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Survey Finds Companies Divided on Say-on-Pay Frequency and Uncertain About the Implications

By Jim Kroll and Terri Shuman, Towers Watson
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As most public companies in the U.S. prepare for what will be their first say-on-pay votes, a new Towers Watson survey finds companies divided on key compliance issues, and many are uncertain about how they will deal with the implications of the upcoming shareholder advisory votes on executive compensation. Conducted in mid-December, the online survey garnered responses from 135 U.S. companies, primarily midsize and large organizations in a broad range of industries. Among the key findings:

- Companies are split on how frequently they should put their executive compensation programs to a shareholder vote. Among our survey respondents, annual votes appear to be the preferred frequency, followed by triennial votes.
- While most companies are taking a range of actions to prepare for their 2011 say-on-pay votes, relatively few are making significant changes in their pay-setting processes or their core pay programs (i.e., base pay, annual bonus and long-term incentives). Based on our consulting experience, this is probably because most companies have already made improvements in their executive compensation programs and governance processes in recent years in response to growing shareholder scrutiny and the financial crisis, among other factors.
- Despite the steps companies have taken to make their pay programs more shareholder-friendly in recent years, relatively few have been thinking beyond their first say-on-pay votes to how they will assess and address shareholders' input going forward. This points to a high level of uncertainty about the upcoming votes and suggests that many companies are taking a "wait and see" approach to say on pay.

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Here's a closer look at the findings:

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Current Thinking on Frequency, “Say on Parachutes”

Enacted last summer, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires public companies to conduct shareholder advisory votes on executive pay at least every three years, but leaves it to each company to decide whether it will conduct say-on-pay votes annually, biennially or triennially. Companies are also required to give shareholders an opportunity to vote on their desired say-on-pay frequency at least every six years. Proposed Securities and Exchange Commission (SEC) regulations would require companies to conduct the first of these votes in 2011.

Slightly over half (51%) of the survey respondents currently expect to conduct annual say-on-pay votes, while 39% prefer that the votes be held every three years, and 10% anticipate holding biennial votes. While annual votes are the preferred frequency of many institutional investors and proxy advisors, including Institutional Shareholder Services (ISS), this finding is somewhat surprising given that most companies that filed proxies by the end of 2010 are recommending triennial votes. (See “ISS Policy Updates for 2011 Focus on Shareholder Advisory Votes,” *Executive Compensation Bulletin,* November 23, 2010.)

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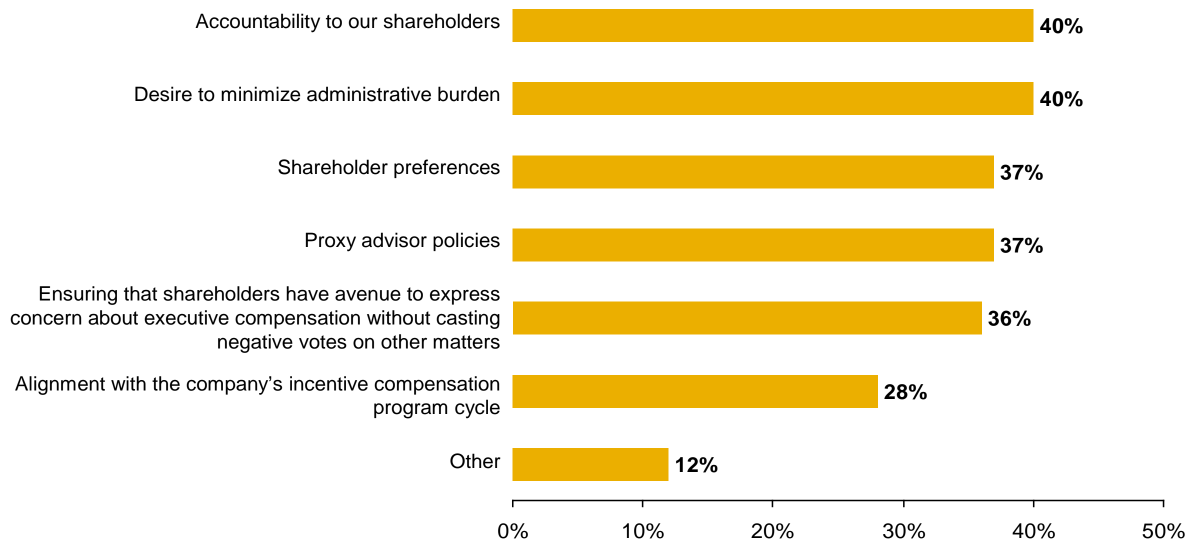
Figure 1 shows the factors having the greatest influence on the survey respondents’ thinking regarding say-on-pay frequency. As you would expect, given the split between companies contemplating annual and triennial votes, the respondents appear to be about equally swayed by the desire to be accountable and responsive to shareholder preferences, and the goal of minimizing the administrative burdens posed by annual votes. (For more on the factors influencing companies’ thinking on the frequency issue, see “Key Considerations in Preparing for ‘Say on When’ Votes,” *Executive Compensation Bulletin,* November 22, 2010.)

Figure 1. Factors influencing company thinking on frequency of say-on-pay votes



Source: Towers Watson Say-on-Pay Flash Survey, December 2010

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Another compliance decision facing companies involves the timing of required shareholder advisory votes on golden parachutes and other change-in-control benefits triggered by corporate transactions such as mergers and acquisitions. Dodd-Frank requires a nonbinding vote on a company's parachute arrangements as part of any proxy or consent solicitation for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation or sale of the issuer's assets. Under the proposed SEC rules, however, companies could avoid the need for a say-on-parachute vote at the time a deal is approved if the company previously disclosed the parachute values in a proxy subject to a general say-on-pay vote or held a separate vote on parachutes at the annual shareholder meeting.

Given the uncertainties about future transactions and the challenges regarding parachute disclosures under the proposed SEC rules, the vast majority (80%) of our survey respondents are deferring say-on-parachute votes until the need arises (i.e., at the time of a transaction). However, 17% of the participating companies expect to seek shareholder approval of parachute arrangements as part of a consolidated say on pay in 2011, with the remainder planning to conduct say-on-parachute votes at their 2011 annual meetings under a separate resolution. Our review of proxies filed to date found no instances of companies planning to conduct separate say-on-parachute votes at their 2011 annual meetings. (For more on the say-on-parachute requirements, see "SEC's Proposed Say-on-Pay Regulations Will Require Added Disclosures," *Executive Compensation Bulletin,* October 22, 2010.)

Changes in Pay-Setting Processes and Pay Programs

The survey also provides new insights into how U.S. companies are adjusting their pay-setting processes and pay programs for the say-on-pay era. Interestingly, slightly over half (53%) of the respondents indicate that say on pay is having no impact on their governance and other pay-setting processes, while only a small minority report making moderate (10%) or significant (1%) changes for 2011. The remaining companies, about a third of the respondents, are making small changes or tweaks in their processes. These findings reflect the fact that most companies have already strengthened their pay-setting processes in recent years and see no need for further changes.

Among those companies making changes in their processes for 2011, most (65%) are focusing more attention on preparing the Compensation Discussion and Analysis (CD&A) section of their proxy statements. In addition, many of these companies (41%) are performing additional analyses of the link between executive pay and company performance, and almost a third (30%) are making or considering changes in compensation arrangements like severance, parachutes, perquisites and tax gross-ups that are not directly linked to performance. Relatively few (only 16%), however, are making or considering changes in their core pay programs (base salary, annual bonus and long-term incentives).

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Additionally, 29% of the companies surveyed report that their boards have become more engaged in the pay-setting process and in developing the CD&A. Clearly, say on pay will bring even greater attention to the work of the board's compensation committee, and committee members are taking their heightened visibility to heart.

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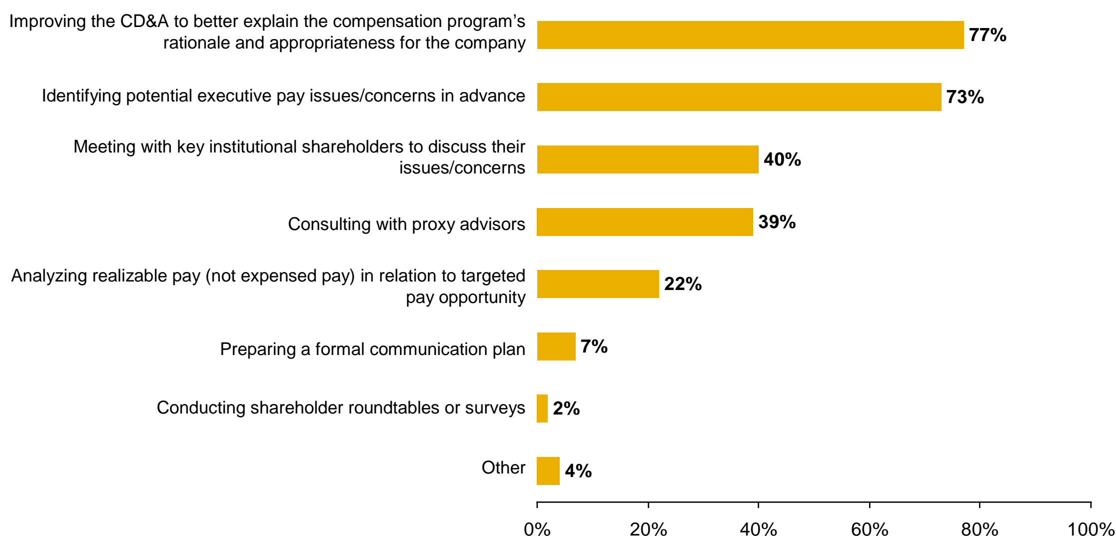
Figure 2 shows the specific actions the survey respondents are taking or considering in preparation for conducting say-on-pay votes in 2011. We asked the same question in a survey we conducted last summer around the time Dodd-Frank was enacted. (See "Survey Finds Companies Sharpening Their Focus on Pay for Performance," *Executive Compensation Bulletin,* August 4, 2010.) While there was little change in most of the preparations, we did see a jump (from 29% last summer to 40% in the latest survey) in the percentage of companies meeting with their key institutional investors to better understand their issues and concerns about pay. At the same time, the percentage of companies preparing formal shareholder communication plans fell from 23% last summer to just 7% today. These shifts suggest that more companies are deciding that face-to-face interaction with key shareholders is essential to laying the groundwork for successful say-on-pay votes.

Figure 2. How companies are preparing for say on pay



Source: Towers Watson Say-on-Pay Flash Survey, December 2010

Defining Say-on-Pay Success

A key area of uncertainty for many companies as they prepare for their first say-on-pay votes is what to make of the results .Is anything over 50% favorable a passing score for the company's pay programs? Or should anything more than a very low level of negative votes be viewed as cause for concern? And does the level of support and opposition really matter, given that the vote is not binding on the company?

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Surprisingly, the company's board has not yet articulated what it views as a successful say-on-pay vote in about half of the companies participating in our survey. However, most boards that have addressed this issue appear to view anything less than 80% shareholder support as unacceptable *(Figure 3).* This is fairly consistent with U.S. companies' limited experience with say on pay to date. Among companies that have adopted say on pay voluntarily or conducted such votes to meet the requirements of the federal Troubled Asset Relief Program (TARP), the vast majority have received support for their pay programs from 80% or more of shareholders casting votes.

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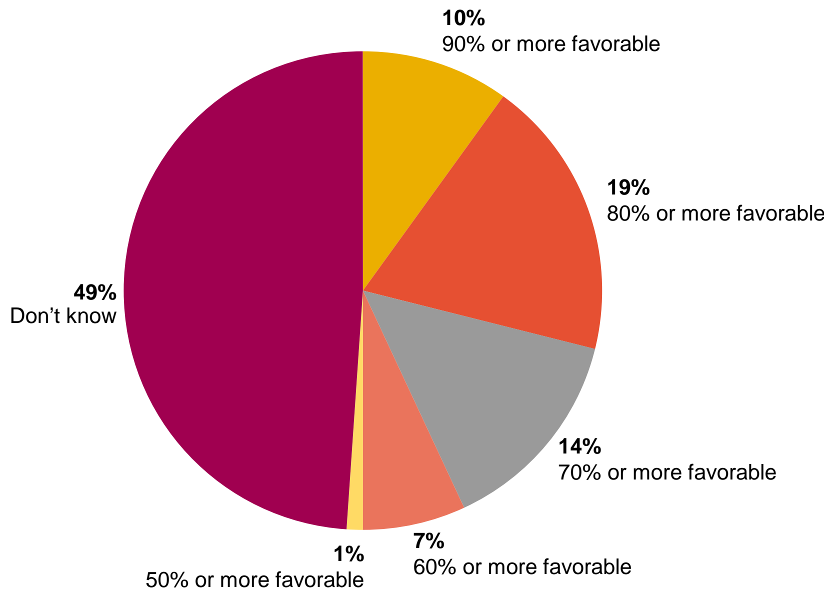
Figure 3. How companies define successful say-on-pay outcomes



Source: Towers Watson Say-on-Pay Flash Survey, December 2010

Managing the Aftermath

Also noteworthy is that only 8% of the survey respondents say their companies have defined a process for analyzing the results of the say-on-pay vote and developing appropriate action plans in response to any shareholder concerns. While a wait-and-see approach may be understandable at this point, companies ultimately should have a point of view on what's an acceptable say-on-pay voting outcome and a plan for addressing shareholder concerns if the voting results fall short of the desired level of support.

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Under current SEC rules, companies must disclose the results of their shareholder votes in Form 8-K within four days after the annual meeting. What's more, the proposed SEC rules would require companies to discuss how they responded to the shareholder vote in the following year's CD&A.

Given these requirements, and the growing importance of having a strong "pay story" to tell shareholders about why the executive compensation program is appropriate and how it helps drive the company's performance, companies need to think through both how they lay the groundwork for successful say-on-pay votes and how they manage the aftermath to maintain a positive ongoing dialogue with investors.

In short, despite all of the important preparations for say on pay that companies have completed thus far, there's more work to be done.

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