

Chadick Ellig Executive Search Advisors
Presents
The Devil is in the Details:
How Dodd-Frank will Reshape Corporate Governance

Panel Points

Executive Compensation Provisions and Their Implications

Companies are at different stages of readiness to implement “say and pay” rules

Implementation steps:

- **Ask questions:** Boards need to ask: Can you link your pay practices through long-term value creation? Are you comfortable defending your practices?
- **Take stock:** Boards need to know in advance of next spring whether or not they are in trouble w/pay practices and compensation
- **Do risk metrics:** Boards should do a pay test, not against peer group but against standard industry. Should look at whether CEO pay is increasing or decreasing above or below the median, why is it going one way or the other; and is the pay aligned w/performance of the company.

Shareholder vote on frequency 1, 2 3 years

- Decision on frequency will depend on attributes of companies and policy decisions. For example, restructured company wouldn't be inclined to wait 3 years but one year too difficult to measure long-term value creation in 12-month period.

Steps to take when a board gets a no-vote on pay

- **Determine cause:** Is it dissatisfaction with CEO, a problematic pay practice, or issues with perks, pension plans, housing plans? What is it that got you in trouble? --*Understand perspective* What is the perspective of important institutional shareholders to determine what should be changed?
- Director compensation experience, independent directors
- Compensation committee must develop a more granular understanding of pay issues and will have increased workload similar to SarBox changes with audit.
- Question as to whether a board made up of experts in specific areas is good for a board as they may not have business judgment and experience. An unintended consequence is that directors aren't connected with the industry. This robs companies with knowledge and wisdom that could be applicable and helpful.
- Drive for independent directors on boards has diluted quality of engagement on business practices—

Conclusion: Executive compensation was the purview of board is now shifting. Boards must engage more with institutional investors and rely more heavily on proxy advisors who may take rigid views.

- How companies communicate to shareholders will be increasingly important
- Shareholder vote on frequency will have lots of pressure for one year as the accountability link hasn't been what shareholders have wanted.
- Composition of compensation committee is still uncertain. Question is if you have to populate with audit, comp, governance, how many spaces will be left to drive strategy?

Proxy Access and Shareholder Engagement

Steps to engage shareholders

- Best defense for proxy access is to be proactive
- Deliver exceptional results to shareholders
- Clearly articulate the board's perspective on issues most important to board
- Listen and respond to shareholder concerns

Proxy access might not be used that frequently if it comes to pass

- Dodd-Frank (DF) stimulates a 3% ownership threshold which is pretty high
- DF requires continuous 3-year holding period,; that eliminates hedge funds
- Proxy access: can't be used to force a change in control; if successful, get a change in about 25% of the board;
- Threat of proxy access may be used to force governance changes

Practical steps:

- Upgrade written shareholder communications
- Proxy should be written in plain English
- Major concerns for 2010-2011 policy survey according to ISS: board independence; competence; and compensation
- Focus on qualifications, leadership structure, and work hard with CDA

How to approach and execute shareholder engagement

- Use proxy as a communication tool
- Directors should not speak directly to shareholders

Board Leadership Post Dodd-Frank

New Whistleblower (WB) rules a real problem

- Monetary rewards encourage employees to bypass internal regulatory controls
- SEC did not mandate that employees first go internally as many hoped
- Attorneys looking for whistleblowers

- Public can blow the whistle—creates unbelievable pressures

Unintended Consequences of new WB rules

- Prepare for huge increase in number of claims filed
- Not all complaints may be valid- WB may be looking for protection from dismissal
- Increase in media attention and potential stock price drop during investigation
- Increase in costs to companies

What companies can do

- Stress importance of conforming to laws and regulations
- Encourage internal reporting, hotlines. Assess effectiveness, make it available to vendors; respond promptly and then market effectiveness of internal reporting
- Increase self-reporting of own violation rather than claim filed with SEC

Accountability for nominating committee's slate of board of directors

- Diversity should play a role in nomination process if it hasn't already
- Not suggesting legislative mandates and quotas
- Facts speak for themselves: There is a business benefit to women on boards
- 11% of S&P companies has no women; 50% of Russell 5000
- Demographic of board directors: average age: 60 years of age

Besides women, who else is missing from the boardroom?

- The 20-something CEOs of billion dollar companies. They think and buy differently.
- A global and foreign perspective: 32% of the S&P 500 revenues come from outside US and yet only 7% of boards has international directors; of that, only 2% are from Japan and China
- Expertise and experience in marketing, IT operations and finance, M&A strategy, cost cutting experience;
- Personality: style, behavior, board members—individuals who can speak with candor and not be afraid to challenge the CEO. Boards afraid to engage