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FIXING A SAY-ON-PAY FAIL

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EXECUTIVE COMPENSATION

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Introduction

While the Say-on-Pay (SOP) vote gets a lot of attention from those in the governance and consulting community, for most companies the vote is generally a stress-free event. In 2019, out of the 2,993 votes we analyzed, an overwhelming majority (70%) received +90% FOR votes. Additionally, another 20% of companies received FOR votes between 70% and 90%.

Many in the governance community view a 70% FOR vote as a threshold for SOP with any voting result below this level indicating a company should be taking meaningful measures to address shareholder concerns. 7% of the companies reviewed in 2019 received passing votes below 70% FOR support.

The remaining 66 companies (2%) failed. Among those 66 companies that failed in 2019:

- 39 passed their 2020 SOP vote
- 15 failed again
- 12 did not have a SOP vote
  - Due to non-annual SOP votes, M&A activity, delisting of securities

We reviewed the disclosures for the 39 companies that passed their SOP vote in 2020 to understand the disclosed reasons for their failed vote in 2019 per their proxy disclosure as well as the steps they took to secure a passing vote the following year.

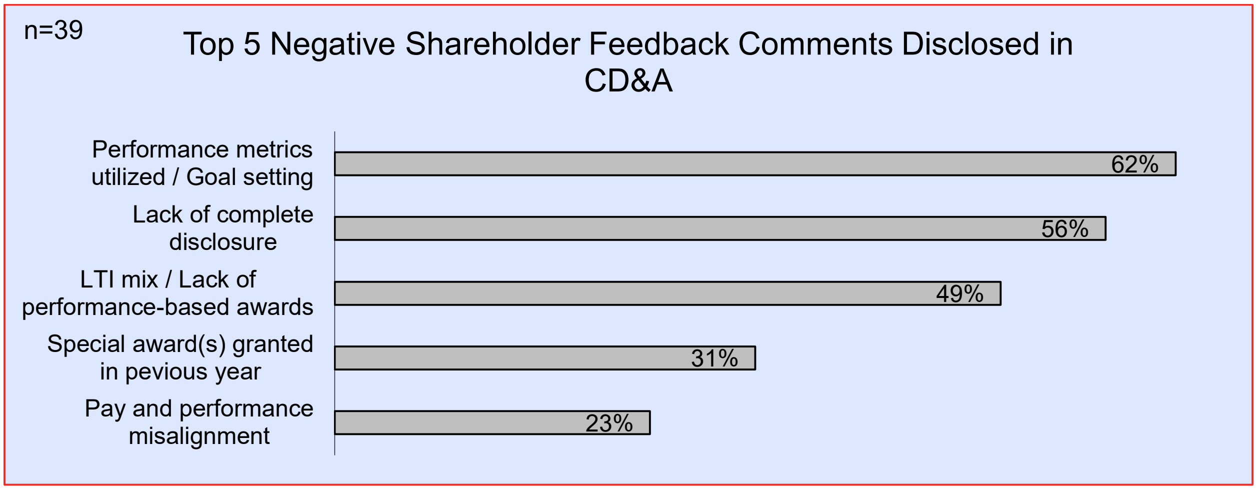
In general, shareholder feedback pointed towards displeasure with the design of incentive plans and oversized one-time special equity awards as the main drivers behind the failed Say on Pay votes in 2019. While additional comments focused on the quality of disclosure provided by the company in their annual proxy statement, it does not appear disclosure quality was ever the leading influence on a company's vote outcome, it was the second most prevalent comment received among the 39 companies we reviewed.

The most common steps taken by the companies that failed Say on Pay in 2019 and passed in 2020 were increasing or enhancing CD&A disclosure, modifying performance metrics, and adjusting the equity mix granted to executives.

The following pages provide some further insight into the actions and steps taken.

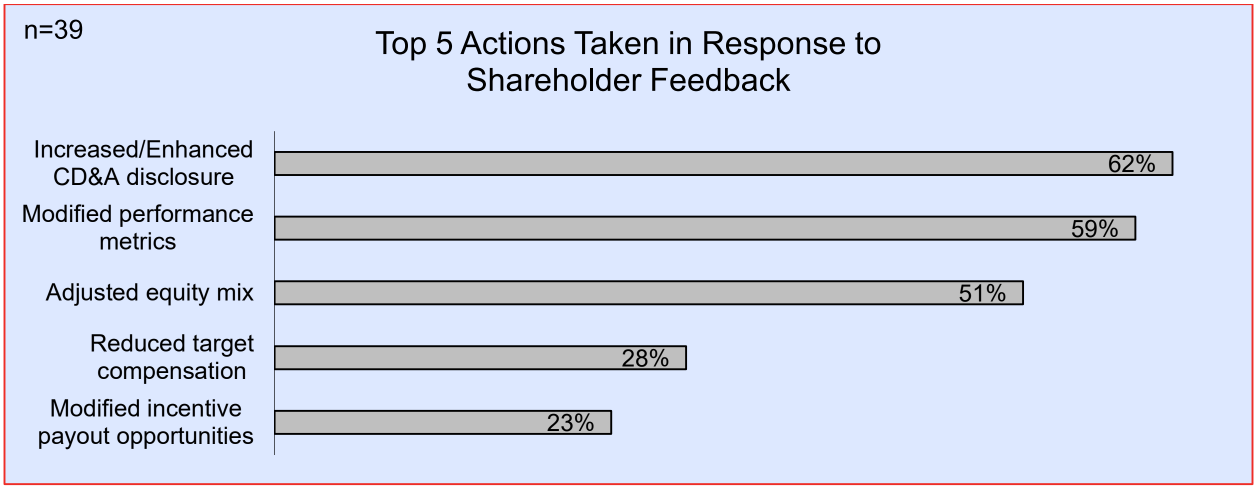
Negative Shareholder Feedback

The majority of companies listed two or three negative comments received from shareholders during their outreach process. Comments pertaining to incentive plan performance metrics utilized and goal setting were the most prevalent, followed by calls for more comprehensive disclosure regarding incentive plans.



Actions Taken in Response to Shareholder Feedback

The most common change among the 39 companies reviewed was to increase or enhance their compensation disclosure. Adjustments to performance metrics for annual and long-term incentive plans as well as changes to the mix of equity awards towards more performance-based grants were also prevalent among the group. Additionally, we note 11 companies in the group reduced target compensation for one or more of their named executive officers.



Our View

Over the last several years we have worked with several clients to improve sub-par Say on Pay vote outcomes. Below are some ideas and comments based on our experience.

Identify the Issues

- *Engage shareholders*
  - Most shareholders are receptive to engagement on executive compensation and corporate governance issues. Meeting one-on-one with major shareholders, either in person or over the phone, not only helps generate a list of issues that shareholders would like addressed, but also a sense of the magnitude of their concern for any particular issue.
- *Review proxy advisory firm reports*
  - Reports from proxy advisory firms, such as ISS and Glass Lewis, provide important insight into the concerns of shareholders as both of these organizations make vote recommendations based on methodologies that are reflective of the concerns of their respective constituencies. Although these reports can provide a catalogue of concerns, they are not always helpful in prioritizing changes. Companies should evaluate these reports in the context of other information gleaned directly from shareholders and an understanding of how influential each of these organizations is within their shareholder base.
- *Recognize the influence of non-compensation factors*
  - Finally, companies should recognize that there are instances where the say-on-pay vote is used to express dissatisfaction with other aspects of company performance or actions. Poor stock price performance, even if temporary, increases scrutiny of pay programs.

Identify Solutions

- *Pick the low hanging fruit*
  - We have found the easiest fixes a company can make are those related to corporate governance, in large part because they have minimal impact on affected executives. While many companies have already addressed these issues, those that have not may use a weak say-on-pay vote as the needed impetus to finally effect these changes:
    - Eliminate tax gross-ups
    - Establish a clawback policy
    - Anti-hedging/pledging policies
    - Increase/establish executive share ownership guidelines
    - Review comparator group for appropriateness
- *Review long-term incentive plans*
  - Given the relative size of long-term incentive compensation for top U.S. executives as a percentage of total compensation, such programs are frequently subjected to shareholder scrutiny. One of the most common critiques is that the program is not sufficiently performance-oriented and companies anxious to court shareholder approval often implement changes designed to enhance the performance profile of the program.
    - Alter the vehicle mix
    - Select different performance metrics
    - Adjust performance metric weightings
    - Increase performance period/vesting
      - Longer term performance periods (three or more years) generally viewed as more favorable by shareholders and advisory firms
- *Review annual incentive plan*
  - Changes in short-term incentive programs in response to shareholder concerns are typically less prevalent than modifications to the long-term program. However, some of the most common changes include:
    - Adjustments to performance metrics
    - Modify pay opportunities for executives

Identify Solutions *(cont'd.)*

- *Consider the quantum of pay*
  - Companies risk future failed votes if the company's stock is underperforming and/or CEO pay is viewed as excessive relative to performance and comparator CEOs.
  - Persistently high pay relative to peers is often the result of special circumstances and can be difficult to correct in the short-term
    - Recognizing the issue can help committees and executives begin to adjust their expectations regarding appropriate pay

Make sure no good deed goes untold

- *Disclose all shareholder outreach efforts and changes made*
  - Changes to compensation programs are only effective in reversing votes if shareholders understand and appreciate them
  - Changes to the program in response to the vote should be prominently featured in discussions with shareholders and the Compensation Discussion and Analysis section of the company's next annual proxy filing.
    - In situations where problematic practices were identified but not changed, be proactive in explaining why no changes were made
    - Persuasive cases grounded in decisions made in the best interests of shareholders are often successful
  - While the say-on-pay vote is non-binding, it certainly warrants a thoughtful response from the company.
    - Complete and candid proxy disclosure of the outreach process, as well as all steps considered and taken in response to the vote can also go a long way in ameliorating shareholder concerns and ensuring a more positive vote result the next year
    - When considering compensation program changes, boards should not hesitate to hold firm against changes that they do not believe to be in the best interests of shareholders

About Steven Hall & Partners

Steven Hall & Partners is an independent compensation consulting firm, specializing exclusively in the areas of executive compensation, board compensation, non-profit compensation and related governance issues. By focusing solely on this critical and complex segment of the human resources arena, we are able to provide our clients with the highest quality expertise and best counsel available on a practical basis. For more information, please visit www.shallpartners.com and follow us on Twitter @SHallPartners.

Contact Information

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