Executive compensation consultants, Joe Mallin and Linda Pappas of Pay Governance, co-hosted the NACD Carolinas "3D" – *Director Dinner & Dialogue* – on April 24, 2017. Some of the highlights of the discussion on executive and director compensation are included below.

1. **Dodd-Frank – what the new administration is saying**

   The fate of Dodd-Frank is uncertain in light of the 2016 election results. The final CEO Pay Ratio rules are currently scheduled to be effective for pay during the fiscal year starting after January 1, 2017 (i.e., 2018 proxy season). However, the SEC opened a 45-day period beginning on February 6, 2017 for issuers to submit comments on the Dodd-Frank CEO pay ratio disclosure rule, particularly related to the cost of gathering information related to determining the median employee. Collection of new comments could allow the Trump administration to make the case for potential repeal/modification, but the timing is uncertain. We discussed the internal employee communication needs related to the pay ratio focused on issues arising from the publication of median employee compensation levels.

   Other proposed rules (i.e., Clawback Policy, Pay-for-Performance Disclosure and Hedging Disclosure) most likely will not be required in 2018 proxies.

2. **Long-Term Value creation – relative total shareholder return (TSR) and other strategic uses of equity**

   Performance shares have now exceeded majority value in long-term incentive (LTI) programs, while the use of stock options continues to decline. In light of this continued decline in options, we discussed the pros and cons of stock options, particularly the motivational effect of their significant leverage versus their dilutive impact to shareholders.

   Some companies are reconsidering the use of relative TSR as an incentive plan performance metric used simply for appeasing proxy advisors ISS and Glass Lewis. Other companies are beginning to realize the use of relative TSR as an exclusive performance metric for a long-term performance measure plan presents challenges in terms of establishing viable peer groups and relative TSR's limited linkage to business strategy. In addition, we discussed the "lottery" effect within a relative TSR plan in which outcomes are known after the fact and are predicated to a great extent on outcomes not controllable by any particular management team. As a result, we also discussed how companies are moving toward relative TSR as being just one of multiple performance goals within an incentive plan, or are considering eliminating TSR as a metric altogether.

3. **Director Compensation**

   Trends in director compensation continue to develop, including the ongoing elimination of meeting fees in favor of a "flat fee" retainer only approach and the use of "full value" equity as opposed to stock options. Additional fees for Committee members and chairs continue to rise as the associated time requirements for these roles continue to grow. In addition, recent director pay litigation has driven companies to put a cap on equity awards for non-employee directors within equity incentive plans, and ISS has expanded its policy on evaluating director pay.

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We discussed the importance of reviewing director compensation using a compensation consultant every 1-3 years, and weighed the different approaches of either making modest adjustments to director pay more frequently versus a "lead-lag" approach of making larger "catch-up" increases less frequently.

4. Incentive Plan Risk Management – learnings from Wells Fargo

The recent Wells Fargo incentive plan issue resulted in significant reputational risk and damage to the Company in various aspects: (i) at the Board level – contentious re-elections to the Board with low vote outcomes for many directors, (ii) at the management level – terminations of senior executives and clawbacks of previously earned compensation, and (iii) most importantly, at the customer level – will fewer customers choose Wells Fargo in the future?

The role of the Wells Fargo Board and whether they should have taken action sooner represents a difficult set of questions without easy answers. While hindsight shows the issue was important enough to have risen to the Board level sooner than it ultimately did, it remains unclear what specific actions the Board could have taken to avoid the significant reputational damage incurred by Wells Fargo. There are many lessons to be learned, including:

(i) What factors determine the information a Board sees on an ongoing basis?
(ii) What was the relative importance of information for this particular incentive plan in the context of all information potentially available from a company of this scale?
(iii) What questions should be asked by a Board, and how those questions should be asked?
(iv) When should a Board question exceptional results, such as the number of relationships the average Wells Fargo customer had, which we understand was much higher than other banks?
(v) How should a Board probe for explanations of large differences in outcomes?
(vi) What other factors could impact the application of judgment by Board members?

5. Say on Pay/Say When on Pay 2017 Year-to-Date Update

2017 "say on pay" results are following a similar pattern to past years, with 93% overall average shareholder support and only 1% of companies failing to receive majority support among Russell 3000 companies. To date, ISS has recommended "AGAINST" 10% of say on pay resolutions, and at these companies average support was only 71%. Thus far, three Russell 3000 companies have failed to receive majority support for their say on pay proposals, each of which received an "AGAINST" ISS recommendation due to pay-for-performance misalignment and other problematic practices.

In terms of say on pay frequency, the vast majority of companies have proposed an annual vote, with an average of nearly 90% of shareholders voting in favor.

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