PUBLICATION

Say-On-Pay Considerations for Compensation Committees

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Now that most public companies have held their 2016 annual meetings, and stockholders have voiced their opinions regarding executive compensation, it is more important now than ever for companies and their compensation committees to take note of the results of say-on-pay and act if the outcome demonstrates stockholder concern.

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires that companies include a resolution in their proxy statements asking stockholders to approve, in a non-binding advisory vote, the compensation of their executive officers, as disclosed pursuant to Item 402 of Regulation S-K (known as say-on-pay). A separate resolution is also required to determine whether the say-on-pay vote takes place every one, two or three years (the say-on-pay frequency vote). The say-on-pay frequency vote is required to be held at least every six years. Companies were first required to hold say-on-pay and say-on-pay frequency votes at their first annual stockholders' meeting occurring on or after January 21, 2011, so we are now five years into the results on say-on-pay votes.

Below are a few important statistics to consider on recent say-on-pay votes:

Say-on-Pay Statistics from Institutional Stockholder Services, Inc. (ISS)

- Average Say-on-Pay Support over the Last Three Years
  - Average support (through June 15, 2016) in 2016 is 91 percent
  - Average support in 2015 was 91 percent
  - Average support in 2014 was 90 percent
- Percentage of Companies That Received More Than 70 percent Support in the Last Three Years (Russell 3000)
  - 93 percent of companies have received greater than 70 percent support in 2016
  - 92 percent of companies received greater than 70 percent support in 2015
  - 92 percent of companies received greater than 70 percent support in 2014

If your company has received less than 70 percent approval on say-on-pay, then you may have a problem with stockholders' view of executive compensation, and, at a minimum, the compensation committee needs to meet to discuss the results of the vote.

ISS Policies Regarding Say-on-Pay Results

According to the ISS Summary Proxy Voting Guidelines for 2016 Benchmark Policy Recommendations for Annual Stockholder Meetings, Section 1.16, stockholders should vote case-by-case on compensation committee members (or, in exceptional cases, the full board) and the Management Say-on-Pay proposal, in the event a company's previous say-on-pay received the support of less than 70 percent of votes cast, taking into account [in part]:

- The company's response, including:
  - Disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support;
  - Specific actions taken to address the issues that contributed to the low level of support; and
  - Other recent compensation actions taken by the company.
- Whether the issues raised are recurring or isolated.

Further, ISS's general recommendation is to vote against or withhold from the members of the compensation committee and potentially the full board if, in part:

- There is no say-on-pay proposal on the ballot, and an against vote on a say-on-pay proposal is warranted due to pay for performance misalignment, problematic pay practices, or the lack of adequate responsiveness on compensation issues raised previously, or a combination thereof; and
- The board fails to respond adequately to a previous say-on-pay proposal that received less than 70 percent support of votes cast.

Glass Lewis Policy Regarding Say-on-Pay Results

Set forth below are excerpts from the Glass Lewis Proxy Paper Guidelines for the 2016 Proxy Season:

Company Responsiveness
At companies that received a significant level of stockholder opposition (25 percent or more) to their say-on-pay proposal at the previous annual meeting, we believe the board should demonstrate some level of engagement and responsiveness to the stockholder concerns behind the discontent, particularly in response to stockholder engagement. While we recognize that sweeping changes cannot be made to a compensation program without due consideration and that a majority of stockholders voted in favor of the proposal, given that the average approval rate for say-on-pay proposals is about 90 percent, we believe the compensation committee should provide some level of response to a significant vote against, including engaging with large stockholders to identify their concerns. In the absence of any evidence that the board is actively engaging stockholders on these issues and responding accordingly, we may recommend holding compensation committee members accountable for failing to adequately respond to stockholder opposition, giving careful consideration to the level of stockholder protest and the severity and history of compensation problems.

Board Responsiveness
Glass Lewis believes that any time 25 percent or more of stockholders vote contrary to the recommendation of management, the board should, depending on the issue, demonstrate some level of responsiveness to address the concerns of stockholders. These include instances when 25 percent or more of stockholders (excluding abstentions and broker non-votes): WITHHOLD votes from (or vote AGAINST) a director nominee, vote AGAINST a management sponsored proposal or vote FOR a stockholder proposal. In our view, a 25 percent threshold is significant enough to warrant a close examination of the underlying issues and an evaluation of whether or not a board response was warranted and, if so, whether the board responded appropriately following the vote. While the 25 percent threshold alone will not automatically generate a negative vote recommendation from Glass Lewis on a future proposal (e.g., to recommend against a director nominee, against a say-on-pay proposal, etc.), it may be a contributing factor to our recommendation to vote against management's recommendation in the event we determine that the board did not respond appropriately.

Bottom Line Considerations for Compensation Committees

If your company has received "yes" votes of less than 70 percent or "no" votes of more than 25 percent for say-on-pay, the compensation committee needs to meet and discuss the voting results and the underlying causes of the stockholder vote. Discussions with stockholders by compensation committee members may also be important. The compensation committee should discuss what steps should be taken to address stockholder concerns. The key is that taking no action, not even a meeting to discuss an adverse vote, may cause more stockholder dissent down the road.