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FREDERIC W. COOK & CO., INC.

Memorandum

U.S. Executive Compensation
2015 Recap, Key Developments & Notable Trends

March 31, 2016

For public companies, boards of directors, and practitioners, 2015 was an eventful year in executive compensation. This article presents the key developments and trends we observed during 2015 and their implications for 2016 and beyond.

Executive Summary

- **In 2015, consistent with prior years, an overwhelming percentage of Russell 3000 companies obtained majority "Say-on-Pay" support.** In 2015, Say-on-Pay voting entered its fifth year.
  - 2,121 companies (97%) passed Say-on-Pay, and 56 companies (3%) failed.
  - On average, passing companies had a 92% approval rate, while those that failed had a 39% approval rate.
  - On a related note, approximately 80% of Russell 3000 companies hold annual Say-on-Pay votes. Companies that will have completed six years of Say-on-Pay in 2016 will be required to refresh shareholder approval of their "say-when-on-pay" frequency in 2017. It is our expectation that companies with annual Say-on-Pay voting will continue to recommend and adopt the same frequency.
- **Institutional investors are demonstrating both a heightened level, and an increased expectation, of engagement on executive compensation matters.** As institutional investors and their portfolio managers strive for best-in-class returns, they are focusing on governance and compensation as key enablers of achievement of financial performance and alignment of interests. This focus was highlighted by Vanguard, one of the world's largest investment management companies, in an unexpected letter to the non-executive board chairs and lead directors of S&P 500 companies last year. Because direct engagement with companies offers the best opportunity for Vanguard and other

institutional investors to provide timely and candid feedback, we expect the level of engagement (particularly as it relates to performance-based elements of compensation) to increase. For companies, engagement offers a valuable opportunity to secure key investor support for compensation design in advance of the formal Say-on-Pay vote. Accordingly, engagement is likely to empower companies to shift away from the pressure to conform to homogenized pay practices and implement compensation structures that are specifically calibrated to the company's compensation philosophy and pay-for-performance strategy.

- **Rigor of performance goals is becoming the key focus area for proxy advisory firms and institutional investors.** With limited exceptions for grandfathered legacy arrangements, the substantial majority of public companies have eliminated "problematic pay practices" (e.g., excise tax gross-ups, single-trigger change of control severance benefits, excessive perquisites) that were the typical targets of external scrutiny. With the phasing-out of these legacy practices, investor focus is shifting to a substantive investigation of pay-for-performance alignment, with particular emphasis on the rigor of performance goals, measurement consistency with generally accepted accounting principles ("GAAP") and transparency of disclosure. This has heightened the scrutiny of annual and long-term metric selection and goal-setting and related proxy disclosure, as investors (with the benefit of hindsight) attempt to assess the appropriateness of selected metrics and difficulty of achievement of targeted levels of performance.
- **ISS implemented a "scorecard approach" for evaluating equity plans.** In 2015, Institutional Shareholder Services ("ISS") implemented a new methodology for evaluating equity plan proposals. In contrast to the previous pass/fail approach based primarily on plan cost, the new Equity Plan Scorecard evaluates a variety of positive and negative factors to drive a weighted score. While the final determination of the maximum share request that ISS will support continues to be a "black box," the Scorecard's holistic (rather than binary) evaluation of equity plans is a positive development. The Scorecard remains in effect for 2016, with some scoring updates.
- **Shareholder proposals relating to accelerated equity vesting upon a change in control increased in popularity.** During 2015, the most prevalent executive compensation-related shareholder proposal among Russell 3000 companies was to limit change in control ("CIC") equity vesting acceleration to a pro rata amount based on service, rather than full acceleration. Notably, the number of such proposals increased from 2014, reflecting continued shareholder focus on perceived employee "windfalls" from a CIC transaction. Furthermore, in an important scoring change from last year, ISS' 2016 Equity Plan Scorecard also focuses on equity plan provisions relating to acceleration of awards in a CIC, including the payout level of performance awards. In our view, "double-trigger" vesting provisions (i.e., if the equity award is assumed by the acquirer, accelerated vesting only applies on a qualifying termination during a specified period following a CIC) is best practice and aligned with shareholder interests.

- **Performance-based awards continue to be the most common long-term incentive vehicle.** Awards based on the achievement of specified performance goals were in place at nearly 90% of large companies and account for approximately one-half of the total grant value for senior executives. A majority of companies continue to use time-based awards as part of a portfolio approach to long-term incentives, allocating slightly more value to stock options than restricted stock, on average. Within performance share designs, total shareholder return ("TSR"), typically measured relative to a peer group or index, is the most prevalent performance metric, in place at over half of companies, followed by profit and return metrics. It is possible that relative TSR has reached the height of its popularity, given some of its complexities and limitations, as its prevalence peaked at 58% in 2014 and decreased to 54% in 2015. We expect TSR to remain a popular metric in long-term incentive design, with the trend likely to be the use of TSR as a weighted component in a portfolio of metrics or as a positive or negative modifier to payouts.
- **The SEC finalized the CEO pay ratio rule.** The Securities and Exchange Commission ("SEC") adopted a final rule on August 5, 2015 that implements the Dodd-Frank Act requirement that reporting companies disclose the median of the annual total compensation of all company employees other than the company's chief executive officer ("CEO"), the CEO's annual total compensation, and the ratio between these two numbers. The final pay ratio rule provides more flexibility than anticipated based on the proposed rule. However, the final rule remains quite broad in that it defines "all employees" to include all full-time, part-time, seasonal, and temporary employees of the company or any of its consolidated subsidiaries, whether located in the U.S. or abroad and without regard to whether they are salaried (unless certain limited exceptions are applicable). Disclosure of the pay ratio will be required for listed companies' first full fiscal year beginning on or after January 1, 2017 (i.e., it is not required until the 2018 proxy season). We outline in this article several steps that companies may consider taking in the near- to medium-term to facilitate compliance.
- **The SEC proposed rules on the remaining executive compensation-related Dodd-Frank items.** In addition to finalizing the pay ratio rule, the SEC has proposed rules requiring the disclosure of corporate hedging policies, pay-versus-performance disclosure, and the adoption and disclosure of clawback policies. In light of these developments – and although compliance with these rules is not imminently required – we indicate in this article several steps that companies may consider taking now with regard to each of these proposed rules.
- **Recent trends in director compensation continue.** Director compensation programs have become simpler, more transparent, and designed to reward directors based on their level of responsibility while promoting independence and objectivity. As compensation levels have largely caught up to the increased workloads of directors, we anticipate director pay levels to increase at modest levels, with low-to-mid single-digit increases annually for some time. The range between the 25th and 75th percentile compensation levels is narrowing, as differentiation on the downside is limited by competition for

qualified individuals and on the upside by investor scrutiny. While a 50/50 split of cash and equity compensation has been the typical mix among mid- and large-cap companies for the last several years, a bias is emerging toward equity compensation at the largest U.S. companies (i.e., 60% equity, 40% cash compensation).

- **Director compensation lawsuits indicate the continuation of a troubling recent trend.** 2015 witnessed a continuing trend in derivative lawsuits challenging director compensation. Two decisions issued by the Delaware Court of Chancery last year further clarify the scope and application of the stockholder ratification defense, under which a Delaware court will apply the more deferential business judgment rule to a director compensation decision if such decision was made pursuant to an equity plan approved by the company's shareholders. In light of these decisions, we expect many companies will preemptively include a separate, "meaningful" annual director compensation limit in new and amended equity plans that are otherwise being submitted for shareholder approval (i.e., in the ordinary course, we do not recommend seeking shareholder approval solely for purposes of a director compensation limit). To be most protective, a shareholder approved annual total director compensation limit should apply to both cash and equity compensation. That said, the meaningful director compensation limit should provide enough flexibility to address special circumstances (non-executive chair, special litigation or transaction committees, etc.) and reasonable annual increases in compensation until the plan is next taken to shareholders for their approval.
- **Tax and accounting developments.** There were a number of noteworthy tax and accounting developments in 2015 that are discussed later in this article.

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I. 2015 SAY-ON-PAY RECAP

A. By the Numbers

In 2015, "Say-on-Pay" voting entered its fifth year. Consistent with prior years, an overwhelming percentage of Russell 3000 companies obtained majority Say-on-Pay support. Of the 2,177 Say-on-Pay proposals in the 2015 proxy statements of Russell 3000 companies, 97% passed and 3% failed their shareholder vote.

2015 Say-on-Pay Voting Results (Russell 3000)		
Vote Result	#	%
Pass	2,121	97%
Fail	56	3%
Total	***2,177***	***100%***

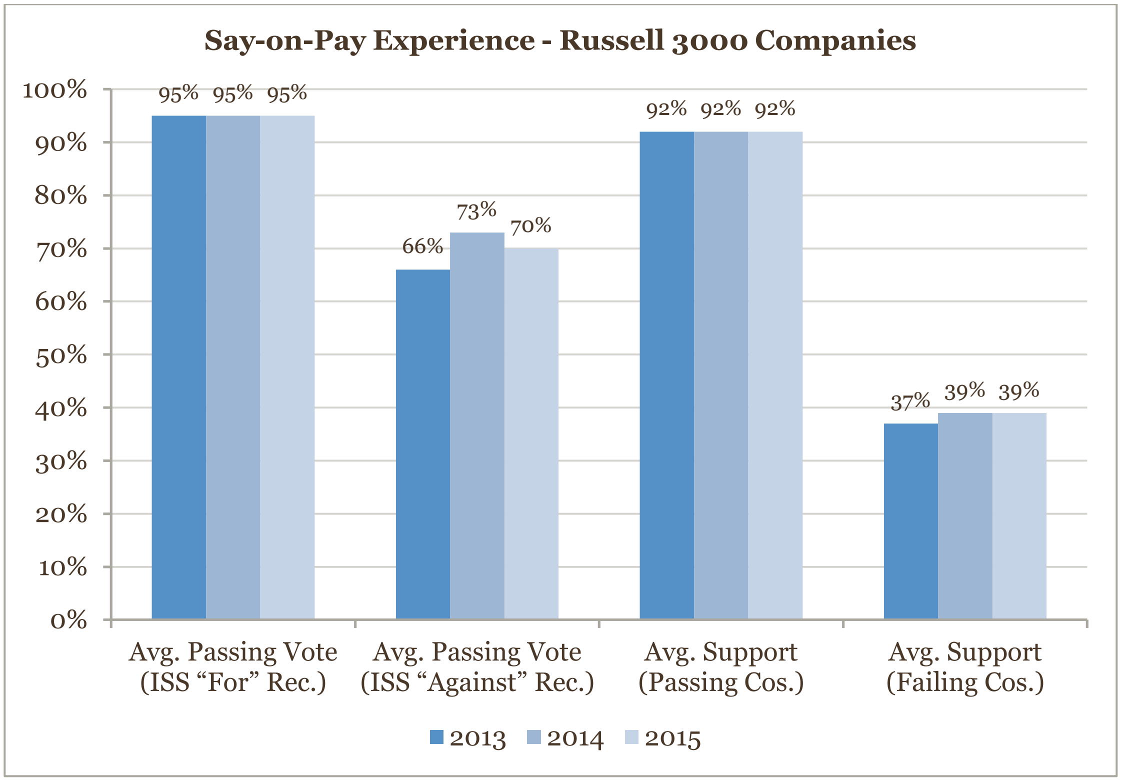
Similar to prior years, the proxy advisory firm ISS issued "Against" vote recommendations on approximately 12% of the Say-on-Pay proposals in 2015.

2015 Say-on-Pay ISS Vote Recommendations (Russell 3000)		
ISS Recommendation	#	%
Against	257	12%
For	1,920	88%
Total	***2,177***	***100%***

Approximately 20% of the companies that received "Against" vote recommendations from ISS failed their Say-on-Pay vote. This proportion is consistent with observations from prior years. Typically, when ISS recommends against Say-on-Pay, shareholder support levels are negatively influenced by 20% to 30%.

2015 Say-on-Pay Voting Results by ISS Vote Recommendation (Russell 3000)				
ISS Vote Recommendation	Passed Proposal		Failed Proposal	
	#	%	#	%
Against	202	10%	55	98%
For	1,919	90%	1	2%
Total	***2,121***	***100%***	***56***	***100%***

Overall, the average Say-on-Pay voting trend has been remarkably stable over the past three years.



B. Key Reasons for ISS "Against" Recommendations

While an ISS recommendation is not per se determinative of the final Say-on-Pay vote result, a "For" recommendation significantly increases the likelihood of securing a positive outcome, and an "Against" vote recommendation typically requires companies to engage in substantial investor outreach.

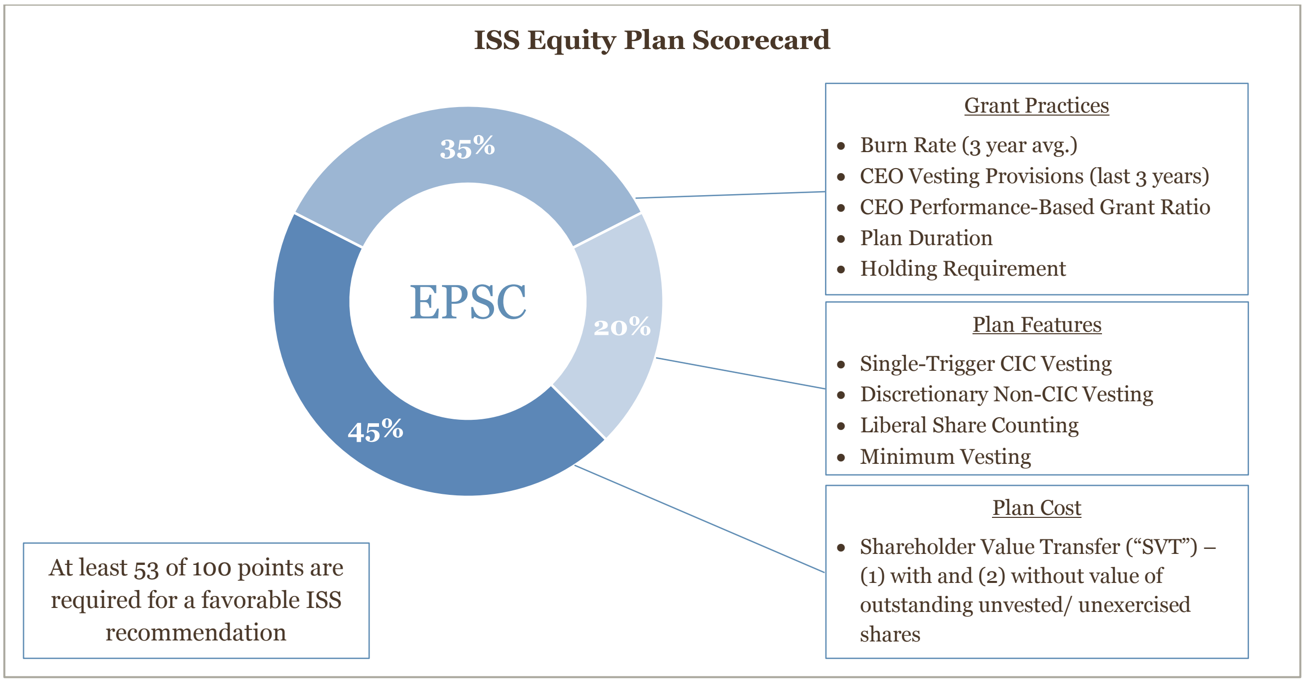
During 2015, the most commonly cited reasons for adverse vote recommendations from ISS included the following:

- Misalignment of pay and performance (primarily evaluated through ISS' quantitative scoring tests);
- Lack of rigor of performance goals (e.g., target goal set below prior year actual performance);
- Multiple payouts based on the same performance metrics (e.g., use of same metrics in short-term and long-term incentive programs);
- Significant grants of non-performance based awards without a clear rationale (e.g., special or retention awards outside of existing incentive programs); and
- Compensation committee unresponsiveness (e.g., failure to address problematic pay practices).

II. ISS EQUITY PLAN SCORECARD

A. Overview

During the 2015 proxy season, ISS implemented a new methodology for evaluating equity plan proposals. In contrast to the previous approach of pass/fail tests, the Scorecard is a scoring system that weighs a variety of positive and negative factors. The plan factors evaluated are grouped under three "pillars": Plan Cost, Plan Features, and Grant Practices.



The Scorecard allows positive plan features and grant practices to mitigate negative plan features and grant practices as well as a shareholder value transfer ("SVT") plan cost in excess of the ISS cap. Conversely, an equity plan with an SVT plan cost below the ISS cap could receive a negative vote recommendation if there are a sufficient number of negative Scorecard factors.

Companies that have been public for less than three years are subject to a modified scoring approach.

B. Overriding Factors

Certain plan features considered by ISS to be "egregious" will result in an automatic "Against" recommendation by ISS regardless of scoring under the Scorecard. According to ISS, plans that may be implicated are those that:

- Have a "liberal" CIC definition (e.g., a CIC trigger based on shareholder approval rather than consummation) that could result in single-trigger vesting of awards;

- Would permit repricing or cash buyout of underwater options or stock appreciation rights without shareholder approval;
- Serve as a vehicle for problematic pay practices or a pay-for-performance disconnect; or
- Contain any other plan features or company practices that are deemed detrimental to shareholder interests (e.g., tax gross-ups related to plan awards or provision for reload options).

C. Key 2016 Scorecard Updates

Effective for meetings held on or after February 1, 2016, ISS has made a number of scoring adjustments to the Scorecard. The three most notable changes are as follows:

- The scoring for the treatment of equity awards in a CIC is no longer binary. Under the updated Scorecard, ISS will award:
  - Full points if the plan provides:
    - With respect to outstanding time-based awards, either (i) no accelerated vesting or (ii) accelerated vesting only if awards are not assumed/converted; and
    - With respect to performance-based awards, either (i) forfeiture or termination of outstanding awards, (ii) vesting based on actual performance as of the CIC either in full or pro rata, or (iii) on a pro rata basis for time elapsed in ongoing performance period(s).
    - It is our understanding that ISS will also provide full points if the equity plan provides for double-trigger equity vesting, and upon such vesting any performance-based awards are paid based on actual performance (either in full or pro rata) or are pro-rated and paid at target, provided the plan also provides the treatment in the two bullet points above in the event the awards are not assumed or substituted for upon the CIC.
  - Zero points if the plan provides for automatic accelerated vesting of time-based awards or payout of performance-based awards above target level.
  - Half points if the plan provides for any other vesting terms related to a CIC.
- The period required to receive the maximum points with respect to a post vesting/exercise holding period has been increased to 36 months (from 12 months) or until employment termination; companies with a holding period of 12 months or until the ownership guidelines are met will receive half points.
- IPO companies were previously not subject to the Grant Practices pillar. Under the 2016 Scorecard, Russell 3000/S&P 500 companies that are recently public will be evaluated under the Grant Practice factors (with the exception of burn rate and plan duration).

For a detailed discussion of the 2016 Scorecard updates and other proxy advisory firm updates, click here.

III. 2015 EQUITY PLAN VOTING RESULTS

Among Russell 3000 companies in 2015, there were a total of 521 proposals seeking shareholder approval of equity plan amendments and 247 proposals requesting shareholder approval of new equity plans. All of these proposals received majority shareholder support.

Equity Plan Proposals in 2015 (Russell 3000)			
Proposal Type	Proposed	Passed	Failed
Amendments of Stock Plans	521	521	0
Approvals of New Stock Plans	247	247	0

Of the 521 plan amendments and 247 new plan approvals, ISS opposed approximately 20%, as presented below, because they failed to receive a passing score under the Scorecard or exhibited other overriding factors.

2015 ISS Vote Recommendations				
	Amendments		New Plans	
	#	%	#	%
Against	113	22%	41	17%
For	406	78%	205	83%
Do Not Vote	2	0%	1	0%
Total	***521***	***100%***	***247***	***100%***

The average passing vote in the aggregate was 89% for amendments and 90% for new plan approvals. With a favorable ISS vote recommendation, both types of proposals passed with 92% shareholder support, on average. Without ISS' support, the passing rate dipped slightly below 80% for both types of proposals, which suggests average ISS influence of approximately 13-14% with regard to equity plan proposals.

Average Passing Vote		
ISS Recommendation	Amendments	New Plans
Against	79%	78%
For	92%	92%
Do Not Vote	81%	95%
All	***89%***	***90%***

IV. 2015 SHAREHOLDER PROPOSALS, INSTITUTIONAL INVESTOR ENGAGEMENT, AND HEDGE FUND ACTIVISM

A. Shareholder Proposals on Compensation Matters

In 2015, the most prevalent executive compensation-related shareholder proposal submitted to a vote among Russell 3000 companies sought to limit CIC equity vesting acceleration to a pro rata amount based on service, rather than permitting full acceleration. Notably, the number of such proposals increased from 2014, reflecting a continued shareholder focus on perceived employee "windfalls" from a CIC transaction.

2015 Compensation Related Shareholder Proposals	Number of Proposals		Average Support (%)*	
	2015	2014	2015	2014
Limit CIC Equity Vesting	31	23	33.4	35.9
Clawback of Incentive Payments	16	3	28.6	28.7
Stock Ownership / Retention / Holding Period	14	28	23.3	22.3
Link Executive Pay to Social Criteria	5	1	6.2	2.5
Report on Government Service "Golden Parachutes"	4	0	21.5	n/a
Shareholder Approval of Performance Metrics	4	3	2.4	12.8
Performance-Based Options	2	1	28.4	28.8
Other	12	11	n/a	n/a

*Votes "For" as a percentage of votes "For" plus "Against" for votes held as of 12/31/15
Source: ISS Governance Analytics

It will be interesting to see if shareholder proposals relating to accelerated vesting of equity in connection with a CIC will maintain traction during the 2016 proxy season.

B. Institutional Investor Engagement

In 2015, institutional investors demonstrated an increased appetite for proactive shareholder engagement in a way that was not characteristic of such investors in the past.

- F. William McNabb III, the chairman and CEO of Vanguard, sent a letter to non-executive board chairs and lead directors of approximately 500 of the largest publicly traded U.S. companies, to affirmatively dispel the notion "that some have mistakenly assumed that our predominantly passive management style suggests a passive attitude with respect to corporate governance." McNabb's letter was intended "to share Vanguard's views on corporate governance, and to provide perspective on the way [Vanguard] think[s] about engagement between shareholders and directors."

- Lawrence D. Fink, the chairman and CEO of BlackRock, similarly sent a letter this year. Writing to CEOs of companies in the S&P 500 index, Fink expressed concern with mounting pressures on companies "to meet short-term financial goals at the expense of building long-term value." Fink urged the CEOs to engage with the company's long-term investors, "resist the pressure of short-term shareholders to extract value from the company if it would compromise value creation for long-term owners," and "most importantly, . . . clearly and effectively articulate their strategy for sustainable long-term growth."

The Vanguard and BlackRock communications signify that regular shareholder engagement is expected by some of the largest institutional shareholders and continues to increase in importance. While the issues that companies and their large shareholders will discuss during the course of their engagement will differ depending on both the company's circumstances at a particular point in time and the shareholder's focus, the company's executive compensation program and its relationship to performance are particularly fertile ground for a substantive conversation. In engaging with shareholders on these issues, companies and their representatives should make sure to educate their investors about the company's compensation program and explain the compensation committee's decisions, with emphasis on how compensation design and decisions are aligned with the company's overall corporate strategy. They should also ensure that they come away from the conversation with a clear understanding of the shareholders' expectations and concerns, if any, with regard to the company's compensation program.

For an overview of the elements of shareholder engagement on compensation matters, click here.

C. Hedge Fund Activism

2015 was also a year of significant hedge fund activism. In our experience, activists traditionally tend to focus less on how much executives earn and more on whether they deserve what they received (i.e., metric selection, weights, goal-setting, leverage, etc.). As activist investors seek to increase their power base, Say-on-Pay issues provide an additional window of opportunity for activists to align with large institutions and pressure management for change, both pay-related and strategic. This has heightened the importance of Say-on-Pay.

V. LONG-TERM INCENTIVE ("LTI") AWARD TRENDS

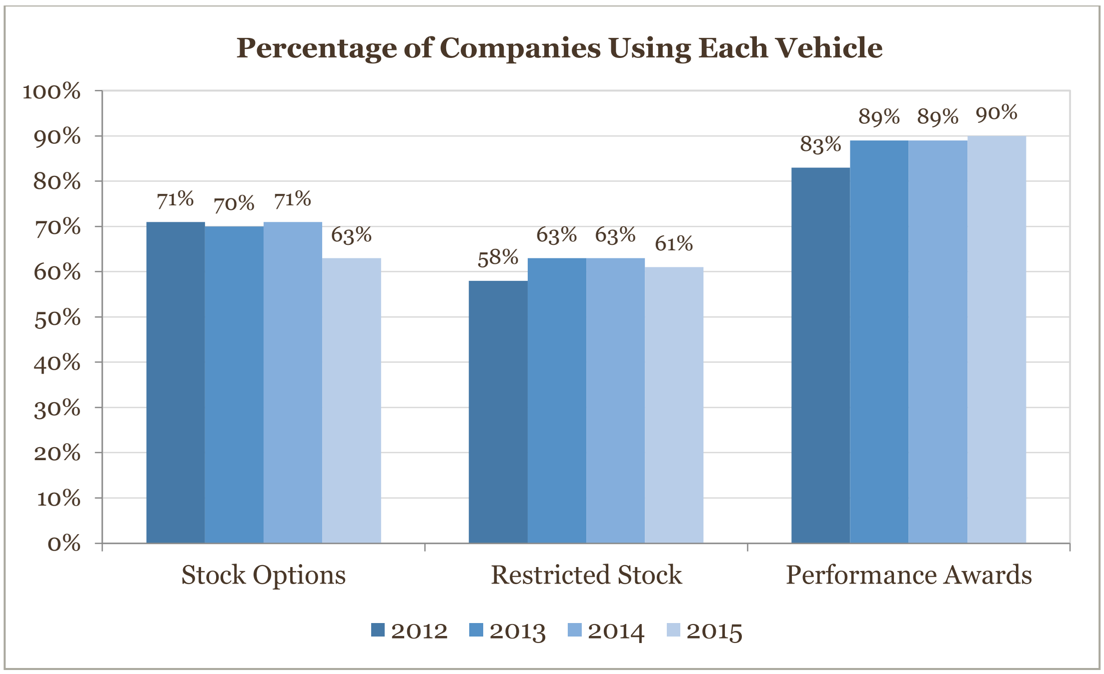
The vast majority of information in this section is based on survey information from Cook & Co.'s *2015 Top 250 Report of Long-Term Incentive Grant Practices for Executives*. To view this report, click here.

A. Types of LTI Vehicles

Most companies employ a portfolio strategy for granting long-term incentives as a means to balance objectives of rewarding stock price appreciation, promoting longer-term financial or strategic performance, and providing a vehicle for retention. In 2015, 83% of companies used either two or three long-term incentive vehicles.

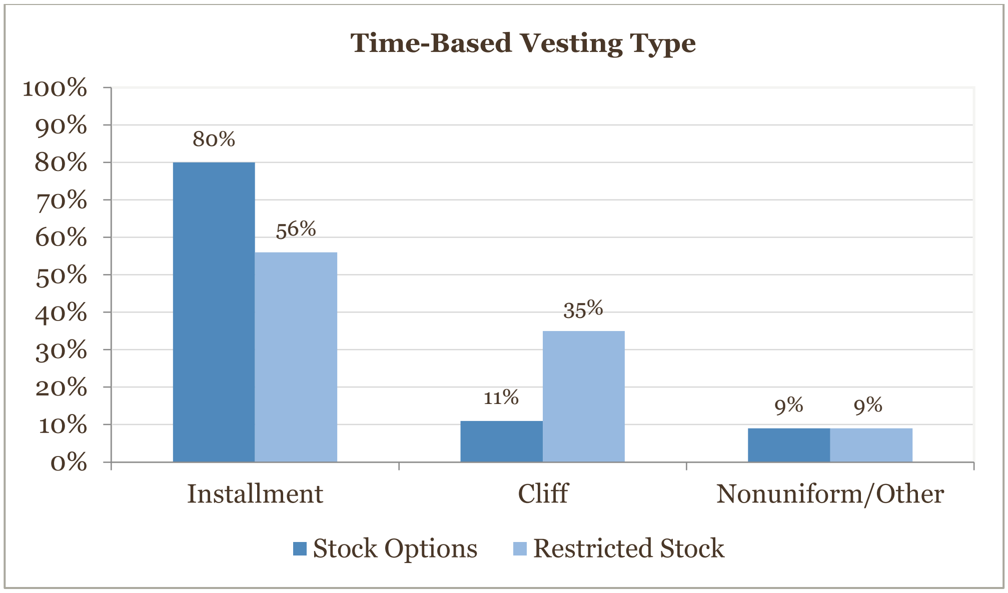
	Percentage of Companies			
# of Vehicles Used	2012	2013	2014	2015
1	17%	14%	14%	16%
2	48%	46%	46%	50%
3	34%	39%	39%	33%
4	1%	1%	1%	2%

While stock option use remains high, it has declined over the last four years; last year, 63% of public companies used stock options, in contrast to 71% in 2012. The prevalence of performance awards has increased over the same time period (from 83% to 90%), while time-based restricted stock usage has remained relatively steady.

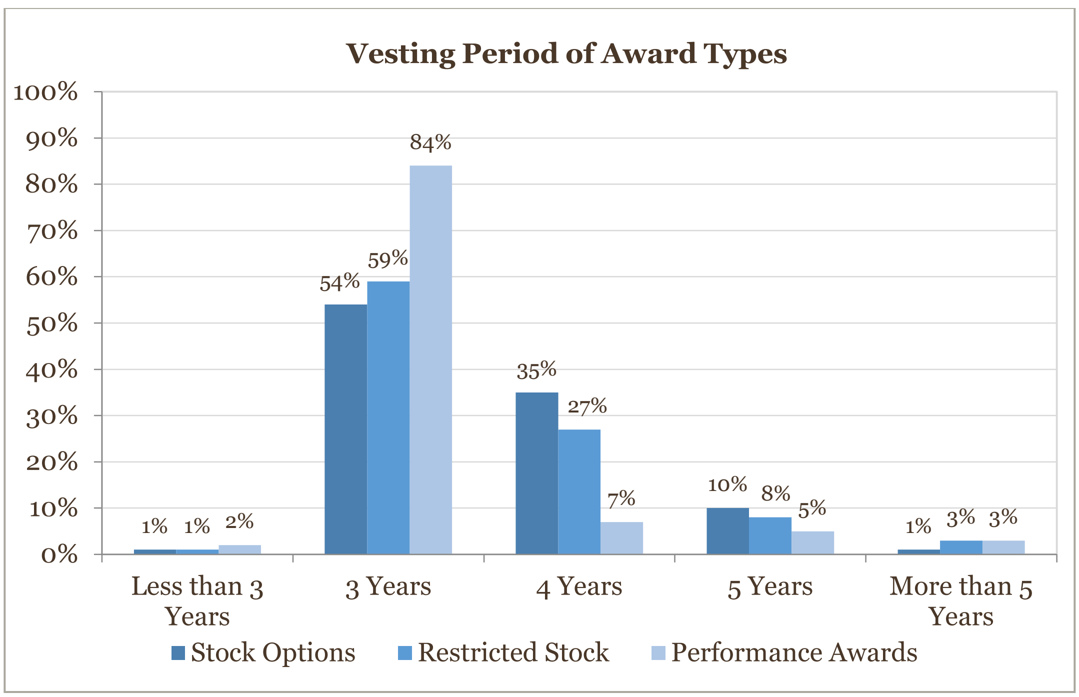


B. Vesting of Time-Based Awards

Most companies (80%) that grant stock options utilize installment vesting (e.g., ratable 25% vesting on each of the first four anniversaries of the grant date). In contrast, it is more common to use "cliff vesting" (i.e., 100% vesting on a specified future date) for time-based restricted stock awards than it is for stock options, as restricted stock is often used for retention awards. Over one-third of companies (35%) use cliff vesting for time-based restricted stock.

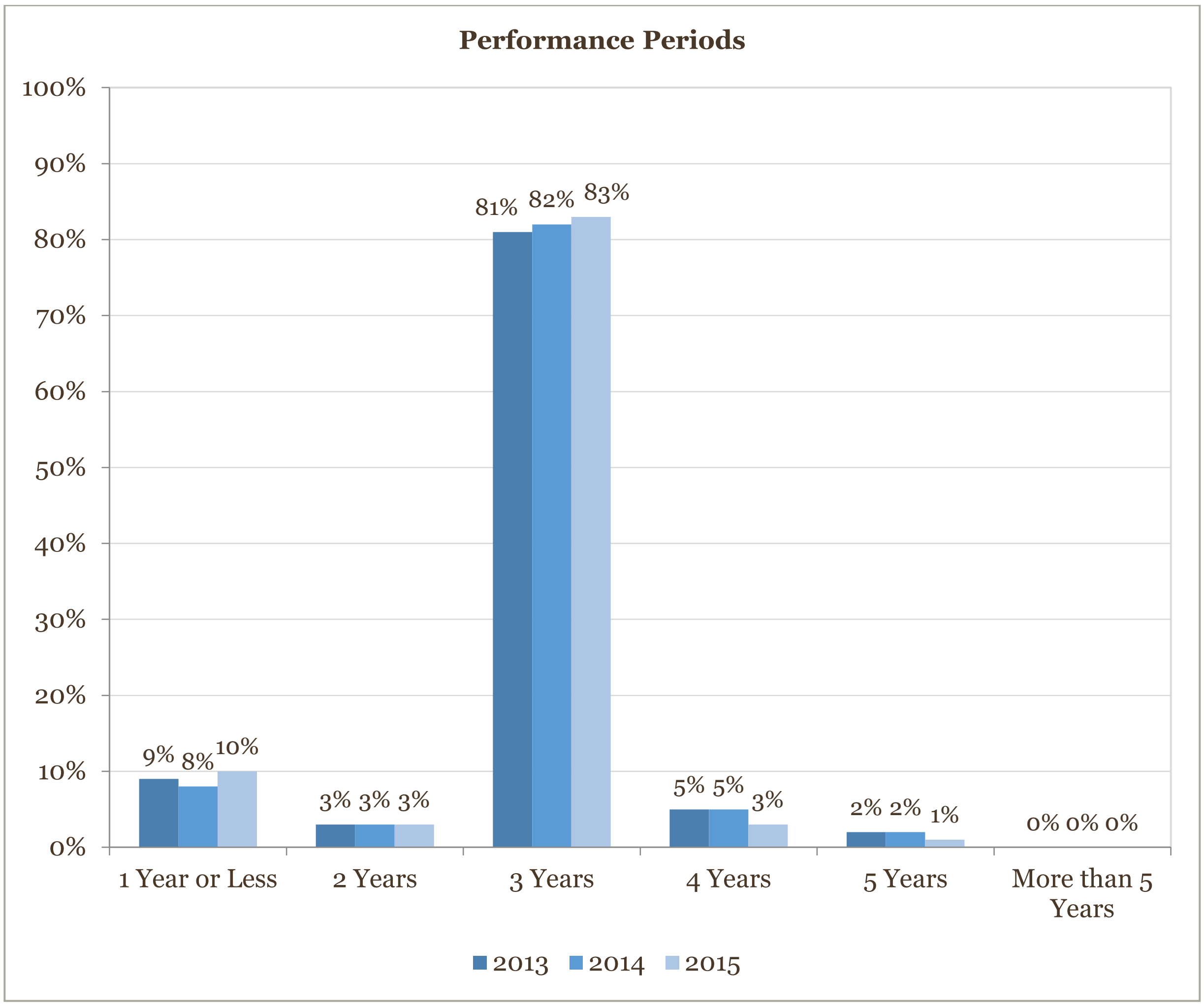


In terms of total vesting horizon, vesting periods range from three to five years, with three years being the most commonly used horizon. Less than five percent of awards vest in either less than three years or more than five years.

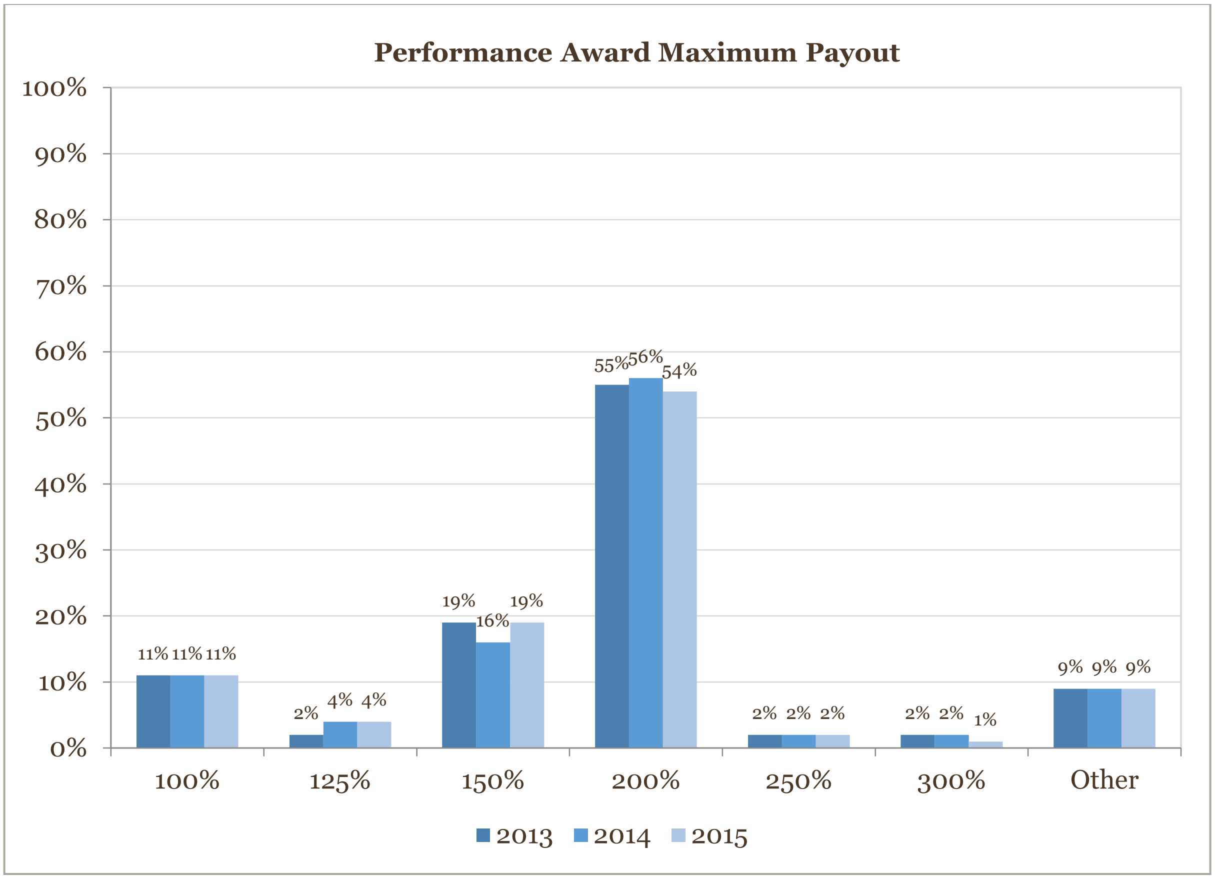


C. Performance Awards – Performance Periods and Payout Curves

Most companies with performance awards use a three-year performance period. The prevalence of this performance period has increased to 83% in 2015 from 81% in 2013. This length balances the challenge inherent in setting long-term performance goals with best practices and external expectations of using multi-year performance periods.



In terms of performance award leverage, a payout of 200% of target is the most widely used maximum. Just over half of all performance awards provide for a 200% maximum payout.



D. Performance Metrics

With respect to metrics, the predominant practice for performance awards is to use one or two metrics. Almost half the companies with performance awards rely on a single metric for determining the payout of the awards; approximately one-third use two metrics, as presented below.

	Percentage of Companies		
# of Measures Used	2013	2014	2015
1	46%	45%	44%
2	34%	33%	35%
3	15%	16%	16%
More than 3	5%	6%	5%

TSR, measured on a relative basis, has become the most prevalent long-term incentive metric, used in over half of all performance awards. When using relative TSR, the typical performance scale ranges from the 25th percentile to the 75th percentile of the comparator group for threshold to maximum payouts. Although no longer the most prevalent, profit measures remain highly utilized; they are used in half of all performance awards. In contrast to TSR, profit measures are most commonly measured on an absolute basis.

Metric		Percent of Companies Using			Measurement Approach (2015)		
Category	Examples	2013	2014	2015	Absolute	Relative	Both
Shareholder Return	TSR	54%	58%	54%	4%	87%	9%
Profit	EPS, Net Income, EBIT/EBITDA	49%	50%	51%	86%	12%	2%
Capital Efficiency	ROE, ROA, ROIC	40%	41%	41%	85%	5%	10%
Revenue	Revenue (Growth)	20%	21%	20%	87%	13%	0%
Cash Flow	Cash Flow (Growth)	12%	13%	11%	92%	4%	4%
Other	Safety, Quality	17%	15%	14%	--	--	--

E. Mix of Vehicles

For the top 20 executives at large U.S. companies, approximately half of the executive's long-term incentive grant date fair value is delivered in performance-vesting awards (generally stock but can be long-term cash). The remainder of the long-term incentive value is delivered in stock options and restricted stock to varying degrees by company and by level. Furthermore, long-term incentive award mix shifts away from stock options and performance awards to time-vesting restricted stock deeper into organizations on the basis that individuals at lower levels have a less direct and substantial impact on company performance. Accordingly, for lower level employees, the purpose of the incentive program shifts to retention through market-competitive stock grants that vest based on the passage of time and away from company performance.

	LTI Vehicle Mix by Level		
Level in Organization	Stock Options	Restricted Stock	Performance Awards
CEO	28%	17%	55%
Other Named Executive Officers	28%	20%	53%
5th to the 20th Highest-Paid Executives	26%	29%	45%
$400,000 to $500,000 in Salary	27%	33%	41%
$300,000 to $400,000 in Salary	27%	31%	42%
$200,000 to $300,000 in Salary	26%	44%	30%
Under $200,000 in Salary	19%	58%	23%

VI. SEC DODD-FRANK RULEMAKING

The SEC was quite active this year in its Dodd-Frank rulemaking on compensation-related matters. In addition to finalizing the much-awaited pay ratio rule, the SEC proposed rules regarding disclosure of corporate hedging policies, pay-versus-performance disclosure, and the recovery, in certain circumstances, of incentive compensation following a restatement of the company's financial statements.

A. Final Rule on CEO Pay Ratio Disclosure

- **The Final Rule.** The SEC's final rule, adopted on August 5, 2015, implements the Dodd-Frank Act requirement that reporting companies disclose the median of the annual total compensation of all company employees other than the company's CEO, the CEO's annual total compensation, and the ratio between these two numbers. The final pay ratio rule provides issuers with more flexibility than anticipated based on the proposed rule. Unlike the proposed rule, the final rule:
  - Defines "employee" as an employee of the registrant or any of its consolidated subsidiaries, rather than any other subsidiaries;
  - Provides tailored exemptions from the definition of "employee" for non-U.S. employees (1) where foreign data privacy laws or regulations prevent the issuer from compiling information necessary to prepare its pay ratio disclosure, or (2) that constitute less than five percent of the issuer's workforce;
  - Permits registrants to make cost-of-living adjustments for compensation of employees in jurisdictions other than that of the CEO, both in identifying the median employee and in calculating the median employee's annual total compensation;
  - Allows registrants to select any date within the last three months of their last completed fiscal year on which to identify the median employee;
  - Permits issuers to identify the median employee only once every three years, "unless there has been a change in [the issuer's] employee population or employee compensation arrangements that the registrant reasonably believes would result in a significant change in the pay ratio disclosure";
  - Expressly states that registrants may provide supplemental pay ratios or other relevant information, "as long as any additional pay ratios are not misleading and are not presented with greater prominence than the required ratio";
  - Amends the transition period for new registrants; and
  - Provides transition periods for registrants ceasing to be smaller reporting companies or emerging growth companies, as well as those engaging in business combinations or acquisitions.

Notwithstanding this flexibility, the final rule is quite broad in that it defines "all employees" to include all full-time, part-time, seasonal, and temporary employees of the company or any of its consolidated subsidiaries, whether located in the U.S. or abroad and without regard to whether they are salaried (unless one of the tailored exemptions described above is applicable).

- **Initial Compliance Date.** Registrants subject to the pay ratio disclosure requirement must comply with the rule for their first full fiscal year beginning on or after January 1, 2017 (i.e., in 2018).
- **Steps to Consider Taking Now.** Issuers should not be lulled by the generous phase-in period the SEC has provided issuers for compliance with the rule. To ensure timely and seamless compliance with the pay ratio disclosure requirement, covered companies should consider taking the following initial steps in 2016:
  - **Assemble a Team.** Issuers should consider assembling a multi-disciplinary working group to spearhead compliance with the pay ratio rule. This working group should consist, for example, of representatives from the company's human resources, compensation, payroll, and legal departments.
  - **Draft a Work Plan.** The working group should create a work plan with milestones and target dates for completing each of the steps involved in complying with the pay ratio rule, with a goal of completing a dry run of calculating the company's estimated pay ratio for 2015, with the help of any necessary outside advisors. Part of the dry run process should include identifying elements of the calculation that remain unknown or that must be further refined to prepare the first publicly filed pay ratio disclosure covering fiscal year 2017.
  - **Identify and Gather Data.** As an initial step in the work plan, the working group should determine what relevant data the company and its consolidated subsidiaries have and where that data resides. The working group should then begin to gather this data and consider how to centralize it.
  - **Prepare the Compensation Committee/Board.** Given that covered companies do not need to provide pay ratio disclosure until 2018, briefing the entire board on the forthcoming requirement may be premature, unless a company has a particularly hands-on board. In most instances, it is likely that only the compensation committee will be involved at this point. The compensation committee should be briefed on the parameters of the pay ratio rule and management's plan for complying with the rule. Upon completing the dry run process by the end of 2016 for calculating the company's pay ratio for the last fiscal year, management should update the compensation committee and/or board regarding:
    - the process and methodology it used to identify the median employee and calculate the pay ratio;
    - the company's estimated pay ratio based on 2015 compensation data and how that estimated ratio compares to the expected pay ratios of the company's peers; and
    - any remaining unknown variables and how management plans to determine them.

For further information regarding the SEC's pay ratio rule, click here.

B. Proposed Hedging Rule

- **The Proposed Rule.** The proposed rule amendments, issued on February 9, 2015, implement the Dodd-Frank Act requirement that each issuer disclose in any proxy or consent solicitation material for an annual meeting whether any employee or director, or any designee thereof, "is permitted to purchase financial instruments . . . that are designed to hedge or offset any decrease in the market value of equity securities either (1) granted to the employee or director by the issuer as part of the compensation of the employee or director; or (2) held, directly or indirectly, by the employee or director."

- **Steps to Consider Taking Now.**
  - **Review Existing Policies.** While the proposed rule would not require issuers to prohibit hedging or even to adopt hedging policies, companies should consider reviewing their existing policies to determine whether they adequately address those matters that would need to be disclosed under the proposed rule. To the extent those policies do not address all persons or types of transactions covered by the proposed rule, for example, companies should consider revising their policies accordingly. In revisiting their policies, companies may decide to take into account, among other factors, the proxy voting guidelines of the major proxy advisory firms regarding hedging by executive officers and directors.

For more information regarding the proposed rule on disclosure of corporate hedging policies, click here.

C. Proposed Pay-Versus-Performance Rule

- **The Proposed Rule.** The proposed rule, issued on April 29, 2015, implements the Dodd-Frank Act requirement that issuers disclose in any annual proxy or consent solicitation the relationship between executive compensation actually paid and the financial performance of the issuer, "taking into account any change in the value of the shares of stock and dividends of the registrant and any distributions." The proposed rule would require registrants to:
  - Present, in a prescribed table:
    - "total compensation" as disclosed in the Summary Compensation Table, presented separately for the company's CEO and as an average for the other named executive officers ("NEOs") listed in the Summary Compensation Table;
    - executive compensation "actually paid" (as calculated in accordance with the proposed rule), presented separately for the company's CEO and as an average for the other NEOs listed in the Summary Compensation Table;
    - the registrant's cumulative total shareholder return ("TSR") over the "measurement period"; and
    - the cumulative TSR of the registrant's peer group over the same "measurement period"; and
  - Describe the relationship between:
    - executive compensation actually paid and the registrant's TSR; and
    - the registrant's TSR and its peer group's TSR.
- **Steps to Consider Taking Now.**
  - **Prepare Draft Disclosure.** Covered companies should consider drafting a mock-up of their pay-

versus-performance disclosure. Since the proposed rule would allow issuers flexibility in deciding which peer group they want to use for purposes of the rule, issuers may want to prepare separate draft disclosures using the peer group included in their CD&A and the same index or issuers they use for purposes of Item 201(e) of Regulation S-K.

  - **Revise Timeline.** Registrants should be mindful that they may need to build in extra time in their proxy timelines to allow for formatting the disclosure using extensible Business Reporting Language ("XBRL"), which is required under the proposed rule.
  - **Update the Compensation Committee.** Counsel or management should consider updating the compensation committee on the proposed rule. The compensation committee may request that management begin to engage in dialogue with the company's compensation consultants regarding what additional information they plan to present to the committee as a result of the pay-versus-performance disclosure requirement, as well as the format and content of the company's proxy disclosure management should consider.

For more information regarding the proposed rule on disclosure of pay-versus-performance, click here.

D. Proposed Clawback Rule

- **The Proposed Rule.** The proposed rule, issued on July 1, 2015, directs the national securities exchanges and national securities associations to establish listing standards requiring issuers to:
  - adopt and comply with policies that provide for the recovery of incentive-based compensation, based on financial information reported under the securities laws, that the company's executive officers received in excess of what they would have received under an accounting restatement ("clawback policies"); and
  - disclose such policies as an exhibit to their annual reports.

  Issuers may be subject to delisting if they do not comply with these standards.

  Under the proposed rule, the listing standards must require issuers to adopt and comply with policies mandating the recovery of excess incentive-based compensation "during the 3-year period preceding the date on which the issuer is required to prepare and accounting restatement."
- **Steps to Consider Taking Now.**
  - **Update the Compensation Committee/Board.** Counsel or management should consider updating the compensation committee and/or board on the proposed rule, its potential implications, and how the company might address the new proposed requirements.
  - **Review Executive Compensation Structure.** Issuers should consider reviewing the elements of their executive compensation plans to determine which elements are subject to the proposed rule's definition of "incentive-based compensation."

- **Start Considering the Structure and/or Substance of a New Policy.** Although the SEC's final rule may differ from the proposed rule and the listing standards adopted by the exchanges may be more expansive than those required by the final rule, corporate boards and management may choose to begin thinking about how best to approach – from a structural and substantive perspective – the new policy that they may be required to adopt pursuant to the proposed rule.

For more information regarding the proposed rule on the clawback of executive compensation, click here.

VII. DIRECTOR COMPENSATION TRENDS

In the wake of the financial crisis, the ensuing market turmoil, and the passage of the Dodd-Frank Act, director compensation programs entered a transformative period in which their emphasis shifted from more of a "pay-for-performance" model, similar to that used for executive compensation, to a "pay-for-service" model, which highlights directors' governance and oversight responsibilities. In general, programs have become simpler and more transparent and have been designed to (a) reward directors based on their degree of responsibility, (b) promote independence and objectivity, and (c) align directors' interests with those of shareholders. Elements of this shift include the following:

- Elimination of meeting fees in favor of larger, fixed retainers to simplify administration and communicate that attendance is expected rather than a remunerable act;
- Delivery of a significant portion of compensation in equity to align directors' interests with those of shareholders;
- Use of shorter or immediate vesting horizons for equity awards to avoid entrenchment and promote independence;
- Granting of full-value shares instead of stock options to mitigate entrenchment and deliver more value-certain compensation levels commensurate with services rendered on an annual basis;
- Reliance on fixed-dollar-value formulas for determining equity grants, as opposed to fixed-share-number grants, to further align compensation values delivered with services rendered on an annual basis;
- Termination of the grant of larger "inducement" equity grants in the initial year of board service, as companies no longer need them for recruiting/onboarding in light of increased director compensation levels generally, which are set to be commensurate with the requisite level of service on an annual basis;
- Reduction or elimination of service-based and non-business-related perks (e.g., life insurance, above market interest on deferrals, etc.) to simplify administration and focus on direct compensation for board service; and
- Maintenance of meaningful stock ownership guidelines typically at around five times the annual board cash retainer to align directors' interests with those of shareholders.

While not all of the abovementioned practices were adopted at once across all companies, they have become predominant practice in the marketplace across a wide spectrum of industries and company size categories. As a result, a typical director compensation program in today's market consists of the components below.

- **Board service.** An annual cash retainer and equity grant are provided. The equity grant is sized as a target dollar value and delivered in full-value stock (i.e., restricted or deferred stock) with short (e.g., one-year) or immediate vesting.
- **Board leadership.** An additional retainer is provided for board leadership. In cases where the CEO is also the chairman of the board, a lead outside director role is often established, and that director typically receives the additional retainer. In cases where the CEO is not the chairman of the board, a non-executive chairman role is created, and the person serving in this role receives the incremental retainer. Retainers for leadership tend to scale with the scope of the role and the workload associated with it. Non-executive chairman compensation tends to be significantly greater than lead director compensation, given the more strategic focus usually inherent in the role. The additional retainer for board leadership can be provided in cash, equity, or a combination of the two. Smaller retainers are generally delivered in cash, while larger ones might be split between cash and equity or be concentrated in equity.
- **Committee service.** An additional cash retainer is sometimes provided to each member of a standing committee, with the three most prevalent committees being audit, compensation, and nominating and governance. The additional cash retainer is intended to reflect the workload associated with the service on each committee. Typically, the audit committee requires the greatest time commitment and effort due, in part, to the frequency of meetings and thus generally commands the largest retainer. Compensation and nominating and governance committees follow, though the Say-on-Pay environment has greatly increased the workload associated with compensation committee membership; retainers for service on this committee have increased commensurately with that workload, narrowing the gap with the audit committee. Notably, compensation practices with regard to committee service differ considerably across companies, and some issuers choose to avoid incremental pay for such service. Instead, these companies provide a higher baseline cash and/or equity retainer and assume that the committee workload is distributed relatively evenly among directors, thereby mitigating the need for differentiation.
- **Committee leadership.** An additional cash retainer is generally provided to each chair of a standing committee. Though greater in magnitude, this retainer reflects similar dynamics to a member retainer.
- **Stock ownership.** Directors are generally expected to own a certain amount of company stock, often expressed as a multiple of the annual cash retainer. Some companies require directors to reach the requisite ownership within a certain timeframe, while others expect directors not to sell compensatory stock they receive from the company until the stock ownership requirement is met. Some companies grant deferred shares that are not delivered to the recipient until termination of board service; this practice is especially common among the largest, highest-profile companies.

After several years of steady progression toward these practices, we now see a stabilization of programs in the market (i.e., a slowdown in changes to align with the program discussed above, as some companies choose to maintain the status quo either for the entirety or for certain aspects of their programs). Deviations from the plan design described above often reflect a conscious desire to differ from general market practice after thoughtful consideration; departures from a particular practice often result from a calculated decision to adhere to a philosophical standpoint that is consistent with another practice. The following are notable examples of this dynamic:

- Some companies choose to maintain meeting fees, as they believe that meeting fees are the most effective method to reinforce the importance of meeting attendance and differentiate director pay based on workload.
- Committee meeting fees are more often retained than board meeting fees due to the belief that they more effectively adjust compensation for differing levels of work across committees where workloads can be drastically different.
- Stock options are still embraced at smaller, high-growth companies, particularly in the technology industry.

In the post-Great Recession era, director compensation exhibited a time period of accelerated growth to accommodate for the increased scrutiny and workload. As compensation levels have begun to catch up to the increased role of directors, we anticipate director pay levels to increase at modest levels, with low-to-mid single digit increases annually for some time. The range between the 25th and 75th percentile compensation levels is narrowing as differentiation on the downside is limited by competition for qualified individuals and on the upside by scrutiny. While a 50/50 split of cash and equity compensation has been the desired mix among mid- and large-cap companies for the last several years, a bias is emerging toward equity compensation at the largest U.S. companies (i.e., 60% equity, 40% cash compensation).

A large majority of publicly traded companies review their programs from a design and magnitude perspective on an annual or biennial basis to stay current on the evolving market and fine-tune their programs as appropriate, given changes in the market.

For detailed survey information on director pay, click here.

VIII. DIRECTOR COMPENSATION LITIGATION UPDATE

A. Background

Under Delaware law, director decisions are generally afforded wide latitude under the business judgment rule.[1] The protections of the business judgment rule, however, "can only be claimed by disinterested directors."[2] A decision by directors to award themselves compensation necessarily fails this test, subjecting the decision to the entire fairness standard – a higher level of scrutiny that requires defendants to establish that the transaction was the product of both fair dealing and fair price. However, the court will apply the more deferential business judgment rule to a director compensation decision if such decision was "made under a stock option plan approved by the corporation's shareholders."[3] This is known as the stockholder ratification defense.

In the 2012 case *Seinfeld* v. *Slager*, the Delaware Court of Chancery narrowed the application of the stockholder ratification defense.[4] In that case, a stockholder challenged the fairness of restricted stock units ("RSUs") granted to the company's non-employee directors under the company's stockholder-approved compensation plan. The plan did not include specific RSU grants for directors or set forth a director-specific ceiling on compensation; rather, the plan imposed generic limits of 10.5 million shares total and 1.25 million shares that any one beneficiary could receive per year. Although the stockholders approved the plan, the Court of Chancery held that the directors' compensation decision was a self-dealing transaction because the stock plan lacked "sufficient definition." The court opined that "[t]hough the stockholders approved this plan, there must be some meaningful limit imposed by the stockholders on the Board for the plan to . . . receive the blessing of the business judgment rule."[5]

B. Recent Cases

The last year was marked by additional derivative lawsuits challenging director compensation, with the Court of Chancery echoing *Slager*'s holding and further clarifying the requirements of the stockholder ratification defense.

1. *Calma v. Templeton*

In *Calma* v. *Templeton*, the board's compensation committee granted RSU awards under Citrix's 2005 Equity Incentive Plan (the "Plan").[6] The Plan, which applied to directors, among other beneficiaries, was approved by a majority of Citrix's stockholders in a prior vote. The only limit on compensation imposed by

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[1] When reviewing a business decision under the business judgment rule standard, the court presumes that in making the business decision, "the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interest of the company." *Aronson* v. *Lewis*, 473 A.2d 805, 812 (Del. 1984).
[2] *Id.*
[3] *In re 3COM Corp. Shareholders Litig.*, 1999 Del. Ch. LEXIS 215, at *11 (Del. Ch. Oct. 25, 1999).
[4] *See* 2012 Del. Ch. LEXIS 139 (Del. Ch. June 29, 2012).
[5] *Id.* at *41.
[6] *See* 2015 Del. Ch. LEXIS 126 (Del. Ch. Apr. 30, 2015).

the Plan was that “no beneficiary could receive more than one million shares (or RSUs) per calendar year.” Although Citrix’s non-employee directors were awarded between 3,000 and 4,000 RSUs in each of 2011, 2012, and 2013 – well below the one million RSU limit under the Plan – a shareholder brought a derivative lawsuit challenging the RSU grants for these years, arguing that they were “excessive” when compared to the compensation received by directors of Citrix’s peers.

On the threshold issue of the appropriate standard of review, the court held that “advance stockholder approval of a compensation plan with multiple classes of beneficiaries and a single generic limit on the amount of compensation that may be awarded in a given year” is not sufficient to establish a ratification defense. In distinguishing the case before it from the sixty years of precedent the defendants pointed to, the court noted that in prior cases, the ratification defense was recognized because stockholders approved specific director compensation awards or plans with director-specific compensation ceilings. In contrast, in *Calma*, the stockholders “were never asked to approve – and thus did not approve – any *action bearing specifically on the magnitude of compensation for the Company’s non-employee directors*.”[7] Because the Citrix stockholders did not vote in favor of the specific RSU grants at issue or vote to impose a meaningful limit on directors specifically, the stockholder ratification defense did not apply and the board’s decision was subject to the entire fairness standard of review.

2. *Espinoza v. Zuckerberg*

In a derivative lawsuit brought on behalf of Facebook against its directors, the Court of Chancery issued an opinion last year focusing on a slightly different issue, which the court noted was a question of first impression – namely, “[c]an a disinterested controlling stockholder ratify a transaction approved by an interested board of directors, so as to shift the standard of review from entire fairness to the business judgment presumption, by expressing assent to the transaction informally without using one of the methods the Delaware General Corporation Law prescribes to take stockholder action?”[8] The court’s answer to this question was no. “Stated in the affirmative,” explained the court, the “stockholder ratification of a self-dealing transaction must be accomplished formally by a vote at a meeting of stockholders or by written consent in order to shift the standard of review that otherwise would apply to such a transaction.”

At issue in *Espinoza* v. *Zuckerberg* was the compensation granted to Facebook’s six non-employee directors in 2013. Facebook’s board and stockholders had adopted an equity incentive plan in 2012 that authorized the board to provide stock-based compensation to Facebook’s employees, officers, directors, and consultants. The plan capped awards at “2,500,000 shares of Facebook stock per individual recipient per year and 25,000,000 shares (plus certain adjustments and additional shares from prior award programs) for the entire program.” In 2013, the board unanimously approved a proposal “to provide non-employee directors with annual RSU grants at a value of $300,000 per year, subject to the board’s approval of an

[7] *Id.* at *51 (emphasis in original).
[8] *Espinoza* v. *Zuckerberg*, 124 A.3d 47, 49 (Del. Ch. 2015).

implementation plan." Several weeks later, the board, acting by unanimous written consent, formally approved a plan implementing the proposal. As a result of the board's approval of the compensation plan, each of Facebook's six non-employee directors received 7,742 RSUs in 2013, with a grant date fair value of $387,874.[9]

The plaintiff asserted that the defendants breached their fiduciary duty by "awarding and/or receiving excessive compensation at the expense of the Company" and were thereby unjustly enriched. In connection with their motion for summary judgment, the defendants filed an affidavit of Mark Zuckerberg – Facebook's founder, CEO, and chairman of the board, who controlled approximately 61.6 percent of the voting power of Facebook's common stock – stating that though he "was never presented with an opportunity to approve formally the 2013 equity awards of Facebook's Non-Executive Directors or the Annual Compensation Program in [his] capacity as a Facebook stockholder, had an opportunity presented itself, [he] would have done so." Zuckerberg made a similar statement during his deposition by the plaintiff.

In their motion for summary judgment, the defendants asserted the stockholder ratification defense. They took the position that the business judgment rule should apply to their compensation decision since "Zuckerberg, who indisputably holds a majority of the voting power of Facebook's common stock, and who did not receive any of the 2013 Compensation, ratified the 2013 Compensation in his capacity as a Facebook stockholder by virtue of statements he made in his affidavit and his deposition" after the lawsuit was filed. The court disagreed, however, concluding that "stockholders of a Delaware corporation – even a single controlling stockholder – cannot ratify an interested board's decisions without adhering to the corporate formalities specified in the Delaware General Corporation Law for taking stockholder action" (i.e., voting in person or by proxy at a meeting of stockholders or acting by written consent). Accordingly, the court held that neither Zuckerberg's affidavit nor his deposition testimony constituted a ratification of the board's decision such that the relevant standard of review would shift from entire fairness to the business judgment presumption.

The Facebook action was subsequently settled in January 2016. In connection with the settlement, which was approved by the Court of Chancery in March 2016, Facebook agreed, in relevant part, that:

- its compensation and governance committee would conduct an annual assessment of all compensation, including that paid to the company's non-employee directors, and would engage an independent compensation consultant to assist with such assessment;
- its board would monitor all changes in the compensation payable to the company's non-employee directors; and
- it would submit separate proposals for a vote at this year's annual meeting regarding (1) the 2013 grants to the company's non-employee directors and (2) the company's annual compensation program.

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[9] One of these directors received an additional 20,000 RSUs upon joining the board in 2013.

3. *Other Cases*

Over the past year or so, shareholders of other companies have filed similar lawsuits alleging excessive director compensation, some of which remain pending.

C. Implications of Recent Director Compensation Cases

The cases described above appear to reflect an emerging trend of shareholders challenging director compensation decisions made pursuant to shareholder-approved plans that do not set meaningful limits on compensation paid to outside directors and surviving a motion to dismiss. As the Court of Chancery has made clear, director compensation decisions made pursuant to plans without meaningful limits on non-employee director compensation are subject to the more demanding entire fairness standard rather than the business judgment rule, affording such board decisions less deference and contributing to plaintiffs' successes.

Given shareholders' recent successes, companies should consider including in shareholder-approved plans meaningful limits on annual aggregate compensation levels – both cash and non-cash – permitted to be paid to outside directors.

IX. 2015 TAX UPDATES

A. Section 162(m) Updates

Generally, compensation paid by a publicly-traded corporation to its CEO and three other highest compensated officers (other than the chief financial officer ("CFO")) is not tax deductible to the extent the officer's compensation exceeds $1 million per year. This limitation is subject to certain exemptions, including (1) an exemption for "qualified performance-based compensation" (which is compensation that meets a number of requirements set forth in the regulations under Section 162(m) of the Internal Revenue Code) and (2) an exemption during a special post-IPO transition period for compensation under a plan or agreement that existed when the corporation was not publicly held.

Effective April 1, 2015, the IRS issued final regulations under Section 162(m), clarifying the existing regulations that address both of these exemptions. Specifically, the final amended regulations provide that:

- Stock-based compensation plans must provide a specific limit on the maximum number of shares for which an individual employee may receive options or stock appreciation rights during a specified period, and
- RSUs or phantom stock arrangements (as distinct from restricted stock, options, or stock appreciation rights) that vest or otherwise settle after expiration of the special IPO transition period will not qualify for the post-IPO transition period exemption, regardless of whether or not such RSUs were performance-based.

Additionally, in October 2015, the IRS released a Chief Counsel Memorandum clarifying its position regarding the extent to which CFOs may be considered "covered employees" subject to Section 162(m). While the IRS' ruling position since 2007 has been to generally exclude CFOs from coverage under Section 162(m) in light of the SEC's 2006 changes to the proxy disclosure rules, the recent Chief Counsel Memorandum clarified that a CFO of a "smaller reporting company" (i.e., a public company with a public float of less than $75 million as of the end of its most recently completed second fiscal quarter) may in fact be considered a "covered employee" subject to Section 162(m) if the CFO is one of the company's two most highly compensated executive officers other than the CEO.

Additional information on the final Section 162(m) regulation can be found here.

X. ACCOUNTING UPDATES

A. Elimination of "Extraordinary and Unusual Items"

On January 9, 2015, the Financial Accounting Standards Board ("FASB") issued *Accounting Standards Update 2015-01, Income Statement—Extraordinary and Unusual Items*, to simplify income statement classification by eliminating the concept of "extraordinary items" from GAAP and replacing it with a new standard. Under the prior standard, "extraordinary items" were defined as events and transactions distinguished by their unusual nature *and* by the infrequency of their occurrence, which required companies and their auditors to make difficult judgments about whether items were in fact "extraordinary."

Under the revised standard, companies are to report material items that are either unusual in nature or infrequently occurring, or both, as a separate component of income from continuing operations. The nature and amount of each item should be reported either as a separate line item on the income statement or in notes to the financial statements. An event or transaction is unusual in nature if it ". . . possesses a high degree of abnormality and is of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates. . ." An event or transaction is infrequently occurring if it is ". . . of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. . ."

The revised standard is effective for periods beginning after December 15, 2015 (i.e., 2016 financial statements for calendar year companies) and will be relevant when drafting compensation committee resolutions establishing performance measures and goals for incentive plans. In addition, shareholder-approved plan documents and grant agreements should also be reviewed and changed as appropriate.

B. Stock Withholding Above the Minimum Statutory Rate

Under current accounting rules, stock withholding by employers in excess of the minimum statutory withholding rate will cause the entire equity award to be measured and classified as a liability award and subject to variable accounting. To avoid this result, virtually all public companies limit stock withholding in connection with vesting and/or delivery of equity awards to the minimum statutory rate. However, compliance with the requirement can be complicated for global companies and imposes a cash-flow burden for those participants whose marginal personal income tax rates are higher than the minimum statutory rate.

As part of FASB's accounting simplification project, the requirement to limit stock withholding to the minimum statutory rate will be eliminated for periods beginning after December 15, 2016 (i.e., 2017 financial statements for calendar year public companies). Accordingly, once effective, public companies will be permitted (but not required) to withhold up to the maximum individual tax rate.

To take advantage of higher withholding when effective, companies should note the following:

- In order to avoid an automatic plan violation, it is important to confirm that the tax withholding provision in the company's equity plan does not prohibit withholding above the minimum statutory rate.
- In our experience, plans have typically limited withholding to the statutory minimum to ensure proper administration, and such plans will require a plan amendment to permit the higher withholding.
- Any new or amended plans that are being submitted for shareholder approval should build in flexibility to withhold at the higher rate.
- Net settlement of awards at higher withholding rates may have cash-flow implications for the company. Accordingly, we recommend the ability to withhold at a higher rate be in the discretion of the equity plan's administrative committee (rather than at the demand of a participant).

The simplification project covers several other topics, the details of which can be found here.

If you have any questions or would like additional information, please contact any of the following:

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