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## Day 1
## Directors in the Crosshairs-Directors Pay, Diversity & More
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**Liz:** Director pay and board diversity are hot topics right now. And so, I want to welcome our panelists who will be discussing these issues and how to deal with them. We have Ron Mueller of Gibson Dunn, Reid Pearson of Alliance Advisors, Bob Lamm of Gunster and Amy Wood of Cooley. I will turn it over to Bob to set the stage for this discussion.

**Bob Lamm:** Thank you so much, Liz. And good morning everyone. I'm going to thank my fellow panelists before I forget to do that. When I was in my last in-house position at Pfizer, we and a couple of other companies go say on pay proposal for directors from a group of shareholders and I think it elicited a whopping three percent of the vote. Obviously, that's changed, and director pay really is in the crosshairs. So, we have a pretty limited timeslot. Let's just get into it.

Reid, can you lead us off talking about pay trends and the shareholder and proxy advisor policies?

**Reid Pearson:** Yeah, absolutely. Thanks Bob and thank you everybody. I think the bottom line, at least right now in a couple of studies that are out there, is that director pay is relatively flat over the past couple of years. ISS put out a paper in August stating that the median director pay for an S&P 500 company was about $290,000. That compares to fiscal year '18 where it was about $285,000. So, not much change. The trend continues for mid-cap companies where the average or median, excuse me, the median pay was about $230,000. And for a small-cap index it was about $186,000. So, again, the trend is for the most part that director pay has been relatively flat. The one exception to that has been the role of the lead independent director. Given the additional roles and responsibilities there, not too much of a surprise.

With respect to polices, ISS adopted an, I wouldn't say aggressive, but adopted a policy a couple of years ago where they would actually potentially recommend against the members of the committees that were responsible for setting director pay if there was a pattern of excessive pay—when they say pattern they typically mean two or more years—without a compelling rationale or a compelling reason. And again, just to kind of set that in context, for the S&P 500 the median pay where ISS flagged a company with $752,000. Again, compared to the median of $290,000. The mid-cap index was $597,000 compared to $230,000. And the smaller index was $600,000 compared to $186,000. So, it wasn't a tremendous amount. I think they flagged about 80 companies ultimately for what they consider to be excessive pay. Then they went and they looked towards the more kind of qualitative. Did the company provide a good rationale? And found that about in two-thirds of cases that the companies actually did. It might be the compelling rationale or things like a corporate event such as an IPO. It could have been a commitment to bring down director pay going forward.

So, that left about one-third of companies that kind of had an issue with ISS. And just for a couple of examples, you had Diamond Hill Investment Group where ISS recommended against a director. One, because…actually it built an interesting case because the committee actually granted front-loaded grants to the director. In other words, they had a grant, an equity grant, that was supposed to last, I think for eight or nine years. So, a bit of an unusual circumstance there and certainly an outlier.

Another one was MDC Holdings. They recommended against two. Reasons being excessive pay for the lead independent director. But also, that lead director was receiving a retirement benefit where I think he got about $30,000 a month for five years after he ceased being a director. So, again, a bit of an outlier. And I think that's kind of the theme here with the policies. It's not a massive voting against directors for excessive pay, but they are looking at outliers.

Most of the large investors not influenced by ISS and Glass Lewis haven't really adopted kind of full policies. There is one large active fund which actually uses director pay as a speed bump. In other words, they'll review excessive director pay in relation to their _____ pay proposal interestingly enough.

But most of the other ones have not really adopted a policy. It's more of a 'we'll know it when we see it' type of thing. So, that's a little bit of a trend. A little bit of the policies. Bob, I'll put it back to you.

**Bob Lamm:** Okay. And I will turn it over to Amy because as always, never underestimate the creativity of the plaintiffs' bar. Amy is going to tell us what they're up to.

**Amy Wood:** Yeah, and I know we've been talking about this for a few years. I'll say the update is that we are still seeing the director compensation litigation, so I'll recap just a little bit about where that comes from. And then maybe not go too deep into the case law and developments, but instead just sort of shift over to what can we do, an effort to deflect that type of litigation and who might be concerned about it.

But just by way of background, the reason we're talking about this and that the plaintiffs' bar is focused on this, it's an easier area to attack. Director self-compensation decisions are inherently self-interested. So, unless a defense is available and if properly challenged, that means that those decisions get the entire fairness standard instead of the more differential to the board business judgement rule. The entire fairness standard is the highest level of review. It's the biggest burden on defendants. Defendants have to establish that what's being challenged was a product of both fair dealing and fair price. What that turns into is just ability of plaintiffs' firms to take these cases farther than for instance what some of the executive comp or equity compensation cases that they were testing for a few years.

As the result of some case law, there's some shifting in sort of how can we deflect or defend against these cases prior to the Investors Bancorp decision. It was thought that having a limit in the equity plan on the amount of director comp that was ratified or approved by shareholders when that plan was approved should be enough to shift that back to business judgment. That case called into question whether in fact that works. There were bad facts in that case, so we're still waiting to see if there's an evolution here in terms of the effectiveness of the limits in plans. But I would say that that, kind of the plaintiffs' bar picking this up, companies wanting to defend and deflect these cases by adding limits, did sort of take on a life of its own and now is being talked about by ISS as just a best practice.

When they're looking at a director plan, they're looking at does the plan have a limit on director comp. Now, it's kind of a stand-alone thing when really this was the source of the market shifting to these limits. But we are still seeing those go into equity plans.

I think kind of with that background and in that landscape, what else can we do to deflect or best position ourselves if one of these claims is sent into us? I think kind of going through, well, what do we look at if we are in that entire fairness analysis is helpful. And then hopefully that will tee us right up to move into our next topic, which is disclosure. The factors that the court's going to look at if director comp is challenged are just the absolute size of the awards. Obviously, the comp committee is looking at that anyway. The next factor is the size of the awards relative to historical practices in peer companies.

So, it's a very typical process for settling director compensation, but I think process is important here in making sure that that's being done frequently enough. The analysis of what the amount of the director comp is now including relative to peer companies and the peer group is being reassessed frequently enough as well.

And the next factor is the timing extent and content of the board or committee deliberation on director compensation. Whether the board of committee was advised by experts, the purpose and justification for the awards, whether the awards are being made pursuant to a stockholder approved plan that has limits or guidelines. So, the plans that have a very formulaic automatic grant built in provide the most protection. And where there's discretion subject to a limit, that's not as much protection even when approved by shareholders.

And then finally, the adequacy of the disclosure including the process used to set compensation levels. Which is an interesting factor and has driven, I think, market evolution on this also. The requirements to disclose the process on director comp are nowhere near the requirements for executive comp, but we're seeing that disclosure increase and for good reason. This one and maybe also what investors want to see, Bob, I think you're going to say a little bit more about the disclosure piece of it.

**Bob Lamm:** Yeah, not too much more. I think the disclosure, obviously, can be important for many years. You sort of saw disclosure saying here's our director's comp. You got the director compensation table, a little narrative about the equity awards, and that was it. And like you, Amy, I've noticed a trend for more disclosure not only about the nature and detail terms of the equity awards, but more of the rationale, more of the process, talking about the use of compensation consultant, which of course is required. But I've seen a lot of companies sort of forget about that requirement and not pay too much attention to it.

Obviously, disclosure can't overcome a really bad situation. It's kind of like putting lipstick on a pig. But to sort of get back full circle to what Reid started out with, not only because of ISS but also because investors increasingly want to know about it, giving an explanation of compelling circumstances or why you gave what you gave, I think even if it doesn't necessarily help with ISS it certainly helps with some of your larger investor groups and can help sell the story.

One thing, I don't know if any of you have seen what I'm about to mention, but I've seen a couple of random articles and I can't even remember where I saw them. But many boards have been meeting, albeit informally, constantly since the onset of the COVID pandemic. And I've seen notions that some directors…some companies rather may be giving or considering giving additional pay to the board members because of the additional time they've had to spend. Which kind of harks back to a per meeting fee, which nobody has done, very few people have done over the last years. I think if you're going to provide that sort of additional compensation to your board, you really need to explain why it was ______ it's too soon to tell whether ISS or any of the major institutions will try and correlate additional director pay because of COVID to how the company fared in COVID. Obviously, there are companies that have really been hit hardest, they have worked twice as hard for half the results.

But why don't we move on from that because we could probably spend our entire time talking about director pay. Let's turn to director diversity, another very hot topic. Amy, I'm going to turn to you first to discuss state legislation trends.

**Amy Wood:** Yeah, definitely a hot topic. So many sources of input and concern on board diversity. On the state legislation front, people are probably more familiar with the California legislation on gender diversity and may also be familiar with what's pending now sitting on the Governor's desk for a signature which is kind of paralleling the gender diversity legislation. And that actually applies to all public companies that are headquartered in California, so not just those that are California corporations, but all public companies headquartered in California. And it does impose some quotas on the number of women that need to be on the board depending on the size of the board with some different staged deadlines. The first deadline now having past, it was December 31, 2019. The next deadline is December 31, 2021. So, there was some ramp up time to allow boards that weren't compliant to get there.

The pending legislation in California kind of mirrors the same structure with some differences. So, this is going to apply to not gender diversity, but under-represented communities which are primarily racial and ethnic diversity and the LGBT community. And it's going to similarly impose some quotas based on board size. They're a little bit different in terms of the number of under-represented directors tied to board size. The breakdown is a little bit different there, but same structure. The deadlines are also staged. So, the first deadline would be December 31, 2021 and then the second one would be a year later at the end of 2022. Similar, also, penalties. Same penalties in terms of violations of meeting the requirements.

This second piece of legislation for the under-represented communities, as I mentioned, is sitting on the Governor's desk now. It was presented a week and a half or so ago and he has until the end of September to either sign or veto. So, we'll watch and see what happens with that one. The gender diversity legislation is being challenged in court in a couple of different cases. Presumably, the same challengers may attack this new bill as well. But we will watch and see what happens by the end of the month. And there are a couple other states as well. Washington has already passed legislation. And then there are a number of states that aren't imposing a quota on the number of under-represented directors or diverse directors, but mandating disclosure about board diversity or just adopting more encouraging legislation that's not necessarily a mandate, but encouraging companies to increase board diversity. And there's more information about what's happened and what's pending on all of that status in the materials.

**Bob Lamm:** Great. Turn to Ron. Can you tell us a little bit about the investor policies on board diversity?

**Ron Mueller:** Sure, Bob. Thanks for that. I'll just add on to Amy's point also that there's also federal legislation pending that would basically codify the interpretative position, the staff, ____ staff. It has passed the House. It has the unusual position of being supported by both the Council of Institutional Investors and the Chamber of Commerce. And if it was last week, I would have said look for it to pass before the end of the year, but who knows what's going to happen in Washington these days. So, we may be, again, dealing with diversity on the investor side. And here I think the investors, both large and activists and across the spectrum, have really kind of been in the lead on this.

The summer before last, 2019, Vanguard, BlackRock, State Street all started putting out position papers on diversity. They have long been champions for greater gender diversity on boards, but really expanded that and said not only is there an expectation for at least two women on boards, but really that company should do better than that and look at diversity more broadly including ethnic and other forms. And really, the large institutions have largely taken a disclosure-oriented approach. Vanguard had kind of their four prongs which were publisher perspectives on board diversity, disclosure, board diversity measures--how you're evaluating it, broaden your search for director candidates and make progress on this front.

And really, I think the focus has been on the search process. We saw last year that the New York State Comptrollers lead a shareholder proposal campaign asking boards to adopt the Rooney Rule that they would be sure that there were racial and gender diverse candidates considered in any pool of director candidates. That's really where I see the activity going. I think boards still say listen, when it comes down to the decision on who we're going to select at director, there's a lot of other skills and criteria that are being looked at. But as far as saying, you know, who are we looking at in that pool, the companies are saying we're including racially and gender diverse people. And those are often the ones that have the skills we're looking for also. But we're selecting them for their skills regardless of why they were included in the pools.

I think this year will be another big year focusing on this. We're already seeing it. And given the focus over the summer on racial equality and diversity, it's really, I think, expanding beyond the board composition. So, we have, again, New York State Comptrollers leading a campaign, writing to companies to ask them that they disclose their EEO data. State Street is looking for disclosure of diversity on boards and at leadership and the employee population. So, this is one area that we'll see more and more attention to and proxy statements this year.

**Bob Lamm:** Great. Reid, can you follow up on Ron's comments regarding shareholder proposals?

**Reid Pearson:** Yeah, yeah, absolutely. And I think one dish to tie in a little bit to what Ron was saying earlier, again, it goes back, I know we've heard for years and years about engagement. The diversity in your director search process and all of these things have become very key and central to engagements. And it is important to kind of get those things out there and to kind of explain it. Maybe it's a little bit easier to do kind of in a post-proxy season engagement process as opposed to kind of…not as opposed, but as a supplement to putting everything into the proxy.

But with respect to shareholder proposals, one of the more common ones was asking companies to adopt a report articulating the steps that they're taking to enhance diversity. Asking that they codify diversity women and minorities in the nominating and governance charter. Also, that the companies would make a public commitment to diversity, both women and minority candidates for board nominees. And also, two additional—going back to what Ron said—talking about additional disclosure in the proxy statement with respect to the number of women and minority candidates for board nominees, but also actual board seats.

So, there were 35 proposals on this so far this year through the end of July. Actually, six of them made it onto the ballot. I think the rest there were agreements reached so they were not on the ballot. The proposals did fairly well. Of the six, we've got one proposal at national healthcare where it got almost 60% support. Again, they were largely settled, but when they did make it on the ballot they were typically widely supported.

Another group that Ron had mentioned is the New York Retirement Systems, their board accountability project. A lot of us may remember a few years ago where they had a lot of success in getting companies to adopt proxy access. They had sent letters to 56 S & P 500 companies asking them to adopt Rooney Rule, which Ron noted is that the company will consider diverse candidates for the board but also for CEO, any CEO succession that's going on.

There were 18 follow up resolutions. And actually, all of them but three settled. We had one proposal that did pass. The company later agreed that they would adopt the Rooney Rule. There was another company where in January, kind of before the voting, had actually adopted a proposal that they would seek diverse candidates for the board nominees. Although, they didn't put in the CEO position per the Rooney Rule. That proposal got about 25% support, so not quite as wide as the other company.

Anyway, again, a lot of these proposals had kind of settled out during the year. I think kind of given where the winds are right there it makes perfect sense. Another proposal to bring up would be from the National Center for Public Policy Research. A little bit different take. This is more of a conservative bench there. Their kind of main thesis was we'd like to see diversity of thought as well. Their general feeling is that conservative viewpoints were not fairly represented on the boards. Proposals did not do very well at all. I think the average support level was about 4% or so, under five. Several companies, JP Morgan, Wells Fargo had kind of made compromises with the group. I think the largest vote getter was a Boeing which received about a 14% support.

That's just kind of high level. Bob, back to you.

**Bob Lamm:** Sure.

**Ron Mueller:** Bob, if I could…

**Bob Lamm:** Absolutely.

**Ron Mueller:** Bob, I was just going to mention also, I think you mentioned the creativity of Plaintiff's lawyers on director's compensation. We're also seeing creativity of plaintiff's lawyers on director diversity. It is worth noting that there are a couple of plaintiff firms based in California that have been bringing in theories of derivative cases against boards, and the list grows longer every day. There were several more, I think one or two more boards written up in today's news. And really, alleging both breaches of fiduciary duties of candor, loyalty, good faith, unjust enrichment, a whole panoply of things, based on boards not having diversity. And very creative complaints here. They began with a photomontage of the board, showing particularly a bunch of white males and alleging that the firms, the companies, are suffering both in having lawsuits and in how the company is being managed from this. It will really be interesting to see what happens with these. I think there's very much an element of trying to capitalize on some embarrassment factor. But these suits are important. They will be moving forward. And again, just yet another reason why companies are well-advised to focus on their board's composition.

**Bob Lamm:** Yeah. And that's a great segue way to my comment on disclosure which again, as we said with respect to director compensation, this is a time when more disclosure going beyond the rules and the interpretations is probably to a company's advantage. Particularly, you know, I've just seen and heard a lot of comments about great that we're doing more gender diversity, but that is insufficient. We need to focus more on racial diversity. Not to the exclusion of gender diversity, but in addition to.

In my view, and I don't know if the panelists share this view, the SCC rules on diversity were sort of adopted as an after thought to some other rules that were adopted at the time and are kind of lame, frankly. They don't really ask for too much. So, companies, I think, this year are—or I should say next year—are going to really have to step up to the plate and talk more about their diversity policies, what they're doing to achieve diversity. Obviously, Reid is right. You can't necessarily do all of this in the context of a proxy statement. But I think good disclosure can help reduce the number of engagements that you have to have in order to get your point across.

And I think another challenge with disclosure is that unlike some other areas, this is not an area where you can completely change your board overnight to satisfy whatever your goals are with respect to diversity. My prediction, which I'm often wrong when I predict, but I don't think you're going to see a lot of disclosure about self-identified diversity status. ISS's survey this year, from what I hear, has been kind of a non-event. A lot of companies have chosen not to do anything with it. Not to ask their directors to respond. But clearly, 2021 is going to be a year where more is better when it comes to disclosure.

We have used up time we were going to spend on other issues, but Reid, if you can do a really quick discussion of over boarding, maybe give it two minutes.

**Reid Pearson:** Yeah, sure.

**Bob Lamm:** And we'll see what we can squeeze into that.

**Reid Pearson:** Sure. I will kick it off and then welcome anybody else's input. And hopefully I can do this quickly. Yeah, this has been a, from a kind of pure voting policy, this has been a very big issue over the past couple of years. Investors have had kind of over boarded policies and thresholds in place for a number of years. I think the really big, big change the past two or three years has been the big funds. Vanguard, BlackRock, State Street among many others have really tightened up their policies recently on what they consider to be an over boarded director.

What I typically will tell people that I work with is that if you have an executive, a CEO or an NEO that sits on more than two boards, including his or her kind of home board, and if you have a non-executive director that sits on more than four boards, you need to kind of evaluate the polices. We've done a ton of voting projects based on these things for individual directors just so we can alert the board to see where this voting is going to come out. And I mentioned in an earlier segment about engagement, there are going to be some investors that have very strict guidelines about this. But there are others that may be kind of willing to listen to your story. So, again, kind of make sure that you're including that not only in your disclosure but also in your engagement process.

**Bob Lamm:** Great. I think we may have enough time, we've got about three minutes left, so we may have just enough time for a quick lightning round with the subject being accommodating your stakeholders, whoever they may be.  Amy, any quick and dirty comments on that?  Or quick and clean comments on that?

**Amy Wood:** I'm going to make it really, really quick.  There's a lot of focus on the strategy and who to engage in the message, but what I'm going to emphasize is listen. Make room to listen when you're engaging with other stakeholders.

**Bob Lamm:** Ron?

**Ron Mueller:** Yeah.  And I would say both listen and respond, just to build on that.  I think this is one area where you really cannot just assume people will not, that your shareholders will not focus on it.  So, if you don't have a great story to tell, tell why you don't have one, what you're doing and where you're trying to go.

**Bob Lamm:** Reid?

**Reid Pearson:** Yeah.  I would echo those sentiments.  And again, I'm starting to sound like a broken record, but engage to tell your story because it is important.  And you will find that a lot of the large investors are not as black and white about polices as you think. Have those dialogues.  Tell your story.  Again, even if it's not what you might perceive as a good one.  Get out and do it.

**Bob Lamm:** Yeah.  Well, I've been an advocate of engagement since the 1980's when we really didn't even know what to call it.  It was considered a huge outlier to even talk to your investors in those days.  It was kind of show up at the shareholder meeting you lose the buy.  So, I'm a big advocate of that.  I also think that companies, and many companies have enhanced their disclosures over the years, now using the proxy statement not merely to comply with the rules.

In fact, compliance is almost the minimal concern.  But really reaching out and addressing the issues that you know your investors and your stakeholders--we shouldn't forget stakeholders as opposed to stockholders--the kinds of information that your stakeholders are looking for.  Particularly, in the wake of COVID, you're seeing incredible interest, again, on the part of investors and so many others about the well being and health of the workforce.  What are you doing to make sure that people either working remotely or working in the physical office are being taken care of?  That you're doing what you can to maintain health.

I don't want to suggest that the proxy statement should be the be-all and end-all in terms of disclosure, but how your board is actually overseeing all of that stuff can be a very effective tool in telling your investors and your stakeholders what it is that you're about. So, I'll leave it at that.  We actually finished on time, Liz.

**Liz:** Thank you. That was a great discussion. Thank you all. Thanks Reid, Bob, Ron and Amy. Thank you especially Ron. He was pinch hitting today. Beth Ising was supposed to be on this panel. She couldn't make it and Ron stepped in at the last moment. So, I appreciate that. But all of you did great. This was a wonderful discussion. We are moving right into our next panel, which is section 162-M, where things stand. So, what you need to do is go to that room on your agenda tab and click in to join that session. It will start here in a minute or two. I'm going to get myself over there as well, so I will see you all shortly. Thanks.

**Reid Pearson:** Thank you.

**Bob Lamm:** Thanks everybody.

Markeys/pti:kb