“Tis the Season…Are You Ready?

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It’s hard to believe that another proxy season is upon us. It seems like just yesterday we were trying to figure out what the CEO pay ratio would look like, how it might compare to peers and what internal unrest would be created as a result. Although companies worried about the unrest these figures might create (both internally and externally), the reality was much ado about nothing.

As for the rest of the 2018 proxy season, once again, the large majority of companies sailed through reasonably unscathed. Among S&P 500 companies, director slates received majority support; no compensation-related shareholder proposals gained significant traction, and 80+ percent of companies received 90+ percent support for Say on Pay.

Similar to years past, less than 2% of companies in the S&P 500 failed Say on Pay in 2018. Some of these companies, however, may not have expected such negative outcomes – as half had 80+ percent support in the prior year. A positive situation can indeed turn negatively quickly.

Get Organized: If you haven’t started to think about your 2019 proxy, there is still time to get your ducks in a row. Start with the following:

1) Establish a proxy timeline and identify:

    a. Key players and their respective accountabilities.

    b. Critical milestones working backwards from the filing date, leaving enough time to incorporate multiple rounds of edits from various constituents (external advisors, board members, internal HR, legal and others as needed).

2) Review last year’s proxy and think about potential improvements (format, content, etc.).

    a. Collect other samples of best-in-class proxy disclosures that either show other ways to disclose the same information or suggest enhanced disclosure on items you may not have considered before.

    b. Consider whether to include a proxy summary to highlight key messages that may otherwise get buried in the details.

    c. Highlight how your pay programs align with shareholder interests and the overall strategy of the business. Think beyond just pay for performance. Shareholders also want to know why the company chose certain metrics and vehicles and how those choices support long-term business objectives.

3) Understand how proxy advisors will react to your company’s pay programs and proxy disclosure. Anticipate where they may challenge your programs and have a proactive strategy to address those areas with investors.

    a. Understand the “hot buttons” and ensure they still matter in the program.

    b. Run the tests. ISS’s pay-for-performance assessment is relatively straight forward and can be fairly easily replicated. Much of the result hinges on how well the company has performed (measured by relative total shareholder versus peers) – and how those results compare to pay (as defined by ISS). Some inputs remain uncertain, but forecasts typically match the eventual outcomes fairly closely.

(Glass Lewis's pay-for-performance analysis is more complicated and difficult to replicate with ease.)

c. Highlight aspects of your company's programs that investors and advisors will view positively. Often this can be done in a "what we do" and "what we don't do" table – to be sure nothing gets overlooked during their review.

4) Start preliminary calculations of the CEO Pay Ratio. Determine whether changes in your company composition or median employee circumstances may suggest that you have to identify a new median employee in year 2. For example, has your organization undergone a large acquisition, divestiture, refranchising effort, major reduction in force, etc. which has materially changed the workforce? Has the median employee gone on disability leave, reduced hours or been terminated?

   Absent such changes most companies are hoping to keep their disclosure consistent year-over-year.

5) Pay attention to whether the CEO Pay Ratio may increase markedly from last year and whether that will suggest explanation in the disclosure. Increases from last year may result in CEO Pay Ratios receiving more scrutiny than they did in the initial year of disclosure.

Listen to shareholders: If you haven't already begun to engage with shareholders, now is the time. Shareholder engagement should be something that companies are doing proactively – even when there are no burning issues or controversial topics to discuss. Keep the lines of communication open so that if things don't go as planned, you can work these relationships to tell your story and gain support during more tenuous times.

1) Start with your large shareholders, requesting in-person meetings where possible.

2) Determine whether a board member should participate. More and more, institutional investors prefer speaking with a board member on compensation and governance topics that may be of interest in a particular proxy cycle. For example, if Say on Pay support has been falling and performance is lagging peers, investors may welcome the opportunity to hear from the Chairman of the Compensation Committee, in addition to members of management, about compensation policy and alignment.

3) Ensure that all members of the team are prepped for the discussions, arming them with Q&As, fact sheets, a summary of programs and other back-up details, where possible.

4) If Say on Pay support is at issue, shareholder engagement will be even more critical. ISS and Glass Lewis will look for details on how your company engaged shareholders, who participated, what you heard from investors and what you did as a result.

   Some companies have included graphics and tables in the proxy to provide these details – e.g., "What we heard" and "What we did" – to clearly identify the actions taken in response to the concerns raised.

   Board responsiveness has become a critical factor that ISS, Glass Lewis and large institutional investors care about when considering supporting both Say on Pay and director elections in the year following a low vote.

Tell your story in the proxy: The proxy statement is your big chance to shine when it comes to compensation and governance issues. Get all the important details out there. Transparency is key while keeping things focused and concise. The goal is to ensure that your company is telling its story in a way that is readable, understandable and aesthetically pleasing – while demonstrating what is important to the business, how you have been successful (or not) at achieving your goals and why you think your plan designs are critical to the attraction, retention and motivation of your team.

Now, go forth and conquer. Good night and good luck.