Innovations in CD&A Design:
A Proxy Disclosure Analysis

2014

Featuring Commentary From:

Equilar

RR Donnelley
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• Glass Lewis Modeler
• Pay for Performance Analytics Solution

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EXECUTIVE SUMMARY

In recent years, the Securities and Exchange Commission has implemented various changes to the compensation disclosure requirements for public companies in their annual proxies. This has been especially true for the Compensation Discussion & Analysis (CD&A) section, which details a company’s executive compensation and corporate governance practices. Using data from the past five years, Equilar looked into the CD&As of S&P 100 companies to identify these trends and point out significant changes in both the design and content of CD&As.

CD&As have become lengthier each year and mentions of important concepts, such as Realizable Pay, Realized Pay, and pay for performance, have steadily increased in frequency. Some of this likely stems from changes in the regulatory environment. There has also been a shift toward enhancing the readability of CD&As with more companies writing proxy summaries and utilizing colors in their disclosures to make the content easily digestible for readers. This shift is also reflected in the increased prevalence of supplemental pay tables and graphs to better summarize the compensation plans disclosed in CD&As.

Almost half of S&P 100 companies now mention engagement with shareholders in their CD&As, reflecting an increase in shareholder interaction and the effect that advisory votes on executive compensation (Say on Pay votes) have had on companies. Another significant trend is the emergence of proxy advisory firm mentions and discussions of risk mitigation. In a fast-changing regulatory landscape, companies are looking to make their disclosures as comprehensive and accessible as possible to promote understanding among various stakeholders.

Considering these changes in the design and content of CD&As, this report provides an in-depth look at the evolution of trends and strategies used by S&P 100 companies to improve their CD&A disclosures for readers. As executive compensation continues to be a heavily scrutinized issue, trends in disclosure reveal important insights into the changing priorities for top companies today.

RR Donnelley Commentary

RR Donnelley assists over 1,900 U.S. companies with various aspects of proxy statement design, printing, filing and dissemination. This provides us a unique window into issuer concerns and objectives, as well as what is driving companies to evolve their proxies from traditional SEC 14a compliance documents to more visually inviting and compelling communications pieces. Oft-cited concerns include the growing length of proxies (which over the past decade have ballooned from an average of 30 pages to 70 or more), related concerns that increased length is contributing to declining readership, and the influence of proxy advisors and the relative degree investors rely on these third party analyses versus the company’s disclosures.

Driving this evolution are feedback from investors and insight into their informational needs versus SEC disclosure requirements, the intense focus on executive compensation, and the need to tell a clear compensation story driven in large part by annual Say on Pay votes.

This has led to a very positive period of experimentation and creativity in proxy disclosures, use of plain English, proxy summaries and CD&A executive summaries, more graphical and tabular content that highlights key data more impactfully than traditional textual disclosure, and improved navigation to key content.

To ensure our advice and recommendations help make the proxy a more digestible and relied-upon document by investors, over the summer and fall of 2013 RR Donnelley conducted a broad-based survey of institutional investors on how they use proxy statements. Among other facts validated by the survey, compensation is the paramount issue of concern and scrutiny, and the CD&A (or CD&A executive summary) is the most carefully read section of the proxy and the first destination for the majority of investors.
**Key Findings**

- **CD&A length increased over the past five years.** As companies continued to improve compensation disclosures to communicate more effectively with shareholders, CD&A word counts increased 17.6% from an average of 7,773 words in 2009 to 9,142 words in 2013.

- **Supplemental methods of calculating compensation grew more common in 2012.** While Realizable Pay was only disclosed by a single company in 2009, 2010, and 2011, it was disclosed by four companies in 2012 and eight companies in 2013. Over the same period, references to Realized Pay increased from eight companies in 2009 to 35 companies in 2013.

- **Companies included supplemental graphics in addition to required tables.** Supplemental pay table and graph prevalence has risen in the past five years. The number of companies including supplemental pay tables in the CD&A reached 37 in 2013, up from 26 companies in 2009. While one company included supplemental pay graphs in the CD&A in 2009, that number grew to nine companies in 2013.

- **The Dodd-Frank Act continues to be referenced by companies within the CD&A.** There were 24 companies in 2012 and 2013 that referenced the Dodd-Frank Act in their CD&As. Additionally, nine companies mentioned Dodd-Frank every year since its passage in 2010.

- **Pay for performance references increased in the wake of Say on Pay.** Emerging as a principal phrase in compensation disclosures, pay for performance was cited in the most recent proxies of 81 companies, as compared to 59 in 2009.

- **Shareholder engagement disclosure increased as more companies reached out to investors.** In 2009, six companies disclosed outreach efforts to shareholders, this increased to 49 instances disclosed in 2013. The Basic Materials, Healthcare, Financial, and Services sectors saw the most significant increases in shareholder engagement mentions. Proxy advisory firms were mentioned more frequently. In 2009, 2010, and 2011, three companies referenced either specific proxy advisory firms or proxy advisory firms in general. These references increased to 11 and 17 companies in 2012 and 2013, respectively.
**Compensation Program Checklists**

To assure shareholders that their compensation practices are beneficial, many companies have opted to go into more depth with their CD&As. In an effort to cover all angles, this additional disclosure now entails not just detailing the compensation practices they follow, but also the practices they do not follow. One way that companies approach this is through the inclusion of simple “What We Do” vs. “What We Don’t Do” tables. Five years ago, none of the companies within the S&P 100 had these tables featured in their proxies, whereas today 18% incorporate a similar table or program checklist. On average, the “Dos” and “Don’ts” sections tend to be around six or seven items in length and address topics such as pay for performance, severance related compensation, risk mitigation, stock ownership guidelines, anti-hedging/pledging policies, and other key corporate governance areas. Companies including these tables are looking to appease not just shareholders, but proxy advisory firms as well. In evaluating these lists, approximately two-thirds of the items stated in an average “Don’ts” section were found to directly overlap with the items found on ISS’s official poor pay practices list.

Below is an example of how one company displayed a program checklist of pay practices in its proxy filing.

- **Chevron Corp (CVX)**  
  DEF 14A filed on April 11, 2013

  “Best-Practice Features  
  Embedded in our overall compensation program are additional features that strengthen the links between the interests of our NEOs and stockholders.”

<table>
<thead>
<tr>
<th>We Do</th>
<th>We Do Not</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Stock ownership guidelines, for CEO, five times base pay; Vice Chairman, Executive Vice Presidents and Chief Financial Officer, four times</td>
<td>○ Very limited perquisites, all with a specific business rationale</td>
</tr>
<tr>
<td>✓ Stock held in deferred accounts is inaccessible until a minimum of one year following termination</td>
<td>○ No individual Supplemental Executive Retirement Plans</td>
</tr>
<tr>
<td>✓ Clawback provisions in the CIP, LTIP, DCP, RRP and ESIP-RP for misconduct</td>
<td>○ No stock option repricing, reloads or exchange without stockholder approval</td>
</tr>
<tr>
<td>✓ Over 90 percent of CEO’s pay is at risk</td>
<td>○ No loans or purchases of Chevron securities on margin</td>
</tr>
<tr>
<td>✓ Thorough assessment of performance</td>
<td>○ No transferability of equity (except in the case of death or a qualifying court order)</td>
</tr>
<tr>
<td>✓ Robust succession planning process with Board review twice a year</td>
<td>○ No stock options granted below fair market value</td>
</tr>
</tbody>
</table>
Supplemental Pay Calculations

Since 2009, CD&As have increasingly discussed supplemental methods of calculating executive compensation. Summary Compensation Table figures are being supplemented by these pay calculations, namely Realizable and Realized Pay, to paint a fuller picture of how executives are paid. Although there are different methods of calculating Realizable and Realized Pay, for the purposes of this report, all definitions were counted.

RR Donnelley Commentary

Any company that has ever received a negative proxy advisor recommendation -- or investor vote -- because the reviewer simply “missed” a key fact disclosed mid-way in the proxy can appreciate the value of such checklists. One objective of including such lists in a highly visible fashion is to make it as unlikely as possible the information will be overlooked.

Also, since virtually every company maintains some practices which someone may criticize, companies want to put these practices in context. Part of this involves reminding investors not just of pre-existing best practices, but also of “shareholder-friendly” changes they have made over the past year or two, whether based on investor feedback, board and management decisions, advisor input or evolving best practices. In effect, they are saying “you may not agree with every one of our current practices, but give us credit for the direction and distance we have come -- and the journey continues.”
In 2009, only one company mentioned Realizable Pay in its CD&A, but that number grew to eight mentions in 2013. Mentions of Realized Pay grew from eight to 35 from 2009 to 2013. Accenture was the only company to mention Realizable Pay in all five years.

Realizable Pay is affected greatly by stock price and company performance. When compared to targeted pay amounts, Realizable Pay can vary greatly. That can be seen in Devon Energy’s CD&A from 2012. The company compared target and Realizable Pay amounts of CEO pay and discussed the effects of the company’s performance on pay.

• Devon Energy Corp. (DVN)
  DEF 14A filed on April 24, 2013

“Effect of Company Performance on President and CEO Realizable Pay
As noted elsewhere in this CD&A, the Committee has implemented several changes to the Company’s compensation programs in order to further strengthen the tie between Company performance and executive pay. Compensation outcomes resulting from these changes will be manifested by the Company’s on-going performance and the pay realized by our executive officers over time. However, as illustrated by the chart below, Company performance in 2012 has already had a significant effect on actual and possible future compensation for our President and CEO. As of December 31, 2012, realizable pay had fallen by approximately $6.7 million, or 50.2%, from the target level because (a) stock options awarded in December 2011 were out of the money at year end 2012, (b) performance share units awarded in December 2011 were on track to payout only 50% of the shares underlying the grant, and (c) the cash performance bonus awarded for 2012 was paid at 65% of target.”

Because of the difference between reported (Summary Compensation Table figures) and Realized Pay, companies like Exxon Mobil use the comparison to paint a different, and to some, more accurate, picture of what executives make. In Exxon’s case, this was used as a way to show that reported pay for 2012 was higher than Realized Pay.

• Exxon Mobil Corp. (XOM)
  DEF 14A filed on April 12, 2013

“CEO Reported Pay vs. Realized Pay This chart demonstrates the long-term orientation of the compensation program by comparing the difference between the pay shown in the Summary Compensation Table and the actual pay realized by the CEO since his appointment in 2006.”
<table>
<thead>
<tr>
<th>Year of Compensation</th>
<th>Reported Pay$^{(3)}$</th>
<th>Realized Pay$^{(4)}$</th>
<th>Realized Pay vs. Reported Pay</th>
<th>Realized Pay as a Percentage of Reported Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$40,266,501</td>
<td>$15,561,163</td>
<td>$–24,705,338</td>
<td>39%</td>
</tr>
<tr>
<td>2011</td>
<td>$34,920,506</td>
<td>$24,637,196</td>
<td>$–10,283,310</td>
<td>71%</td>
</tr>
<tr>
<td>2010</td>
<td>$28,952,558</td>
<td>$14,229,609</td>
<td>$–14,722,949</td>
<td>49%</td>
</tr>
<tr>
<td>2009</td>
<td>$27,168,317</td>
<td>$8,530,165</td>
<td>$–18,638,152</td>
<td>31%</td>
</tr>
<tr>
<td>2008</td>
<td>$32,211,079</td>
<td>$10,212,091</td>
<td>$–21,998,988</td>
<td>32%</td>
</tr>
<tr>
<td>2007</td>
<td>$27,172,280</td>
<td>$12,884,308</td>
<td>$–14,287,972</td>
<td>47%</td>
</tr>
<tr>
<td>2006</td>
<td>$22,440,807</td>
<td>$6,712,435</td>
<td>$–15,728,372</td>
<td>30%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>43%</strong></td>
</tr>
</tbody>
</table>

$^{(3)}$ Reported Pay is Total Compensation based on the current reporting rules for the Summary Compensation Table. Reported Pay for 2006–2008 includes the grant date value of restricted stock to put all years of compensation on the same basis (rather than the annual expense value that was reported in the Summary Compensation Table for each of these years).

$^{(4)}$ Realized Pay is compensation actually received by the CEO during the year, including salary, current bonus, payouts of previously-granted Earnings Bonus Units (EBU), net spread on stock option exercises, market value at vesting of previously-granted restricted stock, and All Other Compensation amounts realized during the year. Excludes the value of new/unvested EBU and restricted stock grants, change in pension value, and other amounts that will not actually be received until a future date.
### Executive Compensation

<table>
<thead>
<tr>
<th>Executive</th>
<th>Year (1)</th>
<th>Salary</th>
<th>(Non-Equity Incentive Plan Compensation) RBI (2)</th>
<th>(Stock Awards) Restricted Stock</th>
<th>Long-Term Incentives LTPP Award (3)</th>
<th>All Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>William H. Swanson</td>
<td>2012</td>
<td>$1,414,421</td>
<td>$3,400,000</td>
<td>$4,699,989</td>
<td>$6,499,980</td>
<td>$446,160</td>
<td>$16,460,550</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>1,369,704</td>
<td>3,000,000</td>
<td>3,800,021</td>
<td>6,400,000</td>
<td>439,546</td>
<td>15,009,271</td>
</tr>
<tr>
<td></td>
<td>2010</td>
<td>1,327,622</td>
<td>2,800,000</td>
<td>3,799,976</td>
<td>6,386,011</td>
<td>488,921</td>
<td>14,802,530</td>
</tr>
<tr>
<td>David C. Wajsgras</td>
<td>2012</td>
<td>$871,800</td>
<td>$1,000,000</td>
<td>$1,099,995</td>
<td>$1,300,016</td>
<td>$138,098</td>
<td>$4,409,909</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>844,245</td>
<td>865,000</td>
<td>999,987</td>
<td>1,300,100</td>
<td>131,395</td>
<td>4,140,637</td>
</tr>
<tr>
<td></td>
<td>2010</td>
<td>818,315</td>
<td>800,000</td>
<td>1,000,002</td>
<td>1,200,017</td>
<td>122,674</td>
<td>3,941,008</td>
</tr>
<tr>
<td>Jay B. Stephens</td>
<td>2012</td>
<td>$762,979</td>
<td>1,000,000</td>
<td>$1,000,009</td>
<td>$1,199,999</td>
<td>$122,096</td>
<td>$4,035,083</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>738,863</td>
<td>755,000</td>
<td>950,018</td>
<td>1,200,010</td>
<td>120,110</td>
<td>3,764,001</td>
</tr>
<tr>
<td></td>
<td>2010</td>
<td>716,170</td>
<td>720,000</td>
<td>949,994</td>
<td>1,200,017</td>
<td>111,259</td>
<td>3,697,440</td>
</tr>
<tr>
<td>Daniel J. Crowley</td>
<td>2012</td>
<td>$691,028</td>
<td>$575,000</td>
<td>$900,024</td>
<td>$1,250,008</td>
<td>$118,595</td>
<td>$3,534,655</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>667,000</td>
<td>500,000</td>
<td>800,010</td>
<td>1,250,010</td>
<td>117,231</td>
<td>3,334,251</td>
</tr>
<tr>
<td>Richard R. Yuse</td>
<td>2012</td>
<td>$556,680</td>
<td>$675,000</td>
<td>$900,024</td>
<td>$1,250,008</td>
<td>$137,132</td>
<td>$3,518,844</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>506,072</td>
<td>600,000</td>
<td>800,010</td>
<td>1,250,010</td>
<td>177,853</td>
<td>3,333,945</td>
</tr>
<tr>
<td></td>
<td>2010</td>
<td>456,088</td>
<td>500,000</td>
<td>700,007</td>
<td>799,975</td>
<td>382,151</td>
<td>2,838,221</td>
</tr>
</tbody>
</table>

(1) Years in which the executive was a named executive officer.

(2) Annual Results-Based Incentive (RBI) cash award. RBI awards are discussed under "Annual Incentives" on pages 33 - 36.

(3) Long-Term Performance Plan (LTPP) award. LTPP awards are discussed under "Long-Term Incentives - LTPP" on pages 36 - 38.

The above table differs from the 2012 Summary Compensation Table required by the SEC, which appears on page 43, and is not a substitute for that table. The 2012 Summary Compensation Table includes amounts based on the change in the...
Executive Compensation

The supplemental pay graphs identified generally displayed pay against a performance metric. Philip Morris included a graph that showed the changes over three years of CEO pay as well as TSR and Business Rating. The way CEO pay was calculated was also different than the Summary Compensation Table method.

**Philip Morris (PM)**
DEF 14A filed on March 28, 2013

“Alternative CEO Pay Disclosure: The chart below illustrates the total direct compensation paid to our Chairman and CEO with respect to performance in 2010, 2011 and 2012, together with the Company’s rolling three-year TSRS and IC business ratings for such periods. The chart is not a substitute for the SEC required disclosure included in the Summary Compensation Table on page 39. The Summary Compensation Table, in accordance with SEC rules, reflects the equity award paid in the year shown but determined with respect to the prior year’s performance (i.e., the amount of the equity award paid in 2012 is based on 2011 performance). In contrast, the following chart reflects the equity awards granted for the performance year and is intended to convey the decisions of the Committee with respect to linking the components of total direct compensation to a given year’s performance.”

![Chart showing total direct compensation](chart.png)

(1) The 3-year rolling TSR in 2010 relates to TSR from the spin-off on March 28, 2008.

(2) As discussed in the Company’s 2012 proxy statement, Mr. Camilleri’s 2011 total direct compensation was set at the low point of the range indicated by his individual performance and Company ratings.

(3) The following table sets forth the amount for each component of total direct compensation shown in the chart above.

**Specific Metrics and Criteria**

In each of the past five years, a majority of the 100 sample companies disclosed specific performance metrics. In 2009, 62 of the 100 companies mentioned specific metrics in their plans. That number grew to 77 in 2012 but fell slightly to 74 in 2013.

There has also been an increase in the past five years in the number of companies mentioning the criteria and range for their peer group selection. All companies stating the specific parameters of their peer group criteria were tallied in this analysis. With increasing scrutiny of performance in relation to peer groups, companies appear to be increasing the amount of detail in the disclosure of peer group criteria for the readers of their proxies.
Our investor research revealed that the top three topics of interest by institutional investors are director independence, disclosure of performance goals, and pay for performance alignment, with investors giving companies relatively good grades on director disclosure but expressing less satisfaction with the clarity of compensation disclosures.

Companies with formulaic pay plans generally provide the most clarity about CEO and other NEO performance measures (for short and/or long term incentives), weightings, target levels of achievement, actual achievement and resultant payouts. For these companies, investors focus on the clarity, appropriateness and rigor of the performance measures and targets.

This is not to criticize more discretionary plans which to investors appear more opaque or even "black box". But it does place added pressure on those companies to demonstrate pay for performance alignment. To the extent pay is compared to peers including discussion of relative TSR, the focus is on the appropriateness of the peers and why they were selected. Here, we are seeing companies explain in greater detail their peer selection criteria, why they may have changed certain peers from one year to another, and even where their company ranks relative to peers on any of the key peer selection criteria shown in tabular or graphical format.

Lack of clarity around performance goals or peer selection often leads to investor skepticism and negative votes.
Pay for Performance

Pay for performance has emerged as one of the key phrases in compensation over the last several years. It is no surprise that many companies do what they can to assure shareholders that they make this link between pay and performance as strong as possible. The number of companies with direct pay for performance mentions in their annual proxies has increased consistently over the last five years, making up 81% of the S&P 100 in the most recent filing year.

The emphasis on pay for performance is important to note as its influence on the filing goes far beyond this simple metric of keyword mentions. The inclusion of supplemental pay tables and graphs addressing Realizable and Realized Pay expanded discussions on performance criteria in regard to annual bonuses and equity awards, and many other changes to the proxy can also be attributed to the increased focus on pay for performance. With all the attention the topic now receives, its impact will likely continue to increase in the years to come.

RR Donnelley Commentary

Virtually all companies list pay for performance as a key element of their compensation philosophy and its administration. Investors look past these assertions, seeking hard data particularly on CEO pay for performance alignment. A diverse array of graphical depictions is being utilized. But first, several questions arise: 1) What is pay? Is it SEC Summary Compensation pay, or some alternative form of Realized or Realizable Pay? 2) What is performance? Is it TSR (absolute or relative), and/or performance against relevant financial or operating metrics? 3) What is the appropriate performance period? Is it one year, three, five or longer? 4) How does pay compare to peers? Again, the focus is on the appropriateness of the peer group.

One cautionary note: while companies may consider traditional time-vested stock options to be performance based, investors and proxy advisors do not, unless the options vest based on specific performance criteria. In part for this reason, investors have reported to us that they look skeptically upon, or even ignore, the common fixed-versus-performance-based graph unless they have clarity and confidence in the underlying performance criteria.

On a fundamental level, the question we’ve most often heard from investors, even prior to CD&As, is “how does pay support strategy?” If investors understand that alignment, they are more likely to support the overall program. Watch out for sending mixed messages. If in your investor relations messaging you’ve told investors “this is what will drive the success of our company and efforts to grow shareholder value, and how you should track our progress”, yet your proxy discloses nothing approximating those “value-drivers” among the CEO’s performance goals, investors understandably may wonder “you said X is important, but you’re paying for Y. Please explain.” Furthermore, rather than ask the question, many investors will simply vote against and move on to their next portfolio companies whose meetings are the same day as yours.
INTERNAL PAY EQUITY

Internal pay equity is another factor many companies consider when designing pay packages. Although a CEO’s pay is often heavily influenced by external factors, many will agree that the final amount should still remain reasonable compared to what other individuals at the corporation receive. Within the last year, 26% of S&P 100 companies mentioned looking at internal pay equity while determining pay, a 44% increase from five years ago. Interestingly, internal pay equity among S&P 100 companies did improve over that period with the median pay multiple of CEO compensation compared to average NEO pay falling from 3.4 to 2.6. These proxy mentions of internal pay equity, however, rarely go into any detail as to what the company actually targets or aims for when looking at pay equity. With the exception of E. I. du Pont de Nemours and Company, who disclosed target pay multiples for its CEO compared to its other NEOs, no other S&P 100 company provided numbers in internal pay equity discussions.

• Schlumberger Limited (SLB)
  DEF 14A filed on March 1, 2013

“The Compensation Committee also reviewed internal pay equity in October 2012. The Committee reviewed the CEO position in relation to the other executive officer positions, and the executive officer positions both in relation to one another and in comparison with the average of the other executive officer positions. The Committee noted that the ratio of total direct compensation between the CEO and the second-highest paid executive officer (Mr. Ayat) was similar to the year prior to the CEO transition. The Committee also noted that the levels of total direct compensation for the second- to the fifth-highest paid officers were very closely clustered together. As a result of the foregoing, the Committee concluded that internal pay equity was appropriate.”

• ConocoPhillips (COP)
  DEF 14A filed on March 28, 2013

“We believe our compensation structure provides a framework for an equitable compensation ratio between executives, with higher targets for jobs at salary grades having greater duties and responsibilities. Taken as a whole, our compensation program is designed so that the individual target level rises as salary grade level increases, with the portion of performance-based compensation rising as a percentage of total targeted compensation. One result of this structure is that an executive’s actual total compensation as a multiple of the total compensation of his or her subordinates is designed to increase in periods of above-target performance and decrease in times of below-target performance. In addition, the HRCC also reviews the compensation
of Senior Officers periodically to ensure the equitable compensation of officers with similar levels of responsibilities.”

- **E. I. du Pont de Nemours and Company (DD)**
  DEF 14A filed on March 15, 2013

  “The Committee has a long-standing practice of comparing CEO pay to that of other executives. To ensure that NEOs are paid appropriately relative to each other and that we manage the pay differential between the CEO and the other NEOs, we apply a pay equity multiple to average target total cash compensation (‘TCC’ equals base salary plus STIP awards) and average target total direct compensation (‘TDC’ equals TCC plus LTI). The 2012 pay equity multiples were as follows:"

<table>
<thead>
<tr>
<th>Element (Pay Equity Multiple Range)</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>TCC (2-3 times NEO)</td>
<td>2.7</td>
</tr>
<tr>
<td>TDC (3-4 times NEO)</td>
<td>3.2</td>
</tr>
</tbody>
</table>

**Consultant Independence and Risk**

Almost all S&P 100 companies engage outside compensation consultants as part of the process for reviewing and determining compensation. One facet of proper governance when it comes to these engagements is making sure these consultants maintain a high level of independence from company management, thereby ensuring that there are no conflicts of interest. While it is most likely the case that these engagements still met the proper guidelines for independence a few years ago, it is interesting to note that the disclosure involving them has nonetheless changed over time.

Section 952 of the Dodd-Frank Act contained a number of provisions generally relating to the independence of compensation committees and their advisers. Upon the SEC’s adoption of the final rules in June 2012, compensation committee members were required to be independent board members. Moreover, companies were required to disclose consultants utilized by the compensation committee, the nature of the work performed, whether consultants were engaged by the committee or someone else, and the aggregate fees paid for consulting services if the fees exceeded $120,000 during the fiscal year. Almost all companies now take the extra step to cover their bases by including mentions of independence along with their consultant engagements.
Risk is another area that has greatly expanded in CD&As in recent years. There are many components that go into proper compensation-related risk mitigation policy, though the basic intent is usually the same – to ensure the current program properly incentivizes employees without bringing any undue risk to the company. The SEC’s rules requiring disclosure about board involvement with risk became effective in February 2010, resulting in the number of companies disclosing risk mitigation jumping from about half of the S&P 100 to a large majority of the index, thus making risk oversight another staple section of proxies.

**Sustainability**

Concerns involving the environment have risen considerably over the last decade. One instance of this impact on corporations can be seen in relation to shareholder proposals. Earlier in the year shareholders of CF Industries approved a proposal regarding the implementation of a sustainability report, marking the first time in years that a proposal of this type has passed without support from company management. As more and more shareholders begin questioning the environmental effect large corporations have, it should be no surprise that many companies now choose to address the topic in their filings. This trend especially holds true for S&P 100 companies that operate in the Basic Materials sector, every one of which mentioned sustainability in their most recent proxies.

The following are some of the statements companies have included in their proxy filings regarding their commitment to sound environmental practices.

- **The Coca-Cola Company (KO)**
  DEF 14A filed on March 11, 2013

  “We are continuing to embed sustainability-minded innovations into every aspect of our business, including sourcing ingredients, increasing beverage options, aspiring to be water neutral and recovering packages for recycling. In addition, our strong pay for performance philosophy awards executives in a way that motivates them to operate the Company’s business in a profitable and sustainable manner. Additionally, our executives are measured across the six areas highlighted in the Company’s 2020 Vision, which include people, portfolio, partners, planet, profit and productivity.”

- **Monsanto Co (MON)**
  DEF 14A filed on December 10, 2012

  “Our sustainability and corporate responsibility committee reviews and monitors our performance as it affects matters relating to sustainability, the environment, communities, customers and other key stakeholders, including related risks and risks related to reputation. This committee also reviews issues affecting company
products in the marketplace, including issues of agricultural biotechnology, and identifies and investigates significant emerging issues. It also receives periodic reports on the company’s business conduct program, progress related to the company’s Human Rights Policy, and the company’s charitable and political contributions and reports to the full board as to the status of our company’s programs and initiatives on sustainability, environmental matters and social responsibility.”

**Dodd-Frank and Say on Pay**

Enacted in 2010, Dodd-Frank Wall Street Reform and Consumer Protection Act is the most recent piece of legislation that has impacted the corporate governance and executive compensation landscape. The biggest outcome of the Dodd-Frank act is the advisory Say on Pay vote that allows shareholders of public companies to vote on executive pay.

Twenty-four companies mentioned Dodd-Frank in each of the past two years. All mentions of Dodd-Frank in the proxy were counted apart from mentions in the proposals section. The sector with the most mentions of Dodd-Frank was the Financial sector with six of the 24 mentions in 2013. The Basic Materials and Healthcare sectors shared the second highest number of mentions at four each.

The following disclosure example highlights some of the ways in which the Dodd-Frank Act and Say on Pay have impacted companies’ approaches to executive compensation.

- **Wells Fargo & Co. (WFC)**
  DEF 14A filed on March 14, 2013

  “Impact of Prior Say on Pay Votes on Compensation Decisions and Feedback from Our Investor Outreach Program

At the Company’s 2012 annual meeting, our stockholders approved, by 96% of the votes cast, the non-binding advisory resolution on the 2011 compensation of named executives submitted to stockholders in accordance with the Dodd-Frank Act. The Company, Board and HRC pay careful attention to communications received from stockholders on executive compensation, including the non-binding advisory “say on pay” vote. The favorable advisory vote, as well as direct feedback on our executive compensation program and disclosures received in 2012 from the Company’s major stockholders and other stakeholders through our investor outreach program, was considered and reflected in the decision to maintain the overarching framework and balance for named executives’ compensation for 2012, but not for specific pay-level decisions. Based on the preference expressed by stockholders at the 2011 annual stockholders’ meeting, the Board has determined to have an annual advisory vote on executive compensation until the next advisory vote on the frequency of our advisory “say on pay” vote is held.”

![Dodd-Frank Act References](chart.png)
Although all S&P 100 companies now hold advisory Say on Pay votes, not all have chosen to address the topic in their CD&As. In the most recent year of proxy filings, only 65% talked about their Say on Pay results and procedures outside of the proposals section. For some, this may be just a quick mention of how they keep in mind Say on Pay voting results when designing compensation, while for others this may be an in-depth section involving their interaction with shareholders, institutional investors, and proxy advisory firms.

**RR Donnelley Commentary**

In our view, the primary impact of Say on Pay has been expanding engagement between companies and investors on corporate governance and compensation issues. This in turn has led to increased understanding of (if not agreement with) their respective positions.

This engagement has given many companies enhanced insight into investor preferences in compensation vehicles and design, as well as their informational needs. This has driven certain changes to pay practices as well as their disclosure. Proxy design is the icing on the cake to draw the eye to key information.

Be aware that many investors interpret and treat the Say on Pay vote very broadly. Many have voted against Say on Pay not because of excessive or misaligned pay, but due to lack of clarity about performance goals, peer selection rationale and other opaque disclosures. If they don’t understand it, they may not support it.

**Shareholder Engagement**

In response to the Advisory Vote on Executive Compensation legislation introduced by the Dodd-Frank Act in 2009, compensation committees have reached out to shareholders to address any potential shareholder concerns. Mentions of their engagement with shareholders have increased each year since.

**Shareholder Engagement References by Sector**

- **Healthcare**
  - 2009: 6
  - 2010: 8
  - 2011: 11
  - 2012: 33
  - 2013: 49

- **Basic Materials**
  - 2009: 3
  - 2010: 3
  - 2011: 2
  - 2012: 3
  - 2013: 6

- **Financial**
  - 2009: 1
  - 2010: 4
  - 2011: 7
  - 2012: 9
  - 2013: 9

- **Services**
  - 2009: 6
  - 2010: 7
  - 2011: 1
  - 2012: 6
  - 2013: 7
Recent public conversations with shareholders at Oracle Corp. and Simon Property Group illustrate that not passing a Say on Pay vote can lead to immediate shareholder engagement. Simon Properties Group received 25.7% in favor of its executive compensation policy in 2012. After not passing, the company introduced the following program:

- **Simon Property Group (SPG)**
  DEF 14A filed on April 4, 2013

<table>
<thead>
<tr>
<th>Feedback from Stockholder Outreach</th>
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<tr>
<td><strong>We believe that our stockholder outreach process strengthened our compensation program, as well as our understanding of our stockholders’ concerns and the issues on which they are focused. We will continue to make it a priority to ensure that we engage with stockholders in the future.</strong></td>
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At these meetings, we heard feedback related to our Company’s performance, our employment agreement with David Simon, and our ongoing compensation program. Stockholders consistently noted that they were very pleased with our Company’s financial performance, as well as David Simon’s outstanding leadership in the real estate industry (including during the financial crisis) and that he has been recognized as one of the leading CEOs in the world. However, they cited some areas of concern, primarily related to David Simon’s employment agreement. Our Committee met on three separate occasions following the completion of our stockholder outreach program. We then met with two leading proxy advisory firms: Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co., LLC to discuss the stockholder feedback that we have received and potential compensation program modifications. In response to our stockholder outreach, the Committee and David Simon mutually agreed to address several of the common concerns that were expressed by stockholders during the Committee’s outreach.

The response from Simon Property Group helped them pass the following year by more than doubling the approval percentage from the year before, receiving 55.1% in favor of its executive compensation policy in 2013.
With the Advisory Vote on Executive Compensation going into effect in 2011, Oracle Corp provided a section in its CD&A about a similar outreach program to institutional stockholders. Oracle passed its first Advisory Vote on Executive Compensation after receiving 66% in favor of its executive compensation policy. In the following year of 2012, it included a nearly identical disclosure about the outreach program to institutional stockholders, yet only received 40.9% in favor of the executive compensation policy. Oracle then included an extended discussion of stockholder engagement in its next proxy for 2013:

**Oracle Corp. (ORCL)**
DEF 14A filed on September 20, 2013

<table>
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<tr>
<th>Feedback from Stockholder Outreach</th>
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<tr>
<td>The Compensation Committee and the rest of our Board of Directors were disappointed with the results of the fiscal 2012 Say-on-Pay vote. In light of these results, the Compensation Committee engaged in a series of substantial internal discussions and deliberations about our compensation philosophy and possible design alternatives. The Chairman of the Compensation Committee and other non-management members of our Board of Directors also met with several of our largest institutional stockholders to seek their input and feedback on our executive compensation practices. Following these discussions and meetings, the Compensation Committee reaffirmed Oracle’s fundamental principle of clearly linking executive compensation to Oracle’s financial performance and long-term stock price. The Compensation Committee believes Oracle’s executive compensation philosophy and program achieve this goal in a manner that is appropriate for Oracle (and not necessarily other companies) and that significant changes to our executive compensation program were not warranted. The Compensation Committee realizes that certain of our stockholders may disagree with this conclusion, but the Compensation Committee believes that our executive compensation philosophy and the current structure of our executive compensation program are in the best interests of Oracle and its stockholders, and that, in the Compensation Committee’s opinion, this belief has been validated by Oracle’s historical financial and stock price performance over the long term.</td>
</tr>
<tr>
<td>The Compensation Committee and the rest of our Board of Directors value the opinions of our stockholders, including those that disagree with them, and will continue to consider the outcome of future Say-on-Pay votes, as well as feedback received throughout the year, when making compensation decisions for our named executive officers.</td>
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</table>

Oracle’s additional disclosure urged shareholders to understand that it has the shareholder’s best interests in mind while making executive compensation decisions and that it engaged with shareholders to hear their voices about executive compensation practices. Although the disclosure was included in the proxy, the shareholders again voted against the proposal with 43.1% approving.

Disclosure of shareholder engagement has increased in frequency over the past five years among S&P 100 companies. This trend will likely continue as the practice of engaging shareholders emerges as common practice within corporate governance. Engaging shareholders could help companies pass their Advisory Votes on Executive Compensation if shareholders agree that the discussions were effective in aligning companies’ executive compensation policies with shareholders’ best interests.
Proxy Advisors

Proxy advisory firms have become familiar names in the world of corporate governance. Companies frequently issue statements regarding the recommendations of proxy advisory firms. The creation of the advisory vote on executive compensation has magnified the presence of proxy advisors in the discussion of executive compensation policies. It has only been within the past two years that these proxy advisory firms and their recommendations are now more frequently mentioned in proxies.

Although proxy advisory firm mentions are not as prominent as shareholder engagement, the rise of their mentions in proxies is closely related to the reasons that shareholder engagement mentions are increasing. Proxy advisory firms advise shareholders on how to vote on shareholder proposals, and as a result, companies are reaching out to the proxy advisory firms to ensure that their proposals are satisfactory. More companies will likely mention proxy advisory firms in their proxies if they feel it is necessary to counter negative recommendations from the advisory firms.

RR Donnelley Commentary

Dodd-Frank requires companies to disclose to what extent they consider the prior year’s Say on Pay vote when making compensation decisions. The proxy advisors, as well as many major investors, expect more. Particularly following an average or poor Say on Pay vote (often defined as below 70% of votes cast), they target the company for greater scrutiny the following year, expecting the company to conduct extensive post-annual meeting engagement with major investors as well as proxy advisors, and in the next proxy to describe the extent of that engagement, feedback obtained and any company actions made in response to that feedback. Irrespective of the overall vote result, any investor that voted against in one year, is likely to maintain opposition in the future if no changes are made to address concerns.

RR Donnelley Commentary

Many have expressed concern that proxy advisors have outsized influence over Say on Pay and other votes. In reality, most investors that subscribe to one or more proxy advisors use them primarily as data aggregators and as screening tools, often giving a “free pass” to companies receiving positive recommendations, and further scrutinizing companies receiving negative recommendations. To companies, it may appear that investor voting in line with proxy advisor recommendations indicates a causal relationship. Most investors would assert that the votes are parallel – with the proxy advisors simply reflecting the investors’ direct views.

This debate will rage on, but what is clear to us is that one mark of a great proxy is that it conveys a sufficiently clear and compelling story such that a meaningful number of investors, who typically might follow a negative proxy advisor recommendation, will instead support the company.
The design of proxies has changed along with their content. In CD&As, the word count, use of colors, additional graphs, and number of columns are all components of proxy design that have changed over the past five years.

**RR Donnelley Commentary**

For institutional investors, content (and the ability to quickly locate it) is king. That said, design can have a major role. "Design with a purpose" means using design elements, color, summaries, graphs, and navigational tools to draw the reader’s eye to key content. Thus content, as well as the company’s particular issues and proxy objectives, should drive design, not the other way around.

The proxy innovators who in 2011 and earlier led the way in evolving proxies from compliance documents to communications pieces know this. They had first engaged with their investors, identified their informational needs, and using plain English, summaries, graphs, checklists, and other visual devices, set out to meet these informational needs and tell an effective story.

Nor does "one size fit all" when it comes to proxy design. There is no one perfect proxy that all other companies should emulate. Rather, there are numerous clean, crisp, visually inviting styles companies have employed. Each company needs to take into consideration its unique corporate culture, industry, ownership base and issues. What works for a consumer products or technology company, may not for a financial services firm.

Nor is the proxy a static, "set it and forget it" template where only the numbers get updated each year. Leading companies apply the principles of continuous process improvement to their proxies. Once a major style re-design has been undertaken, most companies then incrementally tweak that new design and content based on changing performance, pay outcomes, voting results, and other investor feedback.

**Word Count and New Sections**

The number of words in the Compensation Discussion & Analysis section of proxies has increased over the past five years for companies in the S&P 100. With additional disclosure and transparency becoming standard in the CD&A section, the length of the section has increased 17.6% from proxies filed from 2009 to 2013. In addition, several new sections have been created over the past five years. These new sections, such as proxy summaries and executive summaries, are not replacing existing sections and will likely become recurring sections in future proxies.
In recent years, the average length of proxies as well as the CD&A section has been increasing. Companies are concerned this may be contributing to declining readership.

In response, a major innovation companies are adopting is the use of summaries, whether Proxy Summaries at the front of the document, CD&A Executive Summaries at the front of that important section, and checklist summaries of key practices. "If our investors won’t read 70 pages, perhaps they will read five,” goes the thinking.

Most companies have little difficulty identifying what information they wish to put in their summaries, typically comprised of a combination of information that is drawn forward from its traditional locations in the proxy. What is more challenging, is how not to repeat that same information in its traditional location, so duplication (and ironically, expanded length) often results from creating summaries.

Some duplication is understandable and not necessarily fatal. By including key information in a summary, it’s more likely to be read at least once. That said, companies are seeking to minimize duplication.
Use of Colors

Adding color is an aesthetic approach to the proxy design. The frequency of color in proxies increased from nine companies using color in 2009 to 55 companies using color in 2013. Color has been added to the CD&A through changing the font, adding additional graphs or tables, and including other choices to the proxy design. AT&T provides an example of adding color to a proxy. This is highlighted with the Target Compensation for NEOs graph in its CD&A:

- **AT&T Inc. (T)**
  DEF 14A Filed on March 11, 2009

![Composition of 2008 Target Compensation](image)

### 2008 Long-Term Incentive

- **CEO Compensation**
  - Salary: 65%
  - 2008 Long-Term Incentive: 27%

- **Other Named Executive Officers (except CEO)**
  - Salary: 62%
  - 2008 Long-Term Incentive: 23%

- **AT&T Inc. (T)**
  DEF 14A Filed on March 11, 2013

![2012 Target Compensation Mix](image)

### 2012 Target Compensation Mix

- **CEO**
  - Base Pay: 66%
  - Long-Term Target (50% Performance Share/50% Restricted Stock Units): 26%
  - Short-Term Incentive Target: 8%

- **Other NEOs**
  - Base Pay: 63%
  - Long-Term Target (50% Performance Share/50% Restricted Stock Units): 24%
  - Short-Term Incentive Target: 13%
The addition of color could be a result of companies desiring that their proxies be read, or it could be as simple as the reality that technology has made color in proxies more feasible. Whatever the reason, the number of proxies with color will likely continue to increase in the future.

**RR Donnelley Commentary**

There are many black and white proxies that are visually inviting and well-organized. That said, color can make a significant aesthetic difference. Equally important, a combination of color and other design elements such as shading and call-out boxes can help draw the eye to key information, or make it easier to differentiate the sections of graphs.

In between "no color" (i.e., black and white) and four-color, many companies use two colors in their printed proxies (with blue being the most frequent second color). Keep in mind that multiple shades of each color can be employed, such as dark blue headings, and gray-scale or light blue shading in call-out boxes or tables, and it’s still a two-color process (which is less complex and costly than four-color).

Also, bear in mind that most institutional investors do not see your traditional printed proxy. They typically view the document on specialized work-flow management platforms that are designed for the needs of investors with broad-based portfolios. The most prominent are ISS’ institutional voting platform, and Broadridge’s ProxyEdge platform. Some companies are applying extra color and other design elements to the online version, which their institutional investors will see. Adding color in a digital environment is less costly than in a physical environment.

**ADDITIONAL GRAPHS**

Proxies are becoming more than just text in a document. Adding visuals in proxies was almost a standard for S&P 100 companies in 2013. Examples of these additional graphs include Pay for Performance alignment, supplemental pay, and company stock price over time. This increased use of supplemental graphs is likely to continue to increase in upcoming years as the SEC adds more required disclosures in proxies.

Proxies continue to evolve in content and design to provide important communication about companies’ pay policies in an effective and interesting way. As the 2014 proxy season comes upon us, a new wave of proxies will be filed with new approaches by companies to provide an impactful compensation discussion and analysis for shareholders.
There is wide agreement that graphs, judiciously used, can help reinforce key data points and thus help tell the story. One of the most frequent requests we receive from clients is, “help us make our CD&A more visual and less textual.” As discussed earlier, there is a wide array of pay for performance alignment and pay versus peers graphs companies can consider using, based on their particular facts and circumstances. One concern we often hear, as with adopting any new disclosure regime, is “using this graph, or alternative pay measure looks good this year, but we’re concerned about what it will it look like in the future.” While this is a valid concern, it should not stand in the way of telling an effective story.

What is to be avoided, however, are over-engineered or otherwise confusing graphs. When we asked investors if they have seen graphs that were either confusing, hard to follow, poorly labeled or ambitiously trying to demonstrate several points in one elaborate image, a majority say “yes.” Additionally, a number of those respondents indicated that when they do, they consider it a deliberate effort by the company to mislead them. This was a surprising result as we don’t believe companies create graphs with the intent to mislead. But that’s the perception. So while we applaud creativity, occasionally it needs to be reigned in.

Investors also have commented that, just because other companies use a particular type of graph, don’t feel compelled to use it if it’s not central to the story.
For more information, please contact Aaron Boyd at aboyd@equilar.com. Aaron Boyd is the Director of Governance Research at Equilar. The contributing authors of this paper are Emily Han and Frank Gonzalez, Senior Research Analysts, Garret Sturgis, and Greg Leyrer, Research Analysts.

Report Partner:

RR Donnelley

About RR Donnelley

RR Donnelley (Nasdaq:RRD) is a global provider of integrated communications. The company works collaboratively with more than 60,000 customers worldwide to develop custom communications solutions that reduce costs, drive top-line growth, enhance ROI and increase compliance. Drawing on a range of proprietary and commercially available digital and conventional technologies deployed across four continents, the company employs a suite of leading Internet based capabilities and other resources to provide premedia, printing, logistics and business process outsourcing services to clients in virtually every private and public sector.

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Ron joined RR Donnelley’s Global Capital Markets group as Director of Corporate Governance Services in April, 2013. He is responsible for providing thought leadership on emerging corporate governance, proxy and disclosure issues, and works closely with the firm’s sales and service teams to assist clients on compliance and proxy disclosure issues critical to their success.

Over the past three decades, Ron has advised public companies of all sizes, industries and stages of growth facing investor activism, as well as challenging and sensitive proxy solicitations involving corporate governance, compensation and control issues. This includes helping companies conduct engagement programs with their top institutional investors with the objective of identifying and addressing investor concerns through best practices in proxy disclosure.

Toward this objective, Ron led RR Donnelley’s 2013 survey of institutional investors about proxy statements. This innovative survey identified key content, design and navigational features preferred by investors. By applying the lessons from this survey, RR Donnelley helps clients design and produce proxies that are more likely to be read and understood by these investors.

Another tool RR Donnelley has created to assist clients in meeting investor informational needs is its unique Guide to Proxy Design. The Guide catalogs many innovative and best practice design, content and navigational features or sections of proxies from among RR Donnelley’s industry-leading client base.

During his career, Ron has managed more than 1,600 proxy solicitations, 200 tender or exchange offers and 30 proxy contests, with his proxy fight clients succeeding in over 70% of such situations.

Prior to joining RR Donnelley, Ron’s experience includes three years at AST Phoenix Advisors and nine years at BNY Mellon, providing thought leadership on regulatory changes and emerging best practices, and advising clients on proxy, governance and activism issues. Prior to that, Ron spent four years at The Financial Relations Board (FRB), a leading investor relations agency, where he managed its proxy solicitation, corporate governance and stock surveillance practice. Before that, he was a consultant to major proxy intermediary ADP Investor Communication Services (now known as Broadridge), where he served as its first “Issuer Liaison” with responsibility for its relationships with issuer companies. Earlier in his career, Ron held increasingly senior positions at major proxy solicitation firms Morrow & Co, D.F. King and Georgeson, where he served on its first Board of Directors.

Ron earned a B.A. in Economics from Princeton University.
Related Content Links

Reports

- 2014 Realizable Pay 101 Report
- 2014 Compensation & Governance Outlook Report
- 2013 Say on Pay Warning Signs Report
- 2013 Benefits and Perquisites Report

Articles

- Advances in CD&A Design
- Say on Pay Peer Group Turnaround Changes
- Inputs Matter – A Comparison of Diverse Peer Group and Pay Models

Videos

- Behind The Numbers Say on Pay
- Clawbacks 101
- Ownership Guidelines 101