5 Things You Need to Know for 2016

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Agenda

ISS Equity Plan Scorecard (EPSC)

The new norm of holding restrictions

Pay for performance disclosures

Get the most out of your ESPP

What to expect from performance awards

ISS Equity Plan Scorecard

ISS Equity Plan Scorecard

Year-over-year average equity plan proposal results

- **Russell 3000® Index**
  - **90%** for 2015 and **88.1%** for 2014
  - **730** equity plan proposals for 2015 compared to **707** for 2014
  - **20%** received an "Against" recommendation from ISS (144 companies), consistent with last year
  - Only 1 company—HomeAway, Inc.—received less than majority support (30.2%)
    - Excessive cost, plan permits repricing without shareholder approval, and overall poor plan features
- **Generally, an against vote recommendation resulted in lower average results of 10%-15% for GICS 4030 companies**

Summary of Key Changes for 2016

- While the basic EPSC policy has not changed, ISS made a few modifications to its evaluation framework. These policy updates are effective for annual meetings held on or after February 1, 2016. These changes include:
  - The addition of a model for newly IPO (or emerging from bankruptcy) large cap companies
    - ISS renamed the current IPO model to "Special Cases" model and created a new Special Cases model for newly IPO Russell 3000/S&P 500 companies. The Special Cases model for Russell 3000/S&P 500 companies includes *all* Grant Practices factors *except* Burn Rate and Share Pool Duration
  - Holding period requirement scoring change
    - Increased the requirement to receive full points under the model from 12 months to 36 months ***or*** until employment termination. A holding period requirement of 12 months or until stock ownership guidelines are met will continue to receive half points under the revised model.
  - Change-in-control ("CIC") equity vesting
    - No acceleration (or accelerate if not assumed) for time-based awards **and** forfeited, terminated, pro rata, and/or based on actual performance for performance-based awards receives full points
    - Automatic acceleration of time-based awards or above target vesting of performance share results in no points
    - Other in between and/or discretionary provisions can result in half points.
  - The elimination of "excessive" SVT and burn rate from its Second Step "Overriding Factors" analysis

The ISS Equity Plan Scorecard Approach

Tests			
Steps	**Plan Cost**	**Grant Practices**	**Plan Features**
First Step *Quantitative Assessment*	• Aggregate SVT cost • Share pool SVT cost • Both SVT analyses measured against index appropriate peers in a GICS grouping	• ISS-adjusted burn rate assessment against index peers in a GICS grouping • CEO vesting schedules for most recent full-value awards • Estimated share pool duration • Percentage of performance-based awards granted to the CEO (% of LTI value) • Presence or absence of a recoupment policy for equity compensation awards • Presence or absence of post-vest/exercise holding periods	• Presence of default single trigger acceleration with a liberal CIC definition • Committee discretion to accelerate vesting of awards • Presence or absence of liberal share recycling provisions • Presence or absence of hard-coded minimum vesting provisions for options and full-value awards
Second Step *Stand Alone Qualitative Policies*	**Violation of any of the below can result in an against vote recommendation from ISS, even if the quantitative assessment is passed** • Awards may vest in connection with a liberal change-in-control definition • The plan would permit repricing or cash buyout of underwater options and SARs without shareholder approval • The plan is a vehicle for problematic pay practices or a pay-for-performance disconnect • Any other plan features are determined to have a significant negative impact on shareholder interests		

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Details of the EPSC – “Overriding Factors”

Repricing	Liberal CIC Definition	Poor Pay Practice
Pay-for-Performance Disconnect	~~Excessive SVT~~	~~Excessive Burn~~
Tax Gross-Ups	Reload Options	Others

For the 2016 proxy season, ISS has publicly stated that “excessive” SVT and burn rate will no longer be “overriding factors.” However, it appears that negative scoring can make it impossible to obtain shares under the EPSC approach.

The New Norm of Holding Restrictions

The New Norm of Holding Restrictions

- Mandated holding periods
  - Forced deferral of payout post vest for restricted stock or performance awards
  - Vested shares required to be retained
- Good corporate governance
  - Ensure that individuals are truly *aligned* with shareholders
  - Consistent with plan objective: to create shareholders
  - Proved appropriate *long-term focus*
  - Bonus: Create *path for recovery in the event of a clawback*
  - Double bonus: ISS points in the Equity Plan Scorecard
  - Triple bonus: Illiquidity discount on fair value under ASC 718

ISS and the Equity Plan Scorecard

- Equity Plan Scorecard (EPSC)
  - Plan cost (Shareholder Value Transfer)
  - Plan features (for example, liberal share recycling, minimum vesting, and more)
  - Grant practices (burn rates, clawbacks, performance conditions)
- Requires a total of 53 points to pass
- *“Whether the company has established post exercise/vesting shareholding requirements”*

2015	2016
• >12 month holding = full points • <12 month holding or until ownership guidelines are met = ½ of full points • None = 0 points	• >36 month holding = full points • <36 month holding or until ownership guidelines are met = ½ of full points • None = 0 points

Hold, Please… What About Taxes?

- An employee is subject to income tax withholding on an award of equity-based compensation once:
  - The award has vested AND
  - The underlying shares have been transferred to the employee
- Restricted stock awards (RSAs) are generally taxable at vest
  - Transfer occurs at grant, so vesting creates the taxable event
  - Can create a hardship if the employee is not allowed to sell shares to cover income tax withholding
  - Illiquidity discount cannot be applied to shares that are sold to cover taxes
- Restricted stock units (RSUs) are not subject to income tax until the award is settled
  - Transfer occurs after the holding restriction lapses
  - Illiquidity discount can be applied to all shares without creating a hardship for employee
- Payroll taxes (OASDI and Medicare) are due at vest on both RSAs and RSUs
  - These taxes are frequently withheld from the employee's cash compensation

Taxation is similar to restricted stock with retirement eligibility provisions

Post-Vest Holding Discounts under ASC 718

The estimated discounts for lack of marketability for a 1-year holding period produced by the different models, under a range of expected volatility assumptions, are summarized below.

	Expected Volatility			
Model	20.0%	40.0%	60.0%	80.0%
• "Chaffe"	(6.9%)	(14.7%)	(22.4%)	(29.8%)
• "Finnerty"	(4.6%)	(9.1%)	(13.3%)	(17.3%)
• Collared Strategy (cost of carry)	(2.0%)	(2.0%)	(2.0%)	(2.0%)
• Regression of Empirical Data[1, 2]	(7.2%)	(9.9%)	(12.8%)	(15.6%)

1. Based on information available through October 1, 2014.
2. Based on a statistical regression analysis of transactions in Rule 144 stock with a 1-year restriction period, the estimated illiquidity discount equals (4.35% + 14.1%) x Volatility.

For illustrative purposes only.

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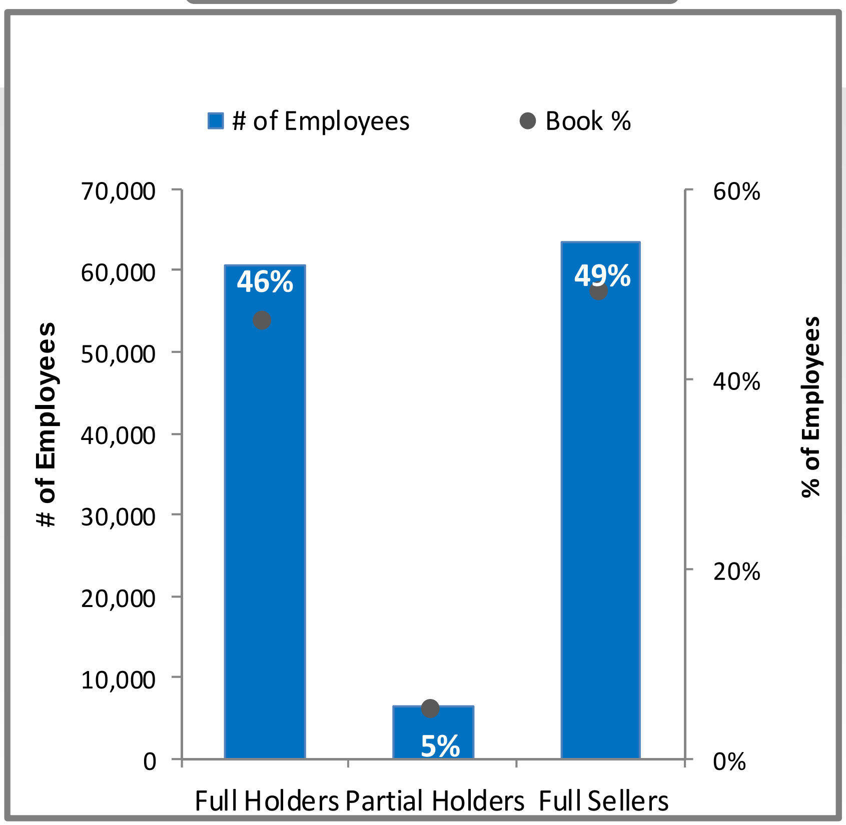
Employee Selling Behavior

Employees



Full Holders

Employees who held on to all their shares

Partial Holders

Employees who held a portion of their shares

Full Sellers

Employees who sold all their shares

- 51% of employees receiving long share awards in 2013 still held at least some of their shares around 18 months post distribution
- 49% of employees sold all their shares in the same time period
- 43% of shares distributed in 2013 are still being held

Source: Fidelity Employee Share Ownership study.

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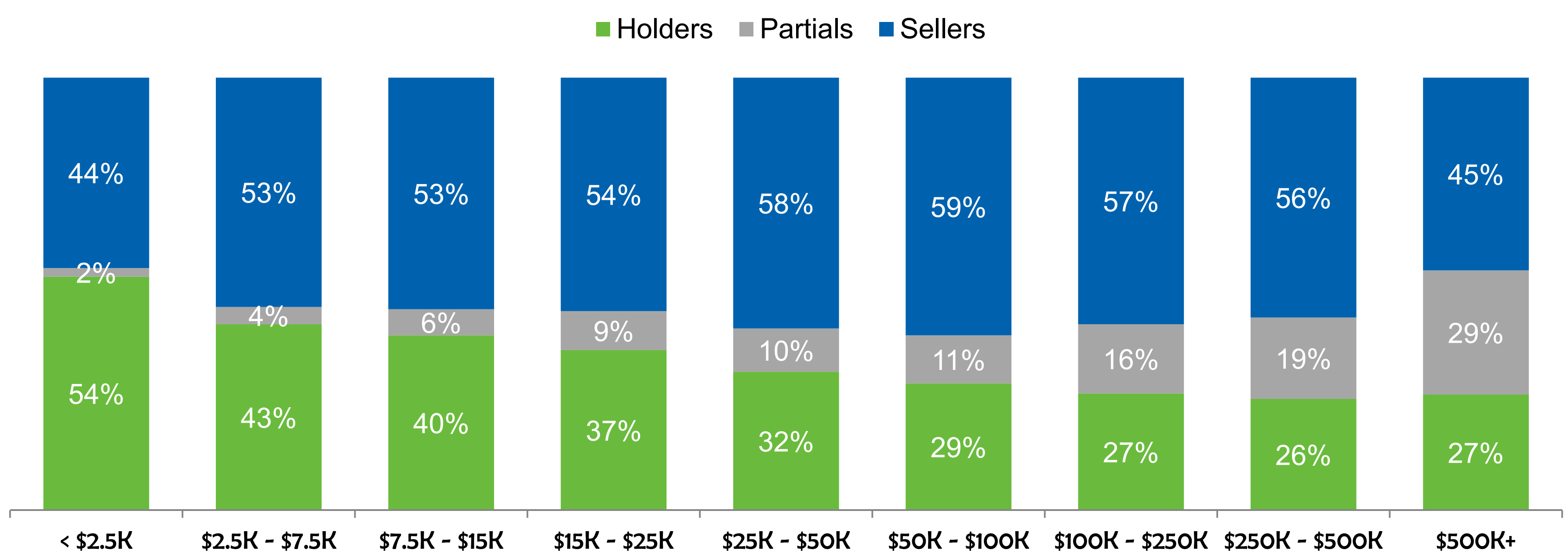
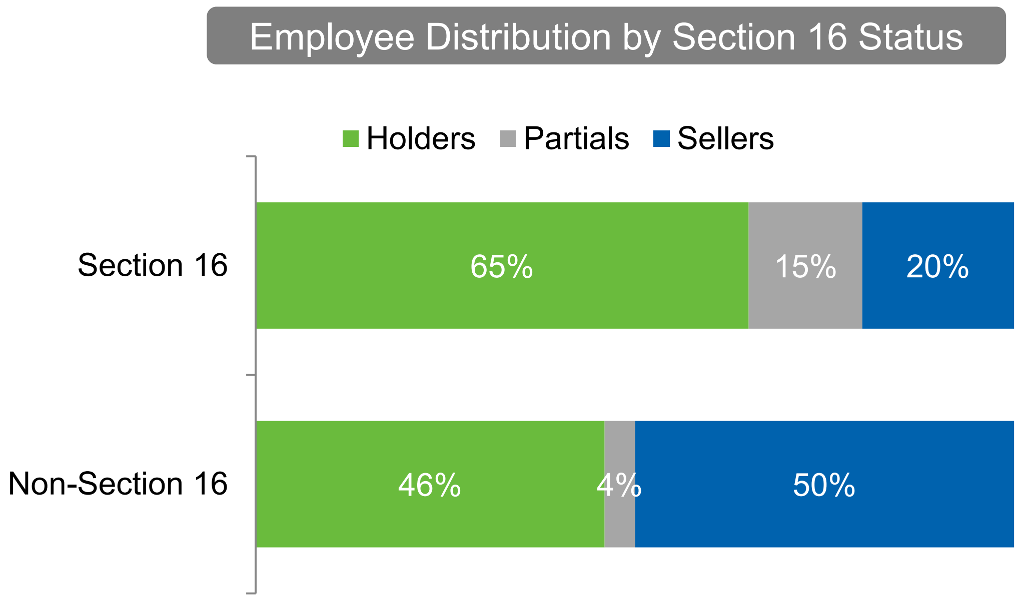
Employee Selling Behavior by Value of Payout



- Across the book, proportion of full holders reduces as the value of payout increases—54% to 27%
- Conversely, as value increases, proportion of partial holders increases significantly, while the proportion of full sellers also moves up; however, the trend reverses as payouts exceed $100K.

 Source: Fidelity Employee Share Ownership study.

Significant Differences in Selling for Section 16 Officers



- Section 16 employees accounted for 0.5% of the base but 12% of the payout value
- Section 16 officers are predominantly holders with 80% holding some or all of their shares
- Presence of holding requirements among other factors could be influencing behavior

 Source: Fidelity Employee Share Ownership study.

Pay for Performance Disclosures

SEC Pay for Performance Disclosures

- On April 19, 2015, the SEC issued proposed rules requiring disclosure of the relationship between executive compensation actually paid and the financial performance of the issuer
- Unclear whether, if finalized before year-end, it will be effective for the 2016 proxy season (doubtful though)
- Requires 5-year tabular data disclosure (initial 3-year disclosure plus additional year added in each of the two subsequent annual filings) of:
  - **Total compensation of the PEO and other NEOs reported in the SCT**
  - **Total compensation “actually paid” to the PEO and other NEOs**
  - **For each year, the cumulative TSR of the company measured as of the end of the year**
  - **For each year, the cumulative TSR of either the proxy peers or the annual report TSR performance peer group, as selected by the company**
- Also required to provide a clear description of the relationship between the compensation actually paid and cumulative TSR for each of disclosed completed fiscal years (required disclosures must be electronically formatted and tagged using XBRL)
- The disclosure may include a graphic representation of the information required to be disclosed

Total Compensation Paid

- As proposed, compensation actually paid equals:
  - Base salary for the fiscal year (*same as SCT*)
  - Nonequity incentives and/or bonus earned for the fiscal year (*same as SCT*)
  - **Equity vested** during the fiscal year valued at the fair value as of vesting date (***differs from SCT, which includes equity fair value when granted***)
    - *Full value equity fair value will generally be priced at vesting date for restricted stock (units) and performance shares earned; however, should include discounts for illiquidity reductions due to mandatory holding periods after vesting*
    - *Stock option fair value at the vesting date must follow valuation guidance under ASC Topic 718, and disclosure is required if assumptions used differ materially from those previously reported.*
  - **"Service cost"** attributable to services for the year (***differs from SCT, which is based on the "change in pension value"***)
  - Above market earnings (*if any; same as SCT*)
  - All other compensation items (*same as SCT*)

Total Shareholder Return

- **TSR of Reporting Company:** Computed in the same way as the stock performance graph required in company annual report or proxy statement
- **TSR of Peer Group:** Company may opt to use either the same peer group it used in its stock performance graph or the peer group reported in the CD&A
- TSR for each peer group company must be weighted based on the company's stock market capitalization at the beginning of each relevant measurement period
- If the peer group is not a published industry or line-of-business index, member disclosure is required

Required Tabular Disclosure

Projected Pay-Versus-Performance Tabular Disclosure

Year (a)	Summary compensation table total for PEO (b)	Compensation actually paid to PEO (c)	Average summary compensation table total for non-PEO named executive officers (d)	Average compensation actually paid to non-PEO named executive officers (e)	Issuer total shareholder return[1] (f)	Peer group total shareholder return[1] (g)
2015[2]	$21,920,817	$43,538,024	$6,568,173	$9,673,857	$287.7 (0.9%)	$211.2 (1.1%)
2014	$24,236,113	$49,767,123	$7,502,130	$8,040,331	$285.1 (32.4%)	$209.0 (28.4%)
2013	$20,995,785	$43,297,435	$7,397,434	$16,285,051	$215.3 (115.3%)	$162.8 (62.8%)

1. 2015 year-to-date TSR performance for CELG and Peers, as of 10/1/2015, measures performance attributed to $100 investment at beginning of 3-year performance period.
2. Projected 2015 compensation provided by client

Calculation of compensation **actually paid** includes vested restricted stock values and vested stock option fair values estimated on date of vesting for all NEOs.

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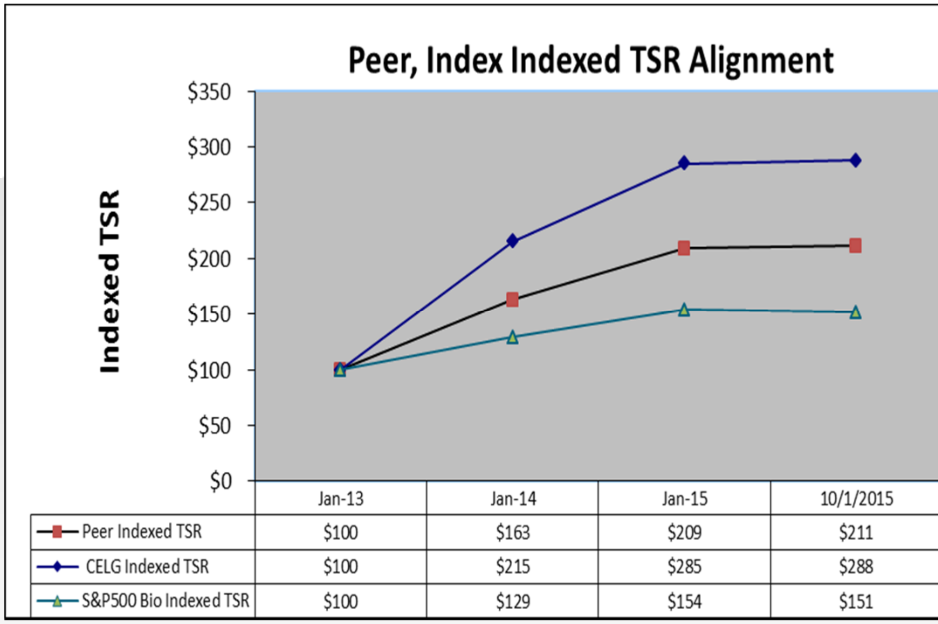
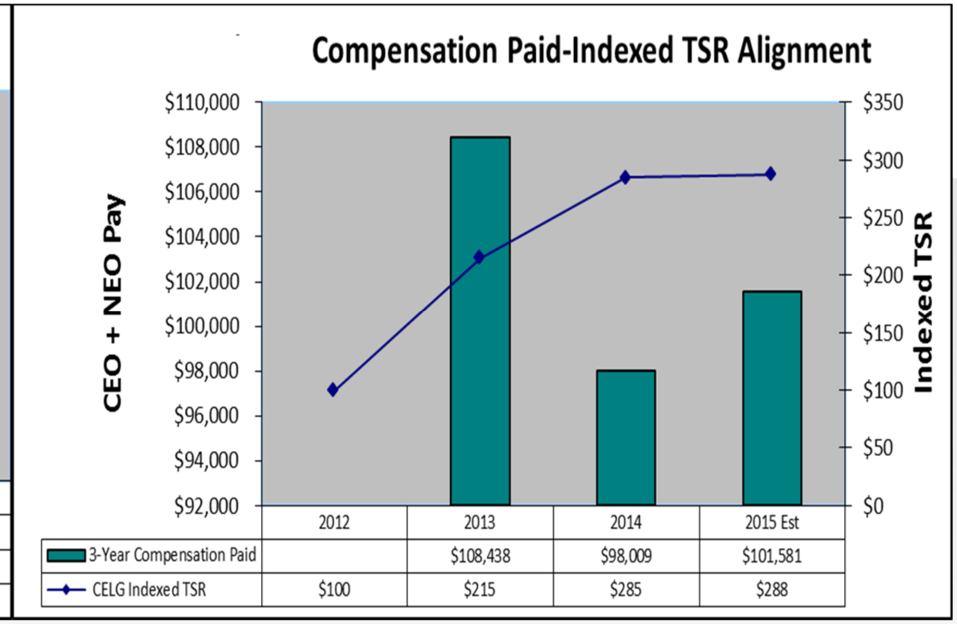
Representative Graphic Disclosures





- Given the SEC's suggestion regarding the use of graphs, we anticipate that most companies will use them as part of the requirement to provide a clear description of the relationship between the following:
  - The company's TSR, the peer group's TSR, S&P 500 Biopharmaceuticals TSR; and
  - The executive compensation actually paid to the NEOs and the company's TSR

Pay versus Performance Considerations

- Stock price movements will occur between equity vesting dates and year-end TSR measurement dates
- Stock price movements can occur due to circumstances outside the control of the company
- We recommend that companies continue to use the CD&A to reinforce how certain elements of pay are tied to corporate performance and/or share price movement, and reference that discussion in the pay versus performance disclosure
- Wherever appropriate, companies should also reiterate why various financial metrics have been selected
- We anticipate that both ISS and Glass Lewis may comment on such disclosures in their say-on-pay evaluations, but will ultimately likely rely on their own existing peer group selection and pay-for-performance methodologies to determine whether a company has a disconnect or linkage in pay versus performance

SEC CEO Pay Ratio: Quick Summary and Thoughts

- Final Rules released on August 5, 2015, after the SEC received more than 100,000 comment letters
- Will take effect for the 2018 proxy season for calendar-year companies
- Requires disclosure of CEO's pay to the pay of the company's median employee
- Calculation methodology
  - Calculation is based on annual total compensation for the last completed fiscal year for the CEO and the median employee; the identification of the median employee need be conducted only once every three years
  - Companies can use annual total compensation, another consistently applied compensation measure, statistical sampling, or other reasonable estimates to identify the "median employee"
- "Total compensation" is calculated consistent with disclosure requirements for the Summary Compensation Table
- Must describe and consistently apply any methodology used to identify the median employee, and any material assumptions, adjustments, or estimates used

SEC CEO Pay Ratio: Quick Summary and Thoughts, *continued*

- Employees considered in calculating median
  - Must consider all employees, including full-time, part-time, seasonal, and temporary employees of company and any of its consolidated subsidiaries
  - Companies may exclude non-U.S. employees in jurisdictions where access to information would violate data privacy laws
  - Companies may exclude non-U.S. employees representing up to 5% of the total workforce (including employees excluded due to privacy)
- Location of disclosure and initial compliance date
  - Disclosure required in registration statements, proxy statements, and annual reports on Form 10-K
  - As long as it's not misleading, companies can supplement the disclosure with more information
- Must comply with final rules for first fiscal year beginning on or after January 1, 2017; as a result, initial disclosure not required until 2018 SEC filings

Get the Most Out of Your ESPP

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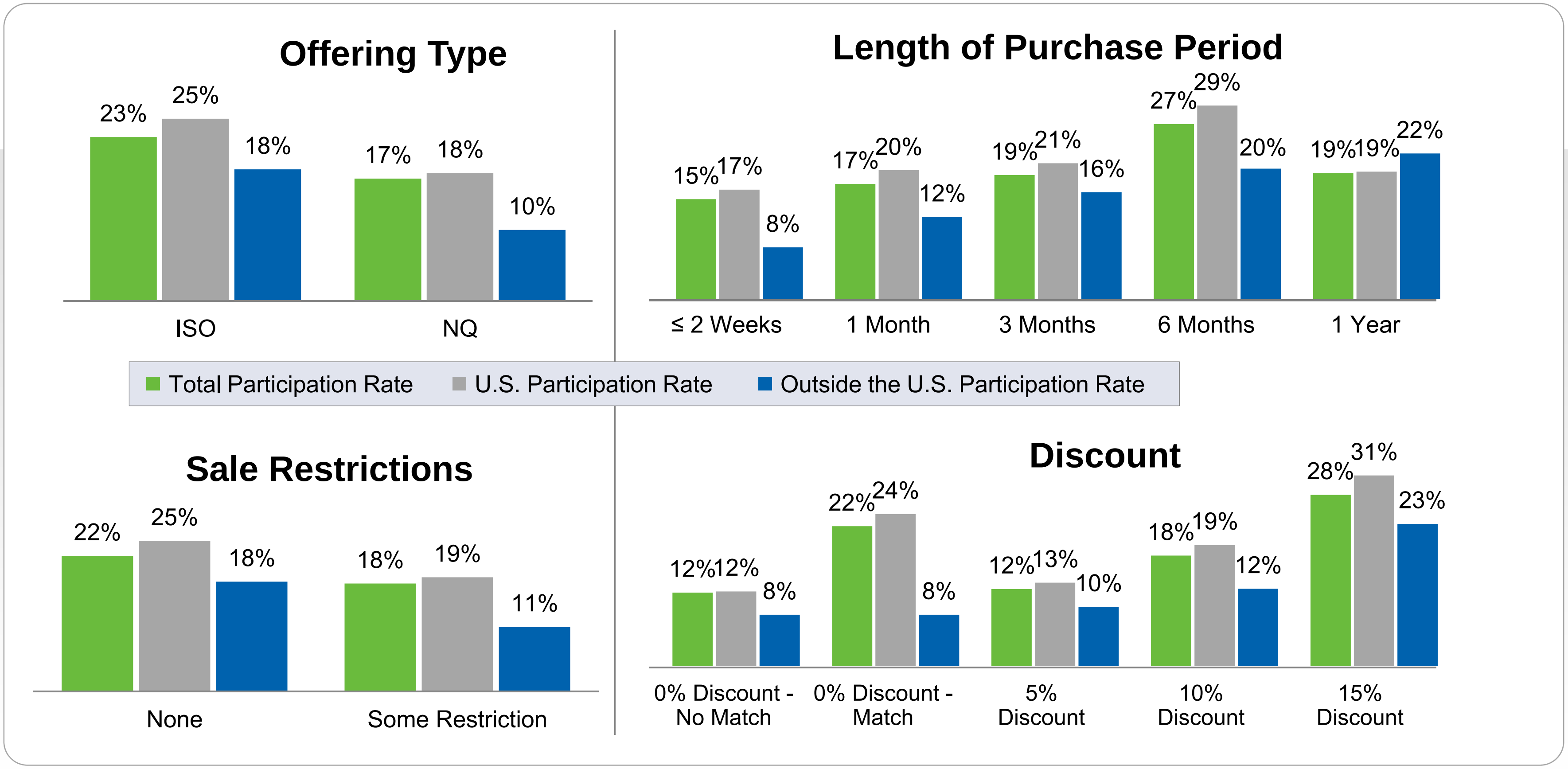
ESPP Trends

- Broad based
- Guaranteed appreciation
  - Right combination of offering period, discount, and look back
- Improve employee motivation/loyalty
  - 48% of ESPP-only “work harder”; 80% want future employers to offer plan
- Non-excessive
- Expense efficient
- Cash inflow
- Engaged employees
  - ESPP-only participants are only slightly less aware of the current stock price than RS/options participants (84% vs. 89%); more likely to check after each purchase period (78% vs. 73%)
- Minimal share usage
- Corporate tax deduction

Participation by Plan Design Features



Fidelity/Radford ESPP analysis, October 2014; Fidelity ESPP clients as of March 31, 2014.

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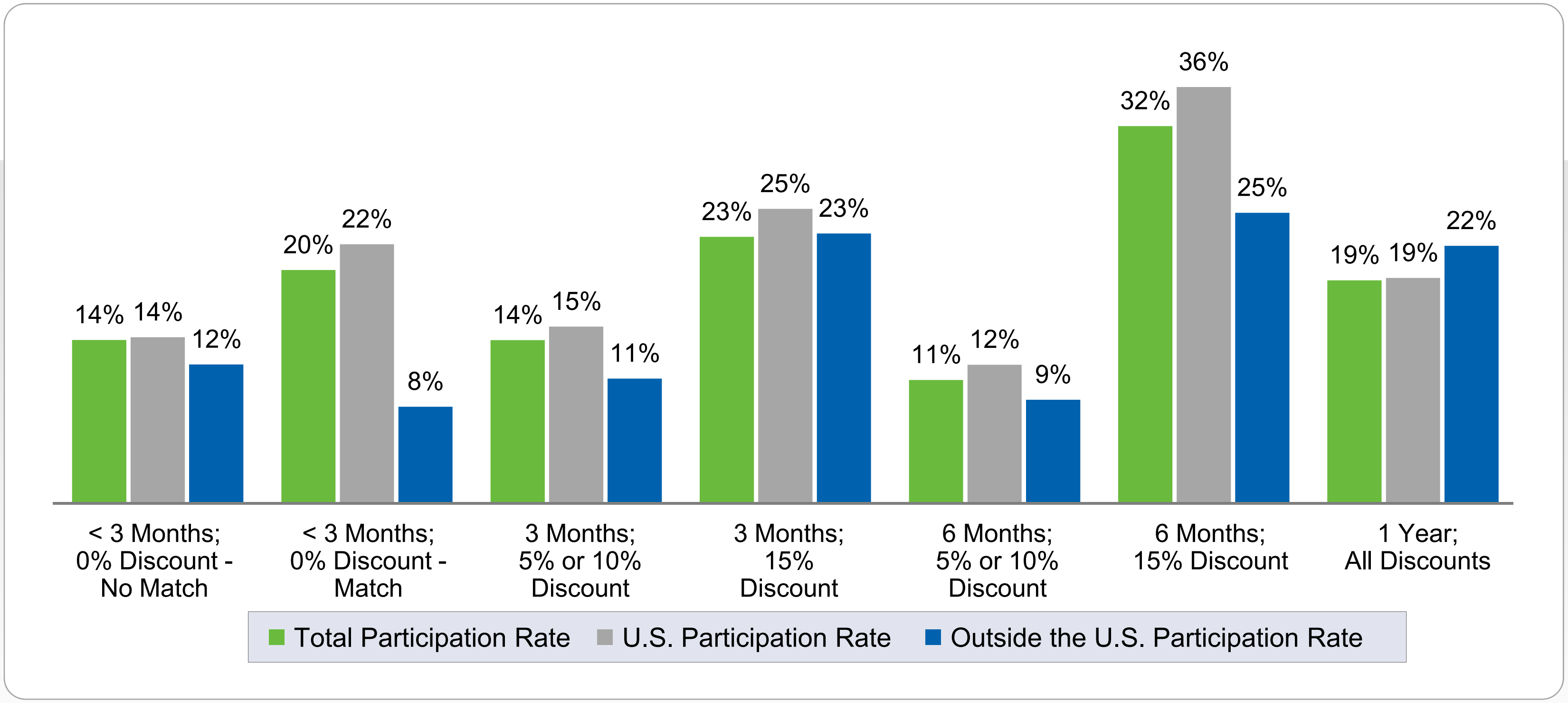
Participation by Length and Discount

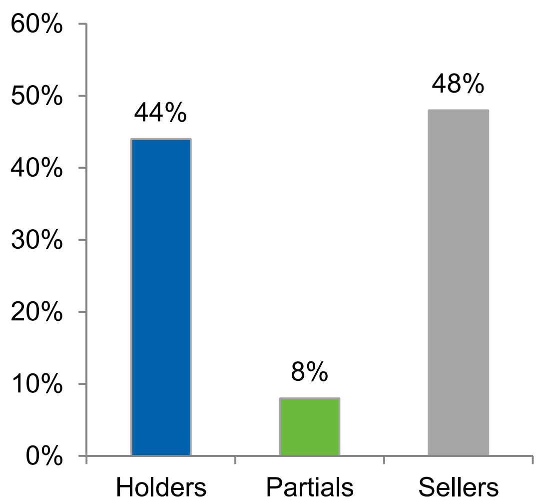


Participation can vary dramatically by plan design type.
Plans with a 15% discount have the highest participation.

Fidelity/Radford ESPP analysis, October 2014; Fidelity ESPP clients as of March 31, 2014.

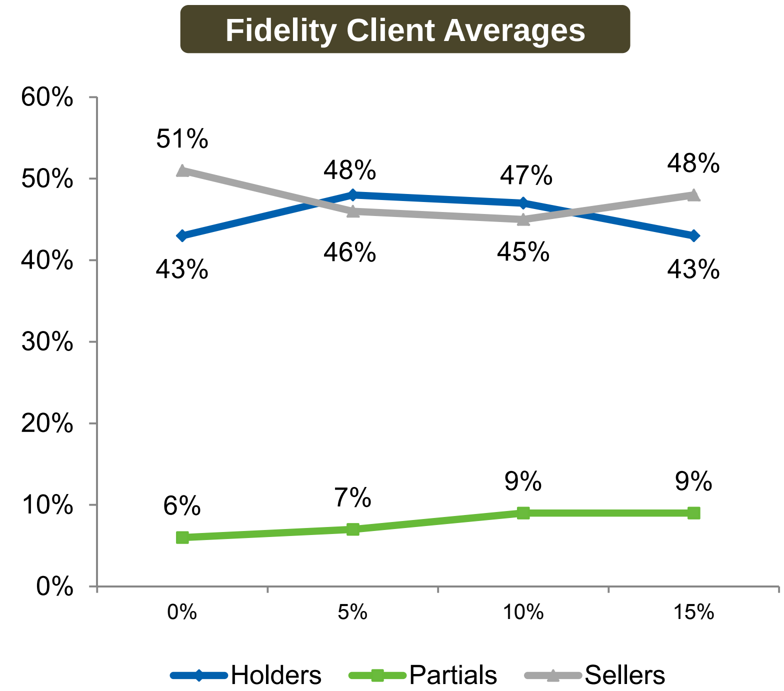
ESPP Holding Behavior

Fidelity Client Averages



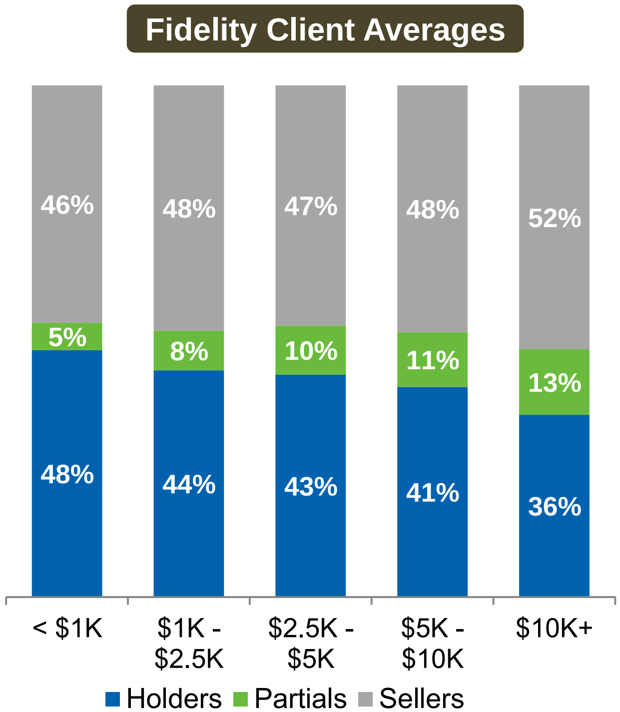
- Charts illustrate behavior across Fidelity clients
- Analysis population includes more than 330,000 participants from 100+ Fidelity clients
- Analysis covers 97% of participants who had purchases in 2012, and excludes 3% of participants who moved shares outside their Fidelity Account® or Stock Plan Account
- Participant behavior across Fidelity clients as of December 2014:
  - 44% held all of their shares around 2.5 years after purchase (holders)
  - 8% were still holding a portion of the shares (partials)
  - 48% had sold all of their shares (sellers)

ESPP Holding Behavior by Discount



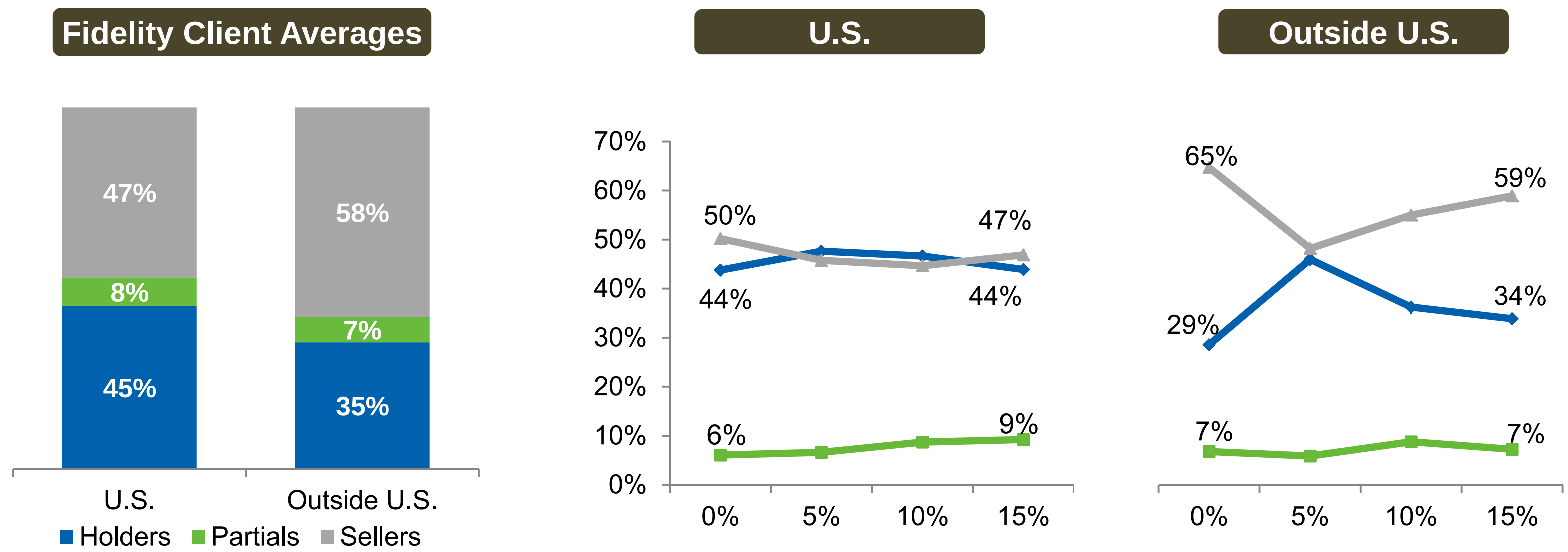
- Charts illustrate the difference in behavior among participants in plans with different discount rates
- Participant behavior across Fidelity clients:
  - Proportion of sellers is the highest (51%) among plans with no discount
  - The percentage of holders is highest (48%) when the discount is 5%, and holds steady (47%) when the discount is 10%
  - The holder population declines marginally as the discount goes up to 15%; however, 15% discount plans have significantly higher participation rates
  - Proportion of partials increases marginally as the discount increases, highlighting that more participants are selling at a higher discount

ESPP Holding Behavior by Contributions



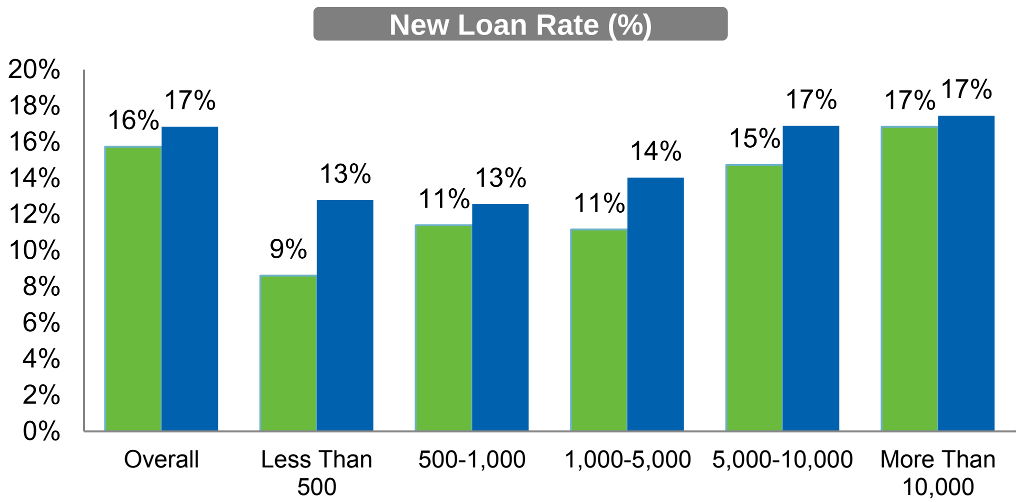
- Participant behavior across Fidelity clients:
  - Contributions—aggregate annual value contributed by participants to purchase shares
  - Does not include any value associated with a discount, look back, or company match
  - Participants with lower contributions are more likely to be holders
  - Proportion of holders declines steadily with an increase in the value of contributions
  - Percentage of partials increases with value
  - This implies that participants contributing more to ESPPs are more likely to sell a portion of their shares

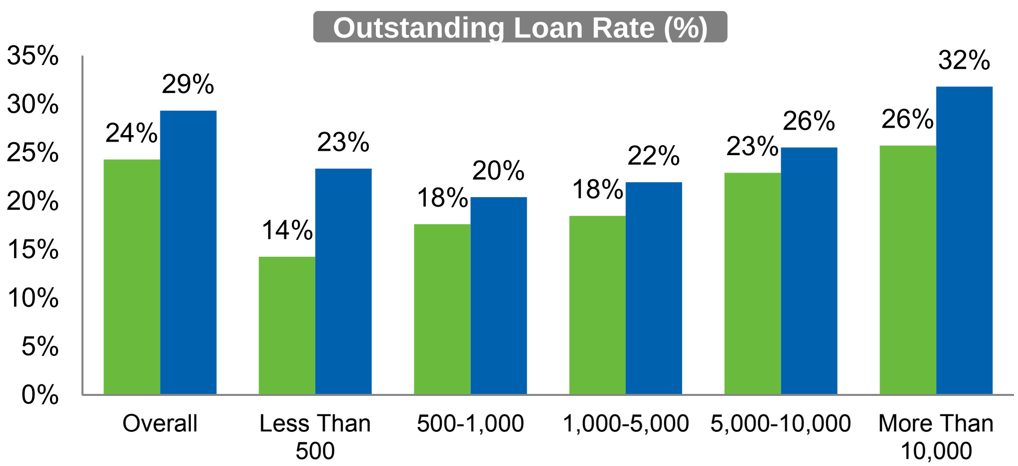
Behavior by Location



- Participant behavior across Fidelity clients:
  - U.S. participants account for a little under 90% of all participants
  - Outside U.S. participants are more likely to be sellers compared to their U.S. counterparts
  - U.S. participants are less likely to be holders at higher discounts, though the proportion of holders is marginally lower
  - Outside U.S. participants clearly demonstrate a higher propensity to sell at higher discount rates

ESPP and 401(k)
Key Findings and Observations: Loans





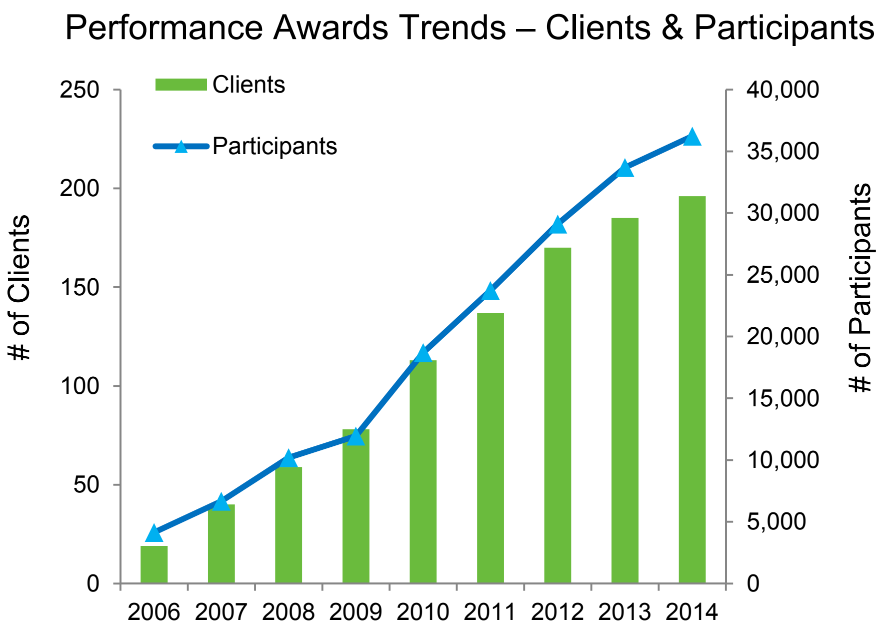
ESPP – 401(k) No ESPP – 401(k)

- Both *new* loan rate and *outstanding* loan rate are lower at clients offering both ESPP and 401(k)
- Both *new* loan amount and *outstanding* loan amount are also lower at clients offering both ESPP and 401(k)

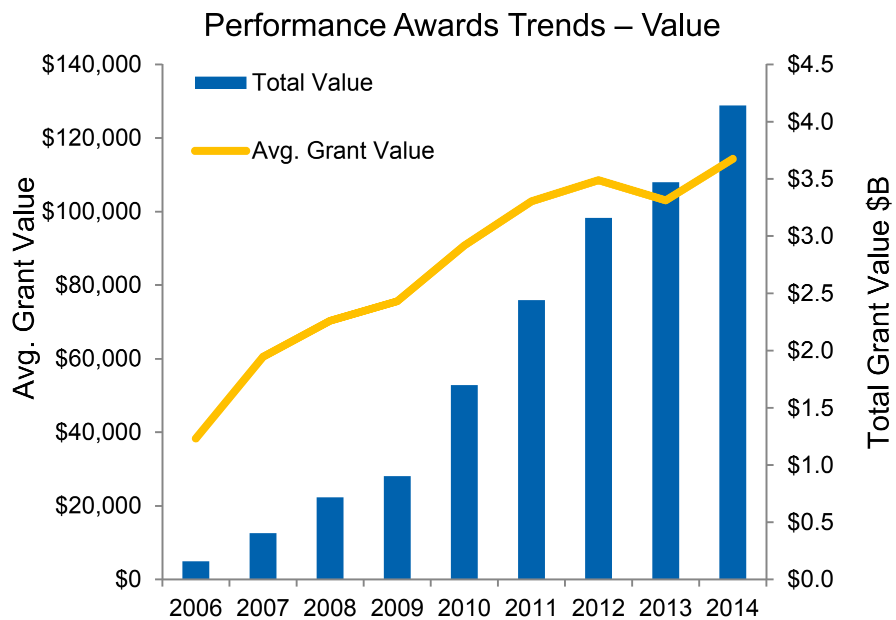
Note: All data is as of June 30, 2014.

What to Expect from Performance Awards

Dramatic Increase in Use of Performance Awards



- The prevalence of performance awards has grown exponentially on the Fidelity platform
- Fidelity currently supports over 200 clients issuing performance awards to ~40K employees
- Over the past 8 years, participants receiving performance awards has grown to an annual rate of 30%



- Value delivered through performance awards has grown from under $200M in 2006 to $4.1B in 2014
- Value of performance awards on the Fidelity platform has now crossed $14B
- Average value per participant has grown 3x

Source: Internal Fidelity Stock Plan Recordkeeping System

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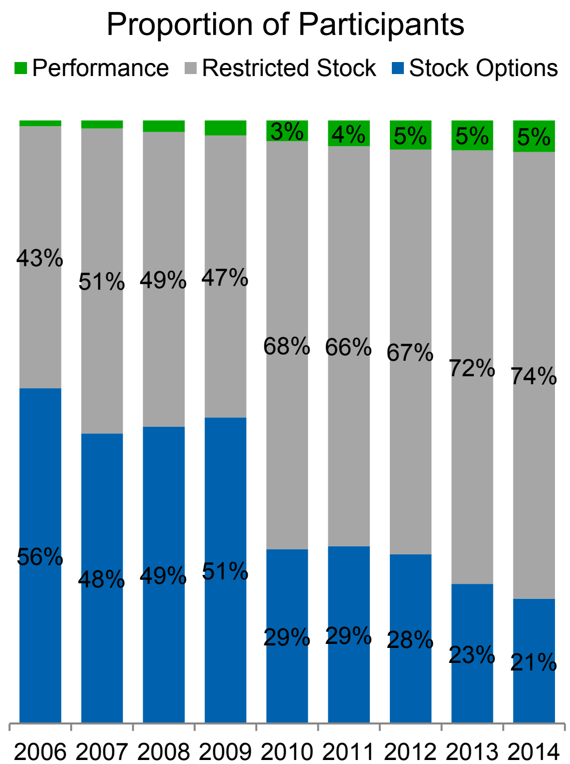
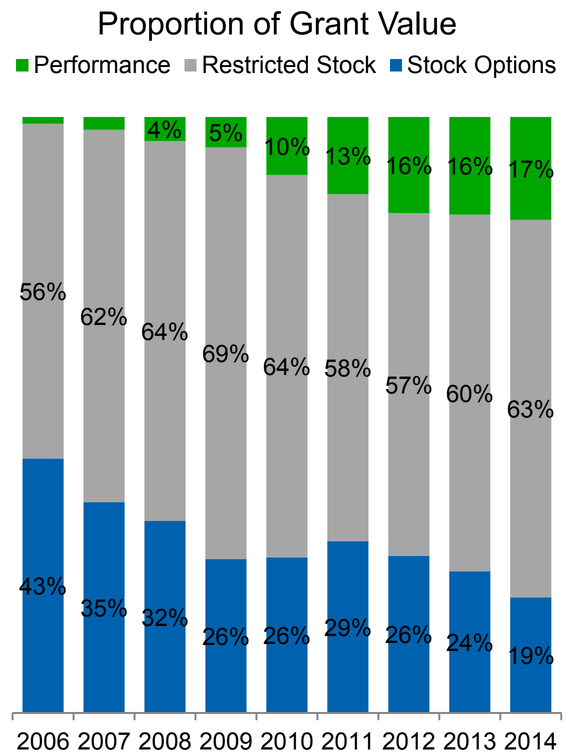
Distribution of LTI Vehicles

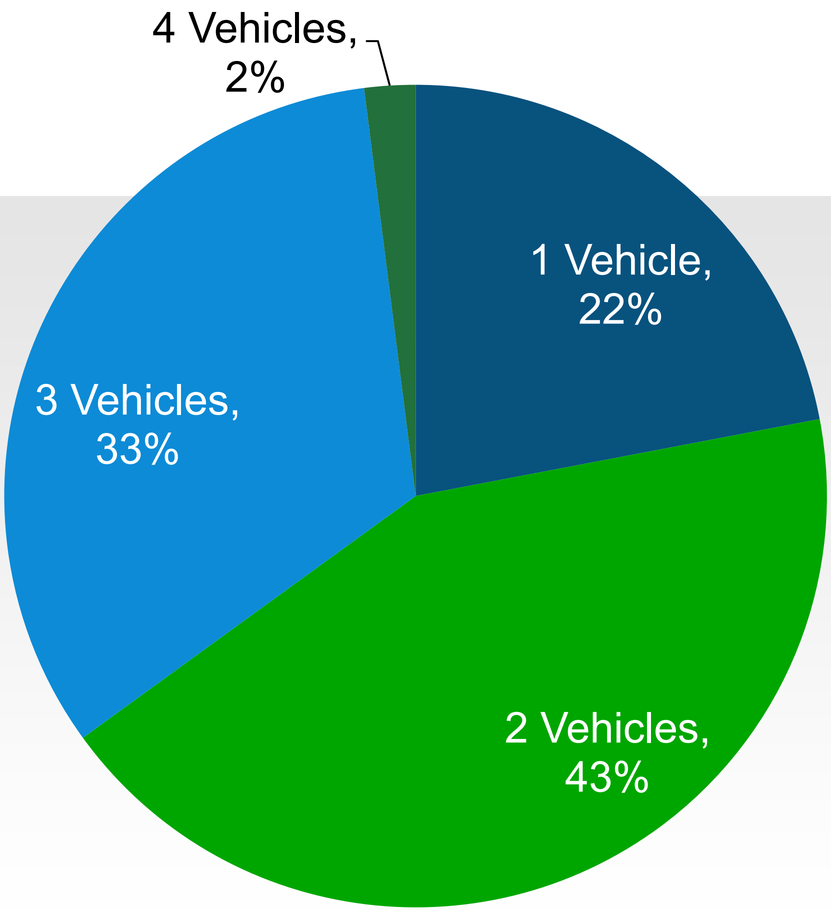




- Stock options were the dominant award type until 2009; however, restricted stock has replaced options as the primary vehicle
- Stock options continue to be granted and the population receiving options has stabilized over the past 5 years
- Although the population receiving options is shrinking, substantial value continues to be delivered through options
- Performance awards are the fastest-growing vehicle; however, given the population receiving this award type, the share value delivered through performance awards has grown faster than share of participants

Source: Internal Fidelity Stock Plan Recordkeeping System; grant value is defined as the value granted to employees on day of grant computed using the fair market value or option fair value on grant date.

Number of LTI Vehicles Used for NEOs



 Source: ClearBridge 100 Annual and Long-Term Incentive Design Report.

Design Trends in Performance Awards

- Multiyear performance periods
- Different goals than annual incentive plan goals
- Real consideration given to whether TSR is really the right metric for your business
- Key should always be: “Have we picked goals that will reward the kinds of behavior that make our business successful?”

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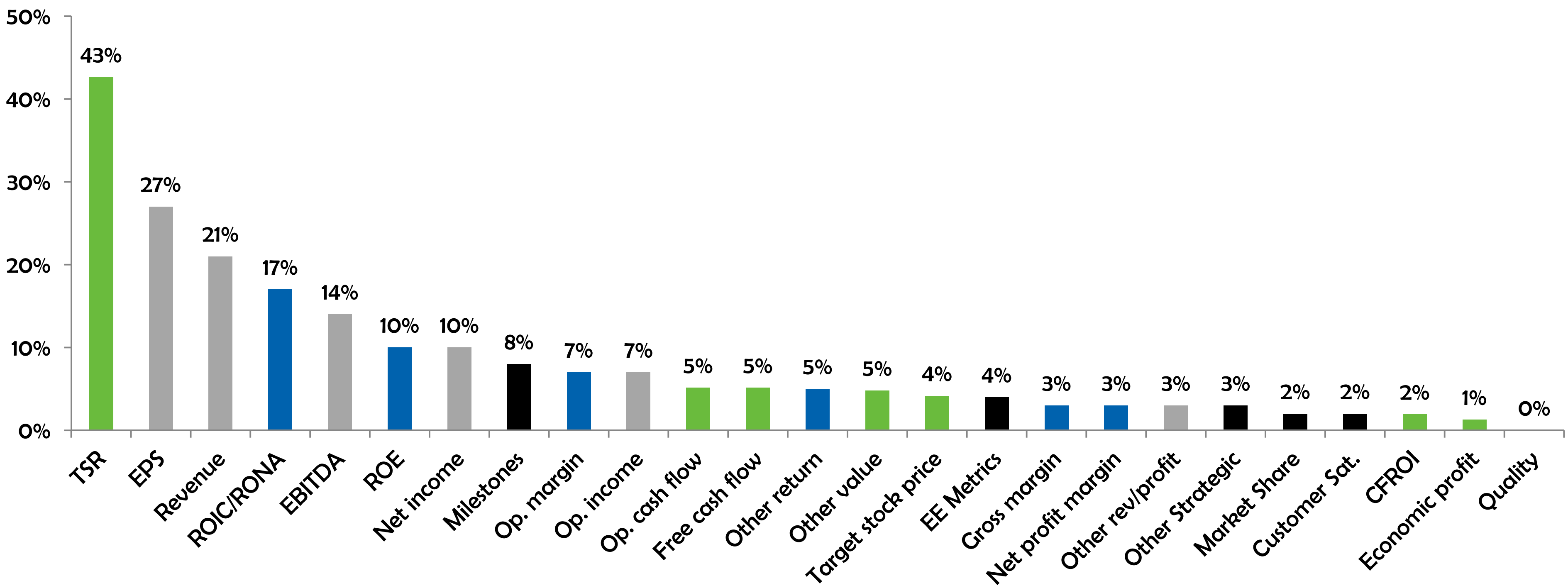
Total Shareholder Return (TSR) Awards

- Pros
  - SEC's new P4P disclosure
  - ISS's P4P alignment test is tied to TSR
  - Goal-setting is relatively straightforward for relative TSR
  - Provides transparency for participants to see ongoing performance levels on a daily basis
  - Easily auditable
  - Predictable expense amortization
- Cons
  - Line-of-sight considerations
  - Can be influenced by external factors
  - Valuation required
  - Expense may be different than face value

TSR Awards – Design Considerations

- Key considerations
  - Percentile rank vs. plan outperformance
  - Peer group (quality vs. quantity, international peers and currency conversions)
  - Payout parameters (threshold, target, maximum)
  - Payout cap (400% of target value)
  - Negative TSR thresholds (capped at target)
  - Treatment of dividend equivalents
  - Holding period after vesting

Types of Performance Metrics Used



Value Metrics: 58%

Return/Margin Metrics: 38%

Revenue/Profit Metrics: 60%

Strategic Metrics: 14%

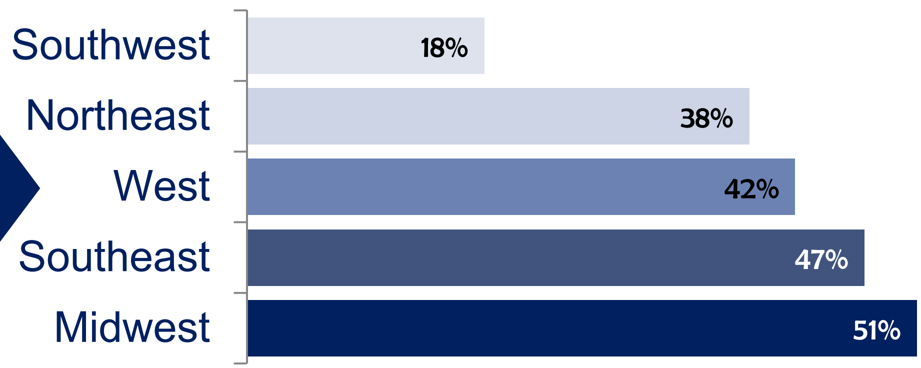
Fun Facts about TSR Awards

Respondents that use TSR

55% Use more than one metric
- EPS is the most commonly used additional metric

97% Use a relative metric

TSR usage by region



Usage of TSR among CA companies is the same as nationally

Source: NASPP/Deloitte 2013 Domestic Stock Plan Design Survey.

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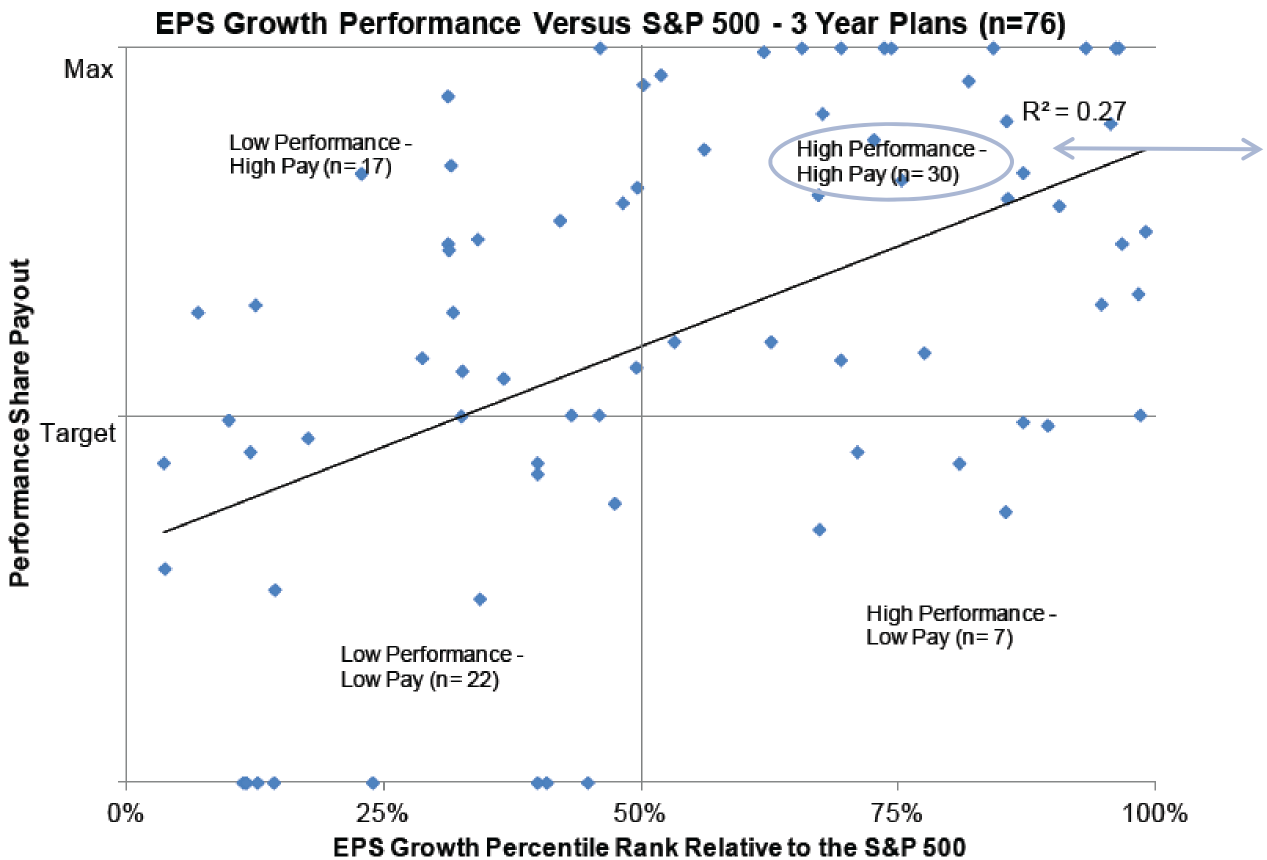
Corporate Performance and Payout – Term Matters



High pay rewarded for **high performance**

81% of the time

3-year plans have the strongest correlation between pay and performance

Key Conclusions:

- Although there are challenges with setting longer-term goals, 3-year plans have a stronger pay and performance relationship
- Bucked expectation that 1-year performance periods would be better aligned due to goal setting

Source: Fidelity Stock Plan Services Performance Plan Study, 2013.

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