issues and gender pay equity
- *Labor Unions.* Over 40 proposals (70 in 2016), primarily on governance and compensation related issues
- *Social Investment Entities.* Responsible for most social policy proposals. Most active include As You Sow (47), Trillium Asset Management (41), Walden Asset Management (23), Mercy Investment Services (22), Holy Land Principles (20) and Northstar Asset Management (20)

Independent Chair

Total Shareholder Proposals Voted On		Average % of Votes Cast In Favor		Shareholder Proposals Passed	
2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
41	47	30%	29%	0	0

- Second most popular proposal, after proxy access
- Shareholder support had plateaued
 - Lead Independent Director appears to be an acceptable substitute for separating the roles of chair and CEO

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Majority Voting and Board Declassification

	Total Shareholder Proposals Voted On		Average % of Votes Cast		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Adopt Majority Voting	14	19	68%	71%	10*	15
Eliminate Supermajority	14	16	74%	60%	13	10
Declassify Board	7	6	68%	79%	5	5

* Includes Netflix—proposal received majority support, but was in binding form and failed to get the necessary supermajority vote to pass.

- Continued decreases in governance proposals coming to a vote
 - Most large-cap companies have these provisions in place
 - Smaller companies tend to adopt these provisions upon receipt of a proposal, due to high success rate if they come to a vote.
 - Majority voting is a common proposal at mid-cap companies

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Written Consent Proposals

RIGHT TO ACT BY WRITTEN CONSENT					
Total Shareholder Proposals Voted On		Average % of Votes Cast In Favor		Shareholder Proposals Passed	
2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
15	17	46%	41%	3	1

- Decrease in number of proposals voted on continues (36 in 2015).
- Success rates relatively low—proposals tend to be made at companies that already have shareholder special meeting rights.

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Special Meeting Proposals

	Total Shareholder Proposals Voted On		Average % of Votes Cast		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Adopt new right	5*	4	45%	41%	3	2
Lower % on existing right	18	15	41%	42%	1	2

* Includes Exxon, though proposal was to adopt a 15% right where NJ law already provided 10% right. Proposal failed.

- Two competing proposals were made by issuers at higher thresholds, both passed at one issuer, and neither at the other (management proposal had supermajority vote requirement)
- 25% threshold is most common, and shareholders remain supportive; in 2017, only one proposal (lowering 25% to 15%) was successful, with 52% support

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Board Diversity Proposals

Increase Board Diversity					
Total Shareholder Proposals Voted On		Average % of Votes Cast In Favor		Shareholder Proposals Passed	
2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
8	8	31%	26%	2	2

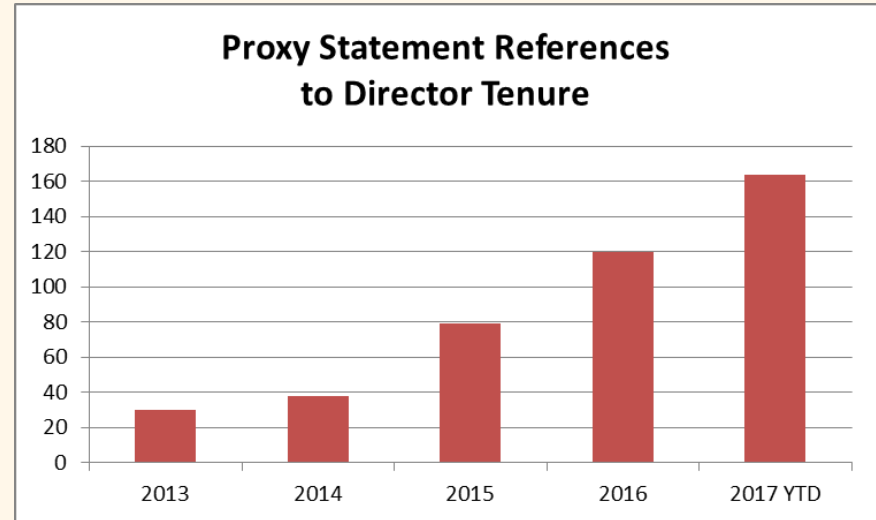
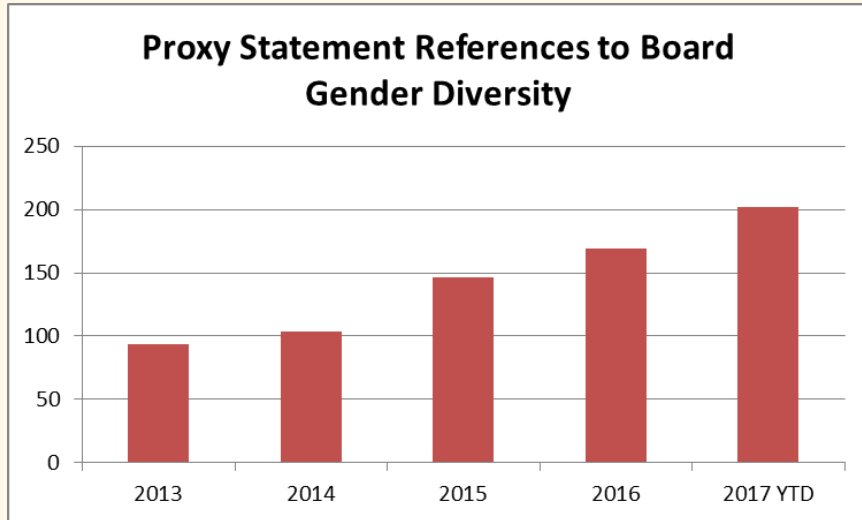
- Potentially a significant proposal topic in 2018
- In 2017, large institutional investors (State Street, BlackRock, Vanguard) have announced engagement focus on board diversity, particularly gender diversity (as well as climate risk, discussed below)
- Several state legislatures (CA, IL, MA, PA) have adopted non-binding resolutions urging board diversity for companies doing business there

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Board Diversity Developments

- NYC Comptroller letters on Boardroom Accountability 2.0 (Sept. 2017)
 - Sent to around 150 issuers who previously received proxy access proposal from NYCC and either adopted proxy access or proposal received majority support
 - Requests directors of issuers to
 - prepare and publicly disclose director qualifications matrix identifying each director's most relevant skills, experience and attributes, as well as each such individual's gender and race/ethnicity
 - engage with NYCC to discuss
 - matrix currently used by board to understand board's view on critical skills
 - how directors are currently evaluated and process for discussing with directors stepping down from the board
 - how to establish a process whereby issuer's director search firms will reach out to NYCC and other significant stockholders for their suggestions on nominees and organizations which specialize in sourcing female and minority board candidates
 - establishing a more structured process for NYCC and other stockholders to suggest board candidates

Board Composition Disclosure Trends



- Director tenure has not been a focus of proposals, but is increasingly a topic addressed by issuers in proxy statements.

Social Policy Proposals

	Total Proposals Voted On		Average % of Votes Cast		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Political issues	60	73	26%	26%	0	2
Environmental issues	60	67	29%	24%	3	1
Anti-discrimination	28	23	15%	13%	0	2
Human rights issues	23	21	7%	8%	0	0
Sustainability report	10	15	29%	30%	1	1
Health and safety	8	10	17%	11%	0	0
Animal rights	3	3	12%	37%	0	1
Other social policy issues	5	6	4%	11%	0	0

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Environmental Focus of Institutions

- Environmental proposals have increased in frequency and support levels.
 - In 2015, the average support level was 18% and no proposals passed, while in 2017 the average support level was 29% and three proposals passed, all climate change-related proposals at energy companies.
 - Three of four proposals on director qualifications in 2017 called for nomination of director with environmental expertise.
 - The most common type of compensation-related proposal in 2017 sought to link executive compensation to social issues such as environmental impact or sustainability.
- The announced ESG focus of institutional investors is likely to further this trend:
 - State Street sent a letter to board of portfolio companies in January 2017 asking for expanded climate risk disclosure, noting “Over the long-term, these issues can have a material impact on a company’s ability to generate returns”
 - BlackRock 2017-2018 engagement priorities and issue-specific reports have flagged climate risk preparedness and disclosure as a key aspect of portfolio company engagement
 - Vanguard 2017 Annual Report and open letter (Sept. 2017) highlight that “[a]s significant long-term owners of many companies in industries vulnerable to climate risk, Vanguard investors have substantial value at stake.”
 - BNY Mellon engagement request (Sept. 2017) states that, in addition to discussing 2017 shareholder proposals, BNYM “would like to discuss the environmental and social factors that may be relevant to your business strategy.”

Compensation-Related Shareholder Proposals

	Total Shareholder Proposals Voted On		Average % of Votes Cast in Favor		Shareholder Proposals Passed	
	2017 YTD	2016	2017 YTD	2016	2017 YTD	2016
Social compensation issues	7	7	18%	10%	0	0
Limit golden parachutes	6	18	32%	30%	0	0
Clawbacks	6	6	14%	14%	0	0
Stock retention	3	12	30%	18%	0	0
Other compensation-related	7	15	14%	19%	0	1

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ISS Recommendations Against Directors

Impact of an ISS recommendation against a director depends on the *reason* for it

2017 ISS DIRECTOR “WITHHOLD” OR “AGAINST” RECOMMENDATIONS (ALL U.S. RUSSELL 3000 COMPANIES)

	Number of Directors Receiving Negative ISS Recommendations	Average Shareholder Vote for Directors (% of votes cast)	Number of Directors Receiving <50% of Votes Cast
<u>MOST COMMON REASONS</u>			
• Independence issues (non-independent directors on key committees or failure to maintain a majority independent board)	311	88%	4
• IPO company with adverse governance provisions (new)	300	87%	2
• Shareholders not permitted to amend bylaws (e.g., Maryland REITs)	202	79%	3
<u>MOST IMPACTFUL REASONS</u>			
• Poor attendance at board and committee meetings (<75%)	53	67%	10
• Overboarding	40	78%	4
• Lack of responsiveness to low say-on-pay	38	71%	2
• Lack of responsiveness to shareholder concerns (e.g., failure to implement a successful shareholder proposal)	26	62%	6

See S&C 2017 Proxy Season Review Memo for full list of reasons for ISS negative recommendations against directors, and related analysis.

Data is for meetings through June 20, 2017 and is derived from ISS information and public filings.

Drivers of 2017 Say-on-Pay Results

	Russell 3000		S&P 500	
	2017 YTD	2016	2017 YTD	2016
Percentage passed (majority support)	99%	98%	99%	99%
Percentage with >70% support	94%	93%	94%	94%
Percentage with ISS “Against” recommendations	12%	11%	9%	8%
Average support with ISS “For” recommendations	95%	95%	94%	94%
Average support with ISS “Against” recommendations	69%	67%	68%	63%

- Overall, U.S. companies had similar say-on-pay results in 2017 to 2016
- Of the 22 companies that had failed say-on-pay votes in 2016 and have had their 2017 meeting, 17 received majority support in 2017, with 14 getting >70% support
- Results reflect companies’ continued efforts to engage with shareholders and proxy advisors, as well as clearer compensation disclosure
- Past success no guarantee of continued success
 - Of the 26 companies in Russell 3000 that failed say-on-pay in 2017, only five failed their 2016 vote and nine had >70% support in 2016.
 - All three S&P 500 companies that failed in 2017 has passed in 2016, with two of the three having >80% support in 2016

Data is for meetings through August 15, 2017, and is based on S&C’s analysis of ISS and Shark Repellent data as well as public filings.

2017 ISS Say-on-Pay Analysis

Continued

- ISS recommendations continue to be driven by pay-for-performance analysis, which is focused on stock price – most important factor is alignment of CEO pay to Total Shareholder Return

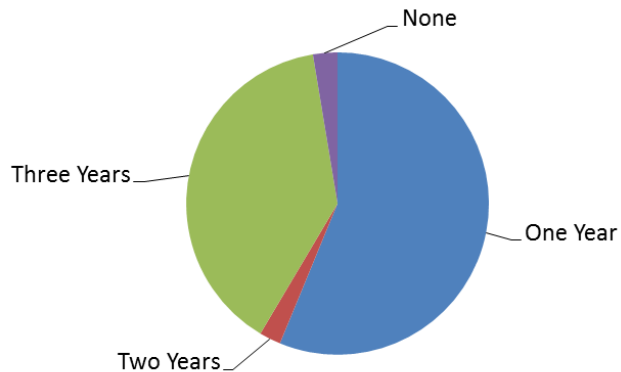
2017 Results of ISS Quantitative Analysis Factor

	<i>U.S. S&P 500 Companies with Negative ISS Recommendations</i>
Total with negative recommendations	37
Number that had “high concern” on:	
• Pay-for-Performance	35
• Compensation Committee Communication and Responsiveness	5
• Severance/Change-in-Control Arrangements	4
• Peer Group Benchmarking	1
• Non-Performance-Based Pay Elements	0

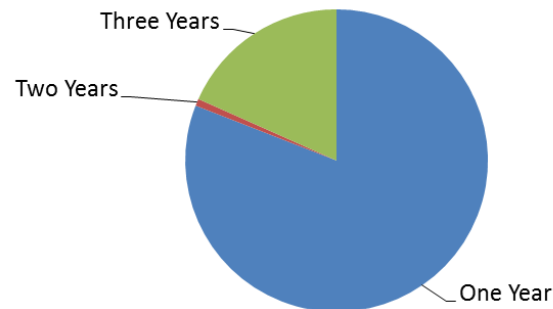
Based on ISS reports for meetings through June 30, 2017.

Say-on-Pay Frequency Vote Overwhelming Supports Annual Say-on-Pay Votes

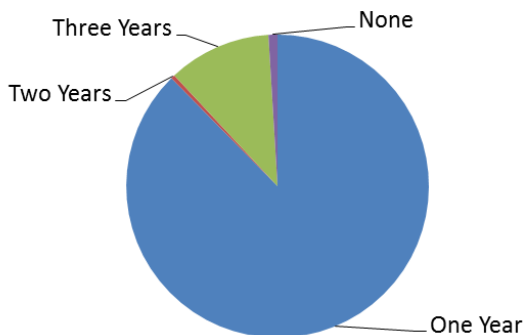
2011 Management Recommendations



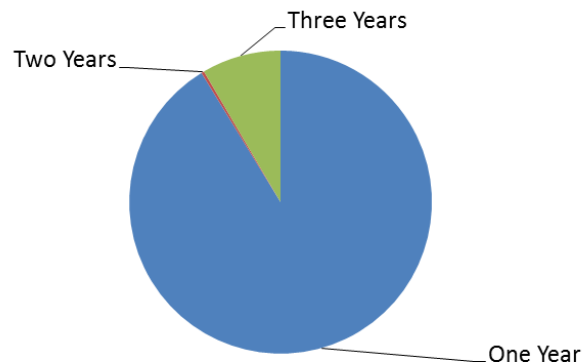
2011 Shareholder Preferences



2017 Management Recommendations



2017 Shareholder Preferences



For meetings at U.S. Russell 3000 companies through August 15, 2017, based on ISS data.

Janet Thiele Geldzahler
Of Counsel, Washington, D.C.
T: +1-202-956-7515
E: geldzahlerj@sullcrom.com

Glen Schleyer
Partner, New York
T: +1-212-558-7284
E: schleyerg@sullcrom.com

SULLIVAN & CROMWELL LLP