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The 2009 Proxy Season: How Will Shareholders Vote on Compensation-Related Proposals in Today's Contentious Climate?

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With the hammering that many stocks took last fall, and the intensifying scrutiny and criticism of executive pay in financial services and other industries, it's probably not surprising that the number of compensation-related shareholder proposals appears to be up this proxy season. While it's far too soon to predict the outcome of this season's voting, early votes suggest that these proposals may garner as much, if not greater, support in today's contentious shareholder environment than in past years. How companies respond to this year's voting also remains to be seen, although it's likely that many boards will be paying even closer attention to shareholder views than in the recent past as a result of changes in several RiskMetrics Group (RMG) policies related to executive pay.

This article reviews the shareholder proposals filed to date and votes thus far on compensation-related proposals in the current proxy season, along with a look at how RMG policy changes are influencing the shareholder engagement dynamic this year on compensation matters in general.

The Evolving Shareholder Dialogue

Shareholder proposals that address key compensation issues are often viewed as a barometer of investor sentiment regarding executive pay. While the number of compensation-related proposals filed and voted on tends to fluctuate from year to year, the general trend in recent proxy seasons has been toward more shareholder activism on a number of compensation fronts. This is reflected in both the number of proposals filed and in the levels of support they receive from shareholders.

Proposals falling into two general categories — say on pay and pay for performance — have tended to dominate the last three or four proxy seasons. In past years, various labor unions took a lead role in filing such proposals. However, our analysis of the 2009 proxy season finds unions playing a somewhat smaller role this year. For example, say-on-pay proposals, the largest and fastest-growing category, were offered by a wide range of proponents in 2009, including pension funds and other investors. This shift, particularly as it relates to say-on-pay proposals, may be due to the fact that various shareholder groups have been discussing the topic and may be pooling their efforts in order to reach a larger number of companies.

Moreover, the number of pay-for-performance proposals has declined again this year because the leading union proponents are taking a year off from filing such proposals (but may resume filing these proposals next year). These proposals, which include measures to adopt performance-based options, link pay to performance, implement "common sense" compensation and adopt performance- and time-based restricted stock, made up the largest category of shareholder proposals as recently as two years ago. They've virtually disappeared from the proxy landscape this season. While shareholder proposals on the topic have declined, the proponents have changed their tactics and are proactively engaging companies in discussions about their pay practices. Other proposals on the decline this year are those addressing golden parachutes, clawbacks and supplemental executive retirement plans (SERPs).

The exhibit below provides a comparison of the kinds of shareholder proposals voted on in recent years versus those filed in 2009 to date. In addition to say on pay, the fastest-growing categories are proposals on executive death benefits ("golden coffins") and tax gross-ups. In fact, golden coffins represent a new area of shareholder concern this year and one that unions have been targeting, along with gross-ups, holding periods and companies receiving federal stimulus funds.

COMPENSATION-RELATED SHAREHOLDER PROPOSALS

	2007		2008		2009 (YTD*)
Shareholder Proposal	**Number of Proposals**	**Average Vote Support**	**Number of Proposals**	**Average Vote Support**	**Number of Proposals**
Say on pay	49	41%	72	42%	102
Executive death benefits	0	NA	0	NA	14
Golden parachutes	12	52%	5	51%	7
Tax gross-ups	0	NA	4	43%	6
Pay for performance	63	31%	22	31%	2
Clawbacks	9	33%	6	17%	3
SERP policy	14	39%	3	40%	1
TOTAL	**147**		**112**		**135**

*Based on data as of April 4, 2009

Source: Company filings and RiskMetrics Group/Voting Analytics Database

Early votes suggest that compensation-related proposals continue to receive strong shareholder support this year — and may ultimately surpass the levels of recent years. For example, the average support for say-on-pay proposals is up to 46% so far this year, while the average support for the small number of golden coffin proposals voted on to date is 45%. What's more, one say-on-pay proposal this year garnered 62% support, while a golden coffin proposal gained 67% of the vote. RMG thus far has been recommending that shareholders support these proposals.

Say-on-pay proposals received just 42% support, on average, in the 2008 proxy season, and proposals passed at 11 companies. To date, a total of 19 U.S. companies have adopted or announced that they will adopt say on pay. Of course, companies receiving federal assistance under the American Recovery and Reinvestment Act are required to conduct nonbinding shareholder votes on their executive compensation at their 2009 annual meetings. As a result, proposals calling for say on pay have been withdrawn at most of the companies receiving such funds, and the actual number of shareholder proposals may ultimately be lower in 2009. (For more details on the new requirements, see "Frequently Asked Questions: A Closer Look at the Executive Pay Restrictions in the New Federal Stimulus Legislation," *ECRonline*, March 3, 2009.)

Votes on Equity Plans and Exchanges

It will also be interesting to see how shareholders react to company proposals to approve new or amended equity-based incentive plans in the current environment. Reduced share values mean companies will need to make larger grants under equity-based plans to deliver the same value of incentives as in recent years. However, with shareholders licking their wounds from recent market losses, some companies are reluctant to ask for shareholder approval of new equity plans or increased share limits under existing plans.

Despite changes in RMG's Shareholder Value Transfer methodology to take into account volatile market conditions, more equity plans — almost three out of every 10 — are receiving negative RMG recommendations thus far in 2009. (For more on the 2009 changes in RMG's methodology, see "A Proxy Season Preview: RiskMetrics Group Updates Policies for 2009," *ECRonline*, December 5, 2008.) Of the 137 omnibus equity plans RMG had reviewed as of April 4 for which data were available, RMG recommended that shareholders vote against 28%. Negative RMG recommendations ranged from 19% to 28% in the three preceding years. Again, it's too early to predict how shareholder votes will play out, but this may signal a trend toward more negative votes on equity plans in the wake of the 2008 market meltdown.

While RMG made no changes in its policies regarding option exchanges for 2009, the data to date suggest that RMG continues to recommend that shareholders vote against option exchanges. RMG recommended negative votes on option exchanges about 80% of the time in 2008. Thus far in 2009, RMG has recommended negative votes on 86% of the exchange proposals RMG has reviewed. It's also worth noting that there has not been a flood of option exchange proposals filed by companies thus far in the current proxy season, but the number of proposals has been increasing as more proxies are filed.

Compensation Committees Feeling the Heat

In addition to growing numbers of shareholder proposals and the potential for more negative votes on equity-based compensation plans in the 2009 proxy season, all signs point to added shareholder scrutiny of compensation committee members in many companies. In some cases, recent changes in RMG voting guidelines may contribute to more negative votes against compensation committee members and other directors standing for reelection.

One of the tests RMG uses in deciding whether to recommend that shareholders vote against directors is the pay-practices test, which involves a qualitative evaluation of a wide range of company pay practices. If this subjective review turns up any "poor" pay practices, RMG may recommend that shareholders vote against or withhold votes from compensation committee members or, in some cases, the entire board. Alternatively, RMG may issue cautionary statements about certain pay practices, without recommending negative votes. For 2009, RMG's list of poor pay practices has been expanded to include excessive severance/change-in-control (CIC) arrangements, overly liberal CIC definitions, tax gross-ups on executive perks, dividend equivalents on unearned performance awards and excessive auto allowances or private use of company aircraft.

RMG's CEO pay-for-performance test is also likely to snare more companies as a result of the economic downturn. This test looks at the company's total shareholder return (TSR) for the prior one and prior three fiscal years and compares this to an industry group median. RMG may recommend voting against compensation committee members and equity plans if:

- the company's one- and three-year TSR are both below the industry median
- there is an increase in the CEO's total direct compensation from the prior year
- more than half of that increase is attributable to equity compensation.

Every quarter, RMG publishes a list of companies in the Russell 3000 that are subject to the pay-for-performance test, based on the TSR criteria outlined above. The most recent list (as of December 31, 2008) identified more than 900 companies for which this test may come into play in the current environment. To avoid negative voting recommendations, companies failing the test must demonstrate steps they're taking to strengthen the link between CEO pay and performance via the Compensation Discussion and Analysis section of the proxy.

The Polls Are Still Open

While most of the votes have yet to be cast, the 2009 proxy season seems certain to be one of the noisiest and most contentious in recent memory with regard to compensation-related issues and proposals. Shareholders in many companies will be trying to send their boards a message. How board members interpret and act upon those messages may further reshape the executive compensation landscape for many years to come.

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