2019 Year-end Executive Compensation Webcast

December 11, 2019
Today’s experts

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*Managing Director, Chicago*  
Leads Executive Compensation practice in North America

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*Managing Director, Chicago*  
Committee advisor and Consumer staples expert

Steve Seelig  
*Senior Director, Arlington VA*  
Advises in taxation, accounting, regulatory and legal matters

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*Senior Director, Los Angeles*  
Committee advisor and expert on Pay-for-strategy alignment and Consumer services industries

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*Director, New York*  
Executive and broad based consultant  
Retail industry expert

Yana Plotkin  
*Director, San Francisco*  
Management and compensation committee advisor and Technology and Health care expert

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*Associate Director, Cincinnati*  
Executive compensation consultant and member of WTW’s Governance team

Claudia Poster  
*Senior Director, New York*  
Committee and management advisor  
Member of Insurance industry, Transactions, and Future of compensation committee teams

Chris Kozlowski  
*Consultant, Pittsburgh*  
Executive compensation consultant and member of WTW’s Pay-for-performance team
Online resources at your fingertips
Our latest thinking, analysis and more

Notable blogs
- ISS seeks input re: 2020 policy
- Pay for performance update
- SEC recommends expanded disclosure of human capital management
- Board pay under the microscope

More content links
- Executive compensation solutions
- Pay for performance analytics
- Compensation data services
- Compensation software
- willistowerswatson.com
Significant change is afoot

- Market uncertainty
- Regulatory change
- Proxy advisor evolution
- Human capital management and ESG prominence
Stakeholder capitalism and pay design implications

Steve Seelig, Marc Roloson, & Panel
Recent events driving board conversations
Business and investor groups

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>▪ Recently declared that the purpose of a corporation is not just to serve shareholders (their official position since 1997), but “to create value for all our stakeholders.”</td>
<td>▪ Disagreed with the Business Roundtable position</td>
</tr>
<tr>
<td>▪ Business Roundtable is an association of senior US corporate executives</td>
<td>▪ Articulated a new pay policy that encourages companies to consider “adopting simpler plans comprised of salary and restricted shares that vest over five years or more.”</td>
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</tbody>
</table>
Recent events driving board conversations
Change in disclosure regime

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>• Recommended that the SEC should consider some form of HCM disclosures that better reflect the company’s market value.</td>
<td>• Has proposed to amend Regulation S-K to include in the 10-K a description of any “human capital measures or objectives that management focuses on in managing the business.”</td>
</tr>
<tr>
<td>• Current disclosure (number of employees) is not helpful</td>
<td>• Part of a move to a “principles-based” approach to 10-K disclosures, so that items are disclosed only if material.</td>
</tr>
<tr>
<td>• Value of human capital is not reflected in financials (vs. R&amp;D investments)</td>
<td></td>
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<td>• Seeking better correlation between HCM and value creation</td>
<td></td>
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</table>

WTW has submitted a comment letter [link] supporting the SEC proposal
Importance of human capital measures

The SEC may soon require 10-K disclosure of human capital measures or objectives in the Description of the Business section.

To what extent has managing human capital resources been important to your organization’s success?

- In the last three years?
- In the next three years?
Board involvement with human capital issues

Topics your compensation committee oversees

<table>
<thead>
<tr>
<th>Topic</th>
<th>Now</th>
<th>In the next three years?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Culture</td>
<td>25%</td>
<td>50%</td>
</tr>
<tr>
<td>I&amp;D</td>
<td>50%</td>
<td>75%</td>
</tr>
<tr>
<td>Succession</td>
<td>75%</td>
<td>100%</td>
</tr>
<tr>
<td>Fair pay</td>
<td>75%</td>
<td>100%</td>
</tr>
<tr>
<td>Training</td>
<td>0%</td>
<td>25%</td>
</tr>
<tr>
<td>Wellbeing</td>
<td>25%</td>
<td>50%</td>
</tr>
<tr>
<td>Total Rewards</td>
<td>75%</td>
<td>100%</td>
</tr>
<tr>
<td>HC risk</td>
<td>50%</td>
<td>75%</td>
</tr>
</tbody>
</table>
Our panel

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Prevalence of ESG metrics used in S&P 500 incentive programs

We are hearing more interest in metrics not previously used to determine incentive payouts

70% of companies include metrics from multiple categories.
How ESG metrics fit into incentive program designs

Customer service is often a defined weighted metric — while HR-related metrics are usually factored into individual performance evaluations.
Role of ESG-related metrics in your executive incentive plans

- Include as separate measure: 12%
- Include as modifier: 10%
- Plan to include next year: 4%
- Considering: next three years: 24%
- No plans to include ESG: 49%
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Proxy advisor and investor views

Steve Seelig & Mike Biggane
## SEC proxy advisor guidance

Two sets of guidance may change how proxy advisory process works

<table>
<thead>
<tr>
<th>Institutional Investors</th>
<th>Proxy Advisors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>August 21, 2019 Guidance</strong> (effective when published)</td>
<td>Clarifies that communications with clients are proxy solicitations and that statements cannot be false or misleading with respect to material facts</td>
</tr>
<tr>
<td>▪ Creates affirmative duty to determine how fiduciary duties are met when using proxy advisor voting recommendations</td>
<td></td>
</tr>
<tr>
<td>▪ Need for more due diligence in choosing a proxy advisor</td>
<td></td>
</tr>
<tr>
<td>▪ Voting decisions should take into account needs of all shareholders for whom votes are cast</td>
<td></td>
</tr>
<tr>
<td><strong>November 5, 2019 Proposed Regulations</strong> (must be finalized before effective)</td>
<td>Dialogue required between proxy advisors and companies:</td>
</tr>
<tr>
<td>▪ Permits companies to review and provide feedback on proxy advice before it is disseminated to institutional investors: Proxy filed:</td>
<td>1. Permits companies to review and provide feedback on proxy advice before it is disseminated to institutional investors: Proxy filed:</td>
</tr>
<tr>
<td>▪ 45 days or more before the meeting, at least five business days to comment</td>
<td>▪ 45 days or more before the meeting, at least five business days to comment</td>
</tr>
<tr>
<td>▪ Less than 45 but at least 25 calendar days before the meeting, at least three business days to comment</td>
<td>▪ Less than 45 but at least 25 calendar days before the meeting, at least three business days to comment</td>
</tr>
<tr>
<td>2. Permits companies to provide a statement in response to final voting advice, hyperlinked to the advice delivered to institutional investor clients</td>
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</table>
If finalized, proposed SEC regulations would:

Regulations would cause proxy advisors to be more transparent about their recommendations

- Strongly Agree: 17%
- Agree Somewhat: 66%
- Neither Agree nor Disagree: 11%
- Disagree Somewhat: 6%
- Strongly Disagree: 0%
**Likely to provide feedback or submit own statement?**

<table>
<thead>
<tr>
<th></th>
<th>Provide feedback to the proxy advisors</th>
<th>Submit our own statement to be attached to the proxy advisor recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Against</td>
<td>46%</td>
<td>51%</td>
</tr>
<tr>
<td>Factual error</td>
<td>82%</td>
<td>65%</td>
</tr>
<tr>
<td>Disagree with their methodology</td>
<td>44%</td>
<td>40%</td>
</tr>
<tr>
<td>Further communications</td>
<td>39%</td>
<td>38%</td>
</tr>
<tr>
<td>We would not comment</td>
<td>8%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Flash survey results
Are factual errors a big concern?

Factual errors by proxy advisors are a big problem

- Strongly Agree: 19%
- Agree Somewhat: 40%
- Neither Agree nor Disagree: 34%
- Disagree Somewhat: 7%
- Strongly Disagree: 0%
## Say-on-pay trends

### Investor support remains high, with P4P still the primary driver of scrutiny

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>90%</td>
<td>Average support for both say on pay (SOP) and equity plan proposals in 2019, with 3% of companies failing SOP</td>
</tr>
<tr>
<td>13%</td>
<td>Companies receiving a <strong>negative SOP recommendation</strong> from ISS in 2019 (increasing to 14% for equity plan proposals)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>82%</td>
<td>Companies receiving <strong>high level of concern</strong> from ISS with respect to <strong>pay-for-performance (P4P) alignment</strong></td>
</tr>
<tr>
<td>40%</td>
<td>Companies with high P4P concerns also identified as having a <strong>substantial compensation increase</strong></td>
</tr>
<tr>
<td>20%</td>
<td>Companies receiving tandem negative recommendation from ISS <strong>against compensation committee members</strong></td>
</tr>
</tbody>
</table>

Source: Willis Towers Watson Global Executive Compensation Analysis Team. ISS recommendations were confirmed using ISS’s Governance Analytics. Data through 12/2/2019.
## 2020 proxy advisor updates — ISS

### Policy updates focus on refinements as opposed to wholesale change

<table>
<thead>
<tr>
<th>Executive compensation</th>
<th>Excessive director compensation without compelling rationale in two consecutive years</th>
<th>Potential impact on 2020 vote recommendation against directors responsible for approving director pay</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Evergreen funding provisions in equity plans</td>
<td>ISS will automatically recommend a vote against an equity plan with this feature</td>
</tr>
<tr>
<td></td>
<td>Equity Plan Scorecard</td>
<td>No changes to passing scores There will be weighting/point reallocations among individual factors within each model</td>
</tr>
</tbody>
</table>
# 2020 proxy advisor updates — ISS

## Policy updates focus on refinements as opposed to wholesale change

<table>
<thead>
<tr>
<th>Pay for performance</th>
<th>Economic Value Added (EVA)</th>
<th>New to the financial performance assessment in 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>GAAP measures</td>
<td>Displayed for informational purposes in 2020 and may inform ISS’ evaluation of P4P alignment</td>
<td></td>
</tr>
<tr>
<td>P4P test scoring adjustments</td>
<td>Quantitative pay-for-performance scoring test changes: Relative degree of alignment and Pay-total shareholder return alignment scoring is being “relaxed” by about 10 points each</td>
<td></td>
</tr>
</tbody>
</table>
Company intentions regarding EVA metrics

Intentions about EVA

- Already calculate EVA: 10%
- Intend to calculate next year: 10%
- Considering calculating in the future: 36%
- No plans in the foreseeable future: 44%
Where EVA will be used in ISS P4P testing?

<table>
<thead>
<tr>
<th>Measure</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Relative degree of alignment</td>
<td>How CEO pay/performance compares to peers</td>
</tr>
<tr>
<td>2. Multiple of median</td>
<td>CEO pay compares to peer median</td>
</tr>
<tr>
<td>3. Pay-TSR alignment</td>
<td>How the company’s CEO pay and TSR have moved over time</td>
</tr>
<tr>
<td>Initial quantitative screen</td>
<td>Low, medium or high concern</td>
</tr>
<tr>
<td>4. Financial performance assessment</td>
<td>Was GAAP, now EVA (see below)</td>
</tr>
<tr>
<td>Overall quantitative concern</td>
<td>High concern triggers additional scrutiny</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GAAP measures</th>
<th>EVA measures</th>
</tr>
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<tbody>
<tr>
<td>ROIC</td>
<td>EVA margin</td>
</tr>
<tr>
<td>ROA</td>
<td>EVA spread</td>
</tr>
<tr>
<td>ROE</td>
<td>EVA momentum vs. sales</td>
</tr>
<tr>
<td>EBITDA growth</td>
<td>EVA momentum vs. capital</td>
</tr>
<tr>
<td>Cash flow growth</td>
<td></td>
</tr>
</tbody>
</table>
### 2020 proxy advisor updates – Glass Lewis

Policy updates focus on refinements as opposed to wholesale change

<table>
<thead>
<tr>
<th>Executive compensation policy changes</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation Committee performance</td>
<td>Vote against all committee members if the board adopts an SOP frequency other than approved by plurality of shareholders</td>
</tr>
<tr>
<td>Contractual payments and arrangements</td>
<td>Disfavor agreements that are excessively restrictive in favor of the executive</td>
</tr>
<tr>
<td>Company responsiveness to low SOP vote (&lt;80%)</td>
<td>Expect differing levels of disclosure including engagement and changes made</td>
</tr>
</tbody>
</table>
Shareholder engagement expectations

Shareholders are demanding better and more frequent engagement on executive pay issues

- **Strongly Agree**: 6%
- **Agree**: 36%
- **Neither Agree nor Disagree**: 49%
- **Disagree**: 7%
- **Strongly Disagree**: 2%
### 2020 proxy advisor updates – Glass Lewis

#### Policy updates focus on refinements as opposed to wholesale change

<table>
<thead>
<tr>
<th>Executive compensation clarifying amendments</th>
<th>Post FYE compensation decisions</th>
<th>Potential impact on say-on-pay vote recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mid-year STI adjustment disclosure</td>
<td>Excessively broad definitions of CIC in employment agreements</td>
<td>Expectation of a robust discussion in the proxy of why the decision was necessary</td>
</tr>
<tr>
<td></td>
<td>Concern of executives receiving extra compensation where no material change in status or duties has occurred</td>
<td></td>
</tr>
</tbody>
</table>
What should you be thinking about for 2020?

Proactive engagement and transparent, succinct disclosures continue to drive improvements

Shareholder engagement
- Are you engaging with shareholders regularly?

Director pay
- What benchmarking has been completed?
- Is your director pay an outlier?

EVA
- How important is EVA for your company?
- What impact will this have on your incentive metrics?

P4P
- How are your results shaping up for 2019?
- Will you have a P4P disconnect?

CD&A
- How well are you telling your story?
Pay for performance

Chris Kozlowski
CEO annual incentive payouts for 2018
S&P 1500 distribution

2018 S&P 1500 CEO bonus payouts (% of target)

Median payout: 113% of target

Source: Willis Towers Watson Global Executive Compensation Analysis team research, reflecting ~900 companies with constant CEO
CEO annual incentive payouts for 2018

By sector

Distribution of 2018 S&P 1500 CEO bonus payouts by sector

Source: Willis Towers Watson Global Executive Compensation Analysis team research, reflecting companies with constant CEO
2019 expectations over time
S&P 1500 median

2019 year-to-date EBIT
S&P 1500 median by sector

Three quarters’ EBIT growth by sector

Source: Capital IQ, three quarters’ results of the S&P 1500 sectors. Exhibit cropped at +15% to preserve scale. Energy sector 2018 growth of 31%.
2019 senior executive bonus expectations

Flash survey results

2019 senior executive bonus early results and expectations

Median early 2019 payout: 103% of target

Sources: 2019 proxy filings of about 100 non-calendar companies; flash survey results of about 90 participants.
Expected 2020 performance
S&P 1500 median by sector

2020 EBIT expectations versus 2019

Source: Capital IQ. 2019 reflects three quarters' results of the S&P 1500 sectors.
2020 incentive plan goal-setting expectations

Flash survey results

2020 goal-setting expectations

- Lower than 2019: 11%
- Comparable to 2019: 41%
- Higher than 2019: 48%

Source: flash survey results of about 90 participants.
Wrap-up and Q&A
In summary

Prospects for 2020 very uncertain

Pay close attention to proxy advisor process

Goal setting — cautious optimism, with discretion

Human capital management and ESG

A time to be vigilant
Questions?

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claudia.poster@willistowerswatson.com