PwC's 2014 Annual Corporate Directors Survey

Trends shaping governance and the board of the future

Executive compensation and director communications

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Please note: Charts may not all add to 100 percent due to rounding

Executive compensation remains a hot topic

Executive pay remains a trend impacting boards. In response, boards are devoting even more time and attention to the critical issue of appropriate compensation. With three years of "say-on-pay" behind us and equity markets rising to new levels, we asked directors to give their current perspectives on compensation oversight.

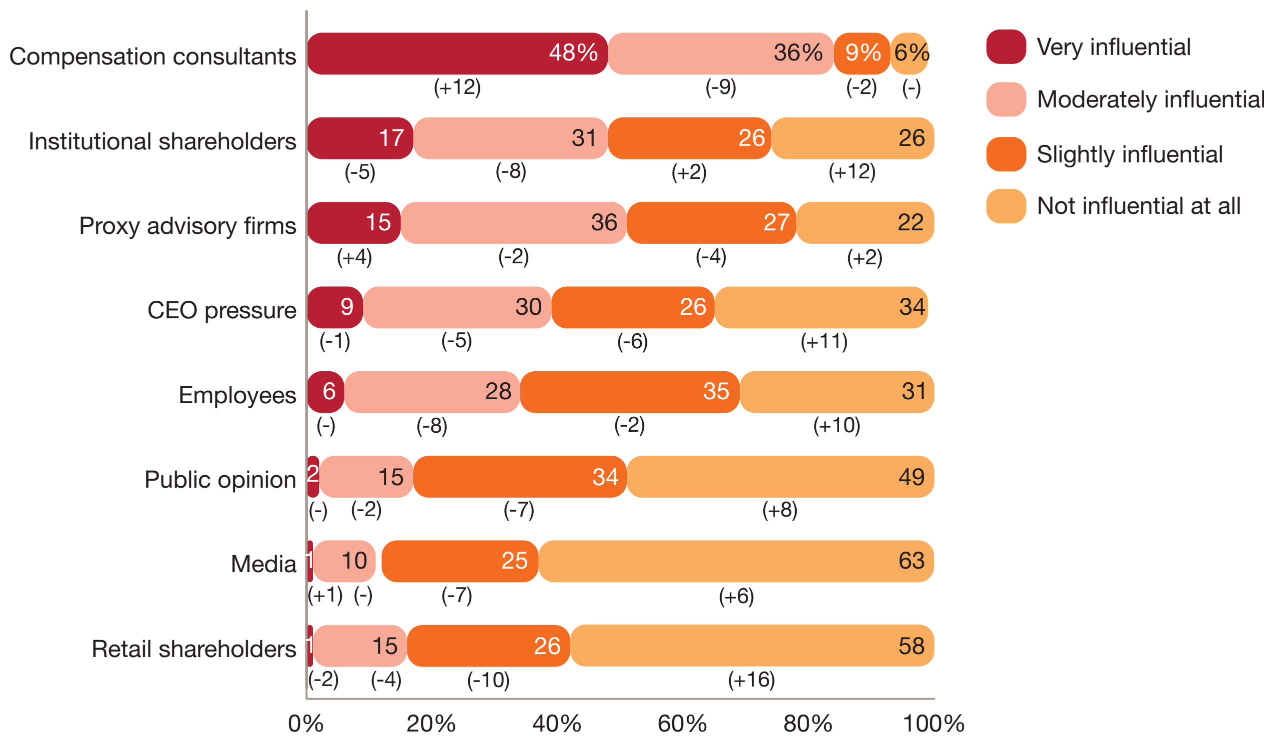
A related trend is the interest of stakeholders in the proxy advisory industry. We also asked directors their perspectives on these firms.

Who influences CEO pay?

Compensation consultants continue to have the strongest influence on director decisions about executive compensation. Forty-eight percent of directors describe them as very influential—up 12 percentage points from 2013. Proxy advisory firms also saw their influence increase, albeit modestly, as 51% of directors describe them as at least moderately influential, compared to 49% last year. CEO pressure has declined as an influence; only 39% of directors describe it as moderately or very influential, compared to 45% last year.

Rate the level of influence that the following have over your board's decisions on executive compensation:

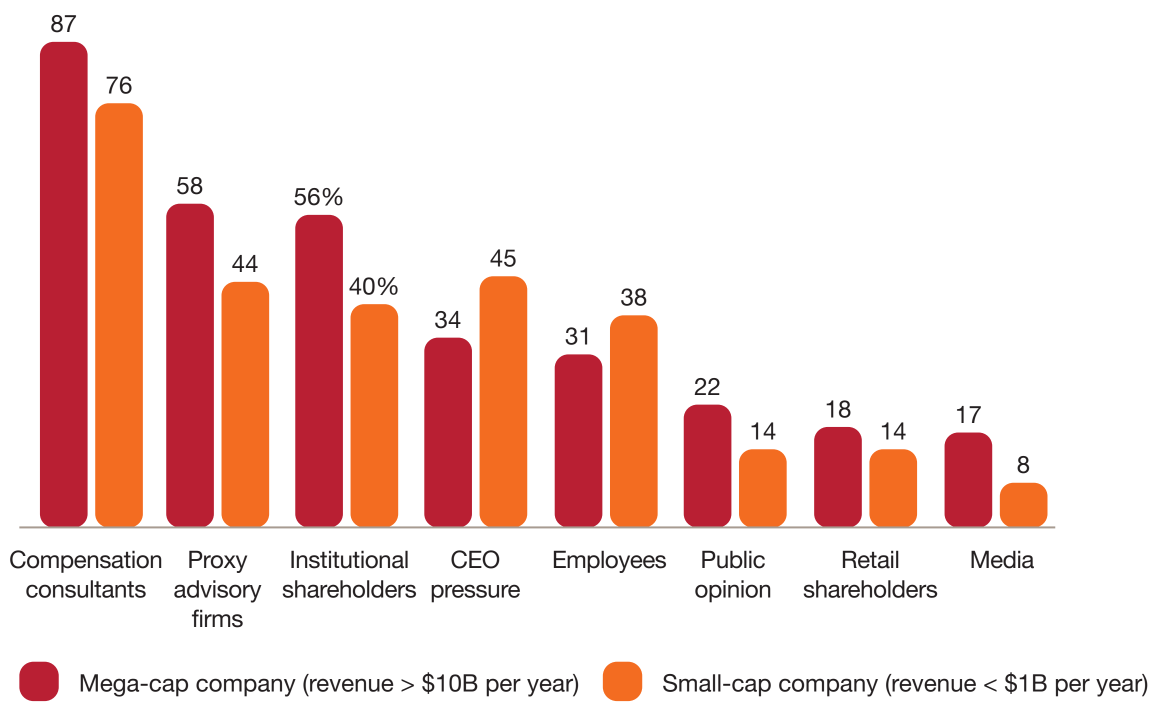
Amounts shown in parentheses represent the change in percentage points from the 2013 survey.



Mega-cap company directors believe compensation consultants, institutional shareholders, and proxy advisory firms are more influential on compensation than do small-cap company directors. Mega-cap company directors also say they are more influenced by the media; 50% say the media has at least some influence on compensation decisions, but only 28% of small-cap company directors feel the same. Directors of mega-cap companies may feel their companies are more of a target of public criticism about compensation practices.

Rate the level of influence the following have had over your board's decisions on executive compensation:

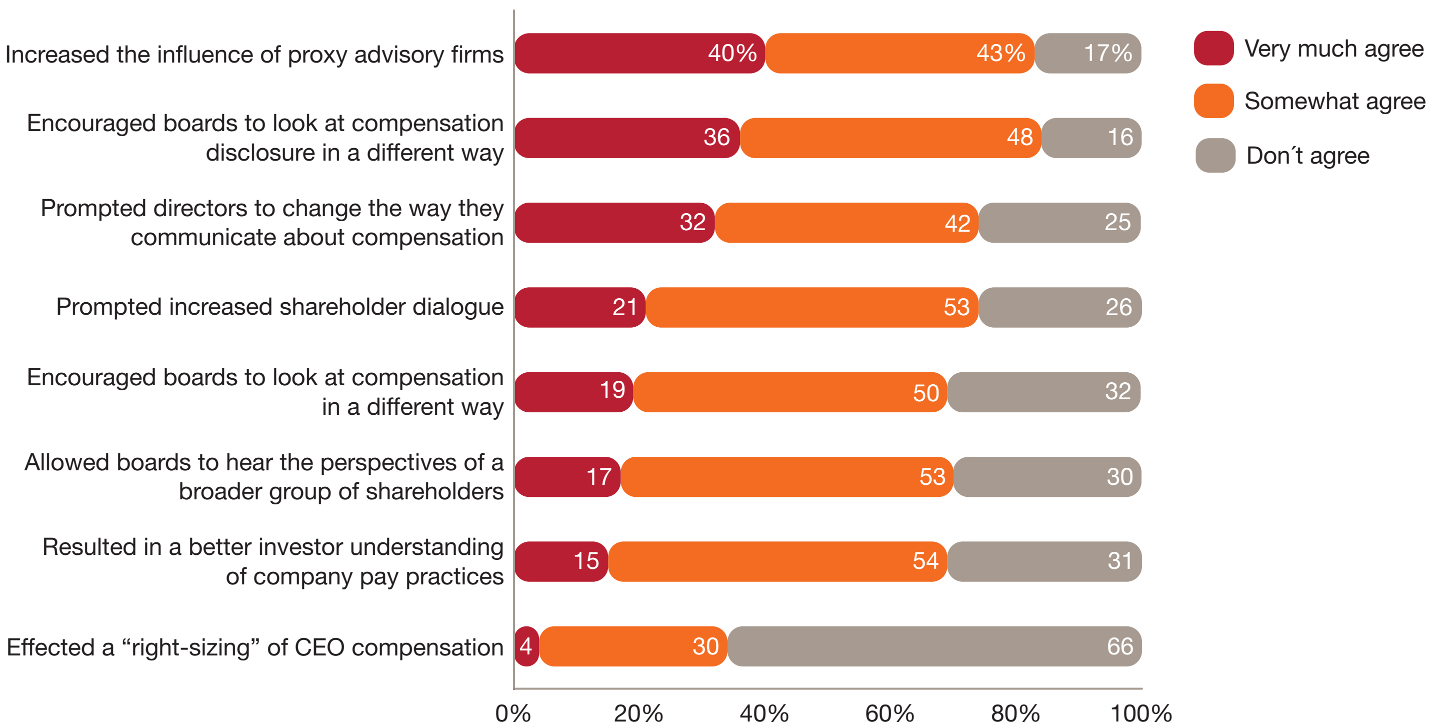
Percentage of directors who indicated the following parties are very influential or moderately influential:



What's the real impact of "say-on-pay?"

Shareholders continued to support compensation plans at high levels during the 2014 proxy season—with average affirmative voting of 89%.[1] Considering "say-on-pay" advisory voting began four years ago, this year seemed like an ideal time to ask directors to step back and assess its cumulative impact. Eighty-four percent at least "somewhat agree" that "say-on-pay" voting has caused their board to look at compensation disclosure in a different way; 83% feel it increased the influence of proxy advisory firms. Nearly three-quarters at least "somewhat agree" that "say-on-pay" increased shareholder dialogue and prompted their board to change the way it communicates about compensation. Yet two-thirds of directors don't think "say-on-pay" has effected a "right-sizing" of CEO compensation, and nearly a third don't think it resulted in a better understanding by investors of company pay practices.

What is your assessment of the cumulative impact of "say-on-pay" voting?



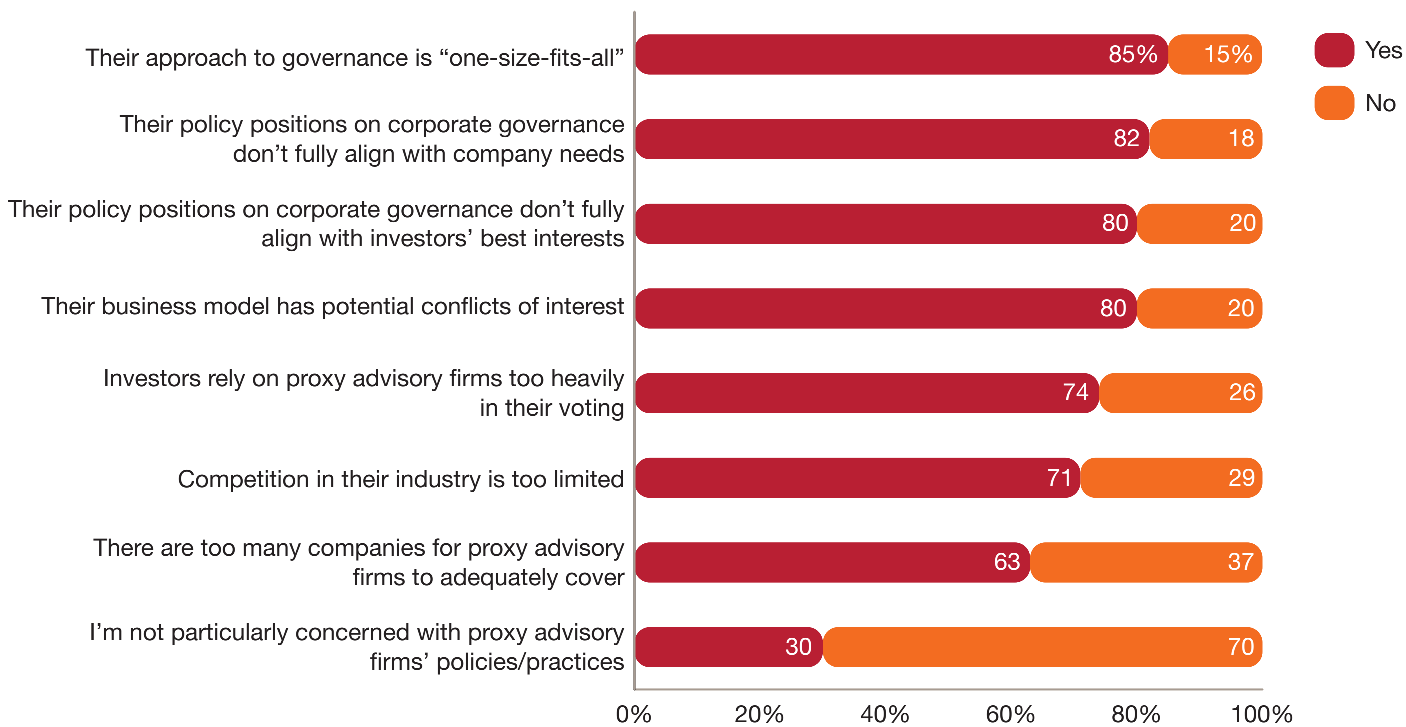
1 *PwC + Broadridge ProxyPulse October 2014*

Proxy advisory firms in the spotlight

Directors continue to express significant concerns with the independence, thoroughness, and voting recommendations of proxy advisory firms. And proxy advisors have the attention of regulators. In June 2014, the SEC issued guidance to investment advisers regarding their responsibilities in voting client proxies and their reliance upon the recommendations of proxy advisors.

We asked directors about their specific concerns with proxy advisory firms. At least eight in ten believe proxy advisory firms use a "one-size-fits-all" approach to governance and that their business model has potential conflicts of interest. A similar percentage says proxy advisory firm policies don't align with company needs or investors' best interests. The larger the company and more tenured the director, the more likely he/she is to have these concerns.

Considering recent public discussions, do you have any of the following concerns regarding proxy advisory firms?



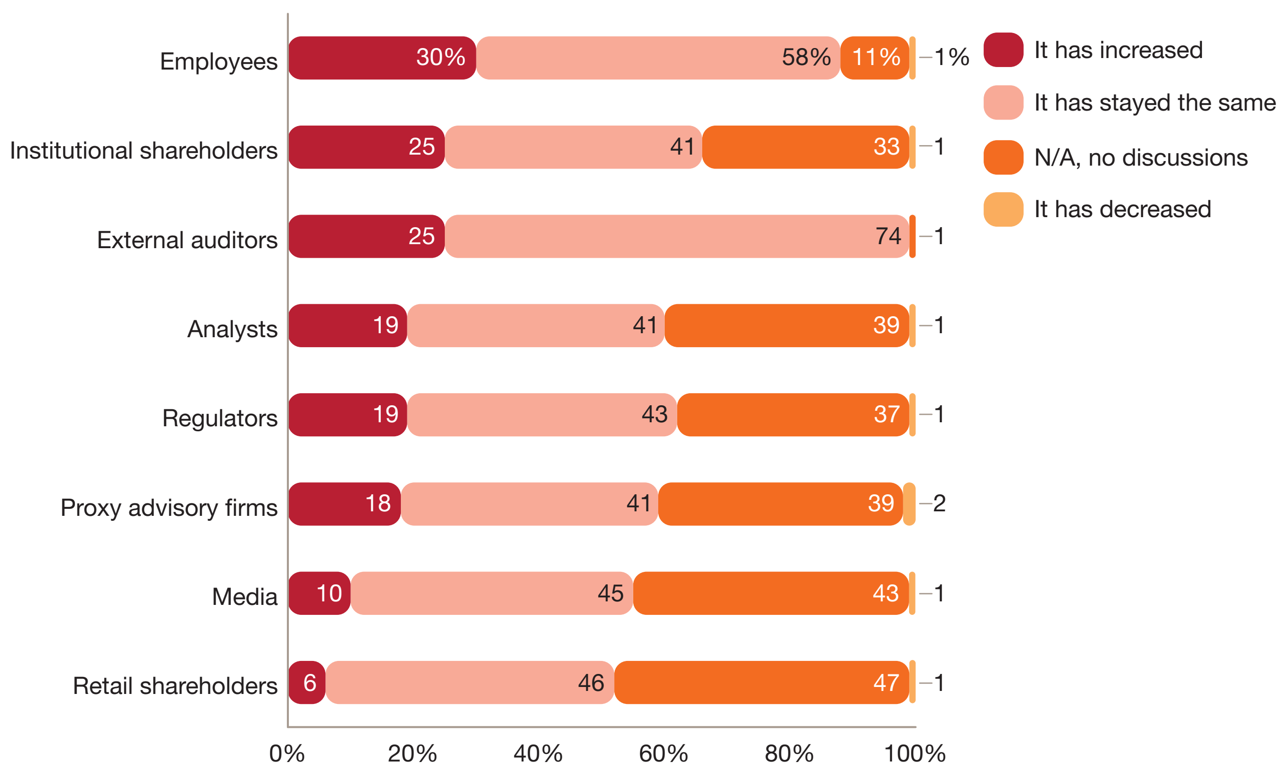
Increasing expectations about director communications

Increasing expectations about director communications is another trend shaping the board of the future. Boards need to determine their role in stakeholder communications—and evaluate their processes and procedures governing such communications. We asked directors about their current behaviors and views on this important trend.

Director communications increase

Compared to last year, director communications with stakeholders increased across all constituencies. Particularly noteworthy is that 30% of directors say they enhanced communications with the company's employees—the largest year-over-year increase of any individual group. Also, a greater percentage of directors are communicating with institutional investors—66% now say they do so compared to 62% last year.

During the last 12 months, how would you describe the level of your board's direct communication with:

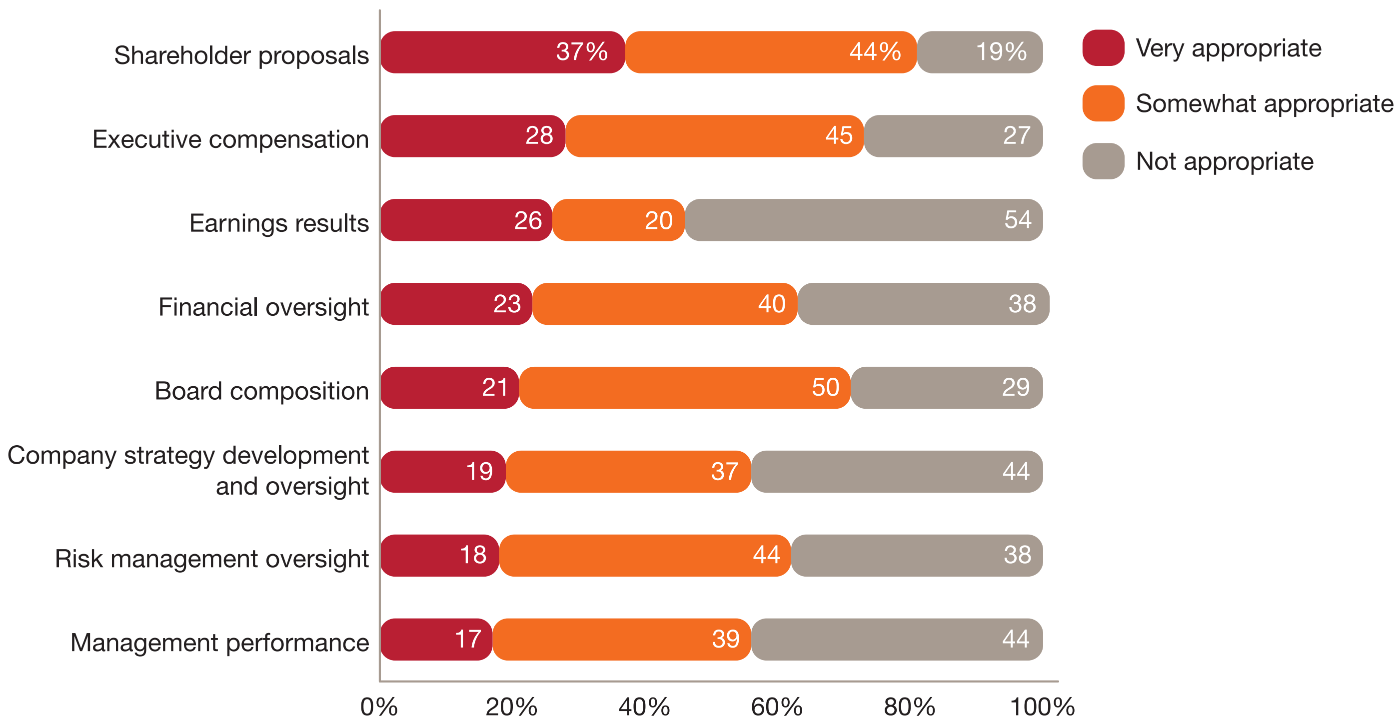


Appropriate topics for director-shareholder dialogue

Seventy-three percent of directors now believe it is at least "somewhat appropriate" to discuss executive compensation with shareholders, compared to only 66% last year. Similarly, a majority of directors (56%) say it's appropriate to communicate with investors about strategy, compared to 45% last year. It's possible that some of this increase may be attributable to positive experiences directors have had communicating about "say-on-pay." This also may be due to the activist shareholder environment.

Almost 30% of directors don't believe it is appropriate to discuss board composition with shareholders, which may include matters like director attributes, board succession, board tenure, and diversity.

Regarding the following topics, how appropriate is it for boards to engage in direct communication with shareholders?

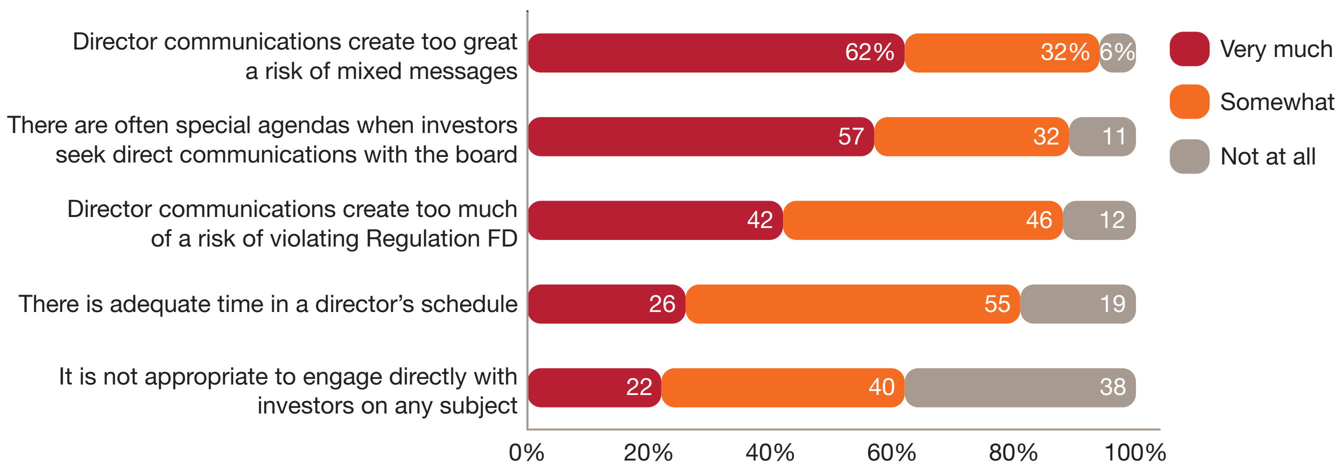


What about the risks of director communications?

Many directors have been reluctant to participate in direct communication with shareholders for a variety of reasons, including the concerns about having too many voices speaking on behalf of the company. Other concerns relate to fears that some investors have "agendas" and worry that discussions may inadvertently violate Regulation Fair Disclosure (Reg FD). Despite increased director-shareholder communications, many of these concerns remain. In fact, 94% of directors are at least "somewhat" concerned about the potential for mixed messages, and nearly nine in ten are concerned about investors having special agendas. Directors also continue to be worried about violating Reg FD—88% are at least somewhat concerned.

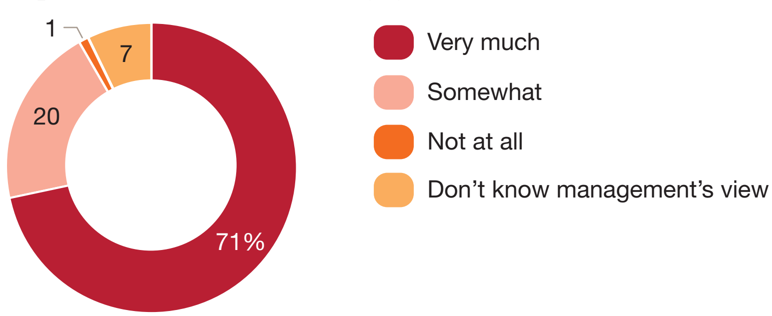
Overall, male directors are more likely to express trepidation about director-shareholder communications; 65% believe it creates too great a risk of mixed messages, compared to 51% of female directors. And 23% of male directors don't believe it's appropriate to communicate directly with shareholders on any topic—compared to just 12% of female directors.

To what extent do you agree with the following regarding director/shareholder communications:



Regardless of the approach to director-shareholder engagement, it's imperative that the board and management have an understanding of each other's respective views. This appears to be the case, as 71% say the board and management are very much aligned. Directors of larger companies say they are more aligned than do those of smaller companies.

How aligned is your board with management regarding each party's respective views on director engagement with shareholders?

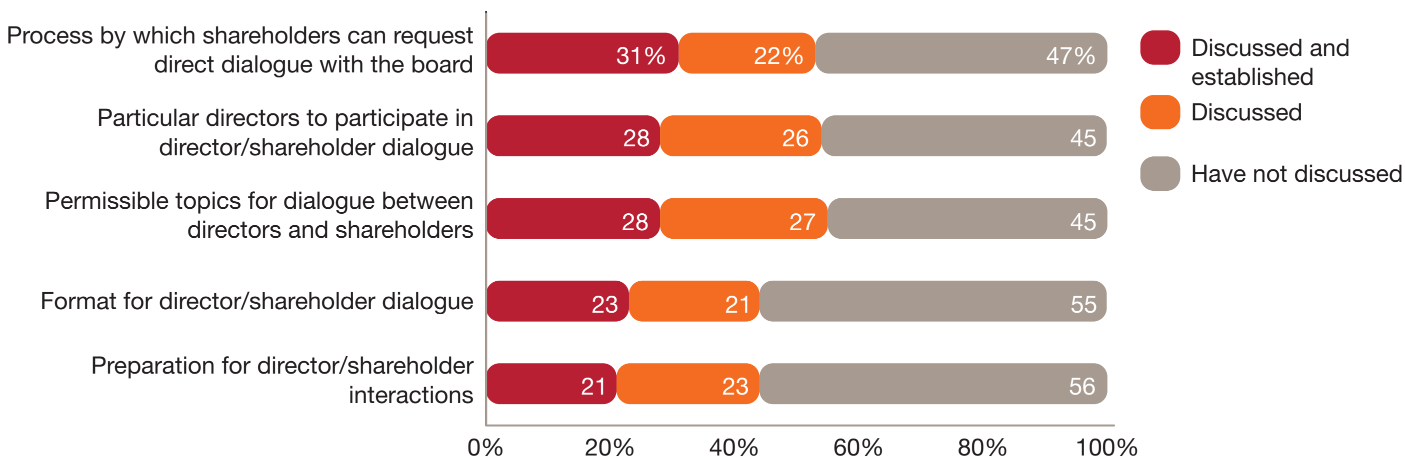


More communication protocols needed

Recently, an influential working group of institutional investors and directors sent a letter to every Lead Director and Corporate Secretary in the Russell 1000 asking them to consider adopting a formal policy on director-shareholder engagement.[2] There have also been other groups that have brought directors and investors together to discuss the issue of engagement, and subsequently issued suggested leading practices. Among the recommendations, a common suggestion is for boards to develop policies and protocols for shareholder dialogue. Despite this fact, only about one-quarter of directors reports their board has discussed and established a format for such dialogue.

Further, more than half of directors have not held discussions about company protocols and practices in preparation for director shareholder interactions. Almost half of directors have also not discussed company protocols and practices regarding the process by which shareholders can request direct dialogue with the board, the particular director(s) who would participate in such a dialogue, and the permissible topics for discussion. A greater percentage of mega-cap company directors have discussed and established director communication protocols and practices. This may be partially because shareholder requests were made of them sooner or because they have greater internal resources.

Has your board discussed or established company protocols/practices for:



2 See the Shareholder-Director Exchange (SDX) Protocol, available at www.sdxprotocol.com

www.pwc.com

To have a deeper conversation about how this subject may affect your business, please contact:

Mary Ann Cloyd
Leader, Center for Board Governance
PwC
(973) 236 5332
mary.ann.cloyd@us.pwc.com

Don Keller
Partner, Center for Board Governance
PwC
(512) 695 4468
don.keller@us.pwc.com

Paul DeNicola
Managing Director, Center for Board Governance
PwC
(973) 236 4835
paul.denicola@us.pwc.com