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EXECUTIVE COMPENSATION

Addressing a Low Say-on-Pay Result

Most publicly traded companies are required to hold a say-on-pay (SOP) vote in which shareholders respond with a "for" or "against" the company's executive compensation. While SOP is a non-binding advisory vote, a below average outcome may lead to the perception of poor board governance and potentially greater risk for shareholder activism.

What Is Considered a Low Vote?

A large majority of public companies receive 90% or greater shareholder support. Depending on the situation and the board's philosophy, addressing a low SOP vote and the extent of action taken depends on the level of dissonance and the likelihood of similar outcomes in the future. Disappointing outcomes generally take three forms:

1. Significantly lower outcome than previous years. If SOP support is above 80% but meaningfully decreased from the results of prior years, it is important to understand whether the vote was the result of a one-time action, such as a retention award, or an ongoing issue, such as changes to pay levels. In situations where the low vote is due to a singular event, taking no action may be reasonable. In instances where future SOP votes are expected to trend lower, corrective action is prudent.
2. Outcome of 80% or below. A number of institutional investors rely on proxy advisers, such as Institutional Shareholder Services (ISS) and Glass Lewis & Co. (GL), to provide voting recommendations. Both expect companies to conduct shareholder outreach on executive compensation following a low SOP vote. ISS considers less than 70% support to be a low SOP vote while this figure is 80% for GL. Proxy disclosure of the outreach efforts, shareholder feedback and details outlining the actions taken are vital.
3. SOP failure. Outcomes of less than 50% are exceedingly rare. However, a failed vote in conjunction with a history of low financial or stock price performance may invite shareholder activism. In this situation, similar shareholder outreach with more significant remediation is necessary.

Steps To Address Low SOP Support

The first two steps help determine the reasons for a low SOP vote:

1. Read the proxy adviser reports. ISS provides companies with a complimentary copy of their annual voting recommendation, and GL will provide a report for a fee. Both reports identify positive and negative aspects of a company's executive compensation programs and rationale for their SOP voting recommendation.
2. Conduct shareholder outreach. Investor relations and proxy solicitors can assist in developing agendas and scheduling meetings with institutional investors. Shareholders tend to react favorably to directors' involvement in these discussions. Document shareholder perspectives on the positive and negative aspects of the programs and analyze for common themes.

The third through sixth steps address remediation. One or all can be deployed based on the situation:

3. Rank remediations. After cataloging and analyzing the commentary, rank the difficulty of remediating criticisms. For example, enhancing proxy disclosure and implementing stock ownership guidelines are quick. Changes to incentive plans typically take a year. Revisions to employment contracts may take time.
4. Fix the "issue." While there may be multiple criticisms, there is often a primary cause for a low SOP outcome. Pinpointing the primary concerns and addressing them may alleviate the need to mitigate all criticisms. This is helpful if certain compensation decisions are made for competitive or cultural reasons.
5. Enhance disclosures. Small filers are permitted to limit executive compensation disclosures. However, this can be counterproductive because proxy advisers take the most conservative approach in evaluating the company's programs. For example, a bank may have an incentive plan based on financial goals but, since it is undisclosed, the proxy advisers will deem the payout as discretionary. For companies with a Compensation Discussion and Analysis, disclosing greater context around company performance, realized pay and the committee's rationale for pay decisions helps "tell the story." Conducting shareholder outreach, disclosing the feedback received and the actions taken will influence SOP vote outcomes in the year after a low vote.
6. Reach out to proxy advisers. In the most difficult cases, consider scheduling a meeting with ISS and GL. These meetings are held at no cost but require advance preparation and often include assistance from a compensation consultant and investor relations professionals.

These six steps increase the likelihood of better SOP outcomes. They also establish a foundation for enhanced compensation-related governance that can reinforce a stronger pay and performance culture and improved shareholder relations.

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