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REPORT

Executive Compensation

Attorney Says Early Filings With SEC Show Trend Favoring Annual Say-on-Pay Vote

While many public companies that have made early proxy statement filings with the Securities and Exchange Commission have chosen the three-year option for the frequency of shareholder advisory votes on executive compensation, there is a growing trend that favors annual voting due to shareholder preference, Peter D. Fetzer, a corporate law partner at Foley & Lardner LLP in Milwaukee, Wis., told BNA Dec. 23.

The SEC in October 2010 proposed rules that would compel public companies to give their shareholders a regular advisory vote on executive compensation as well as an opportunity to decide how often—every year, every other year, or once every three years—they would want to have a say on pay (8 CARE 1133, 10/22/10). Under the proposal, shareholders would have a chance to revisit their vote on the frequency of having a say on pay once every six years.

''It is too early, however, to predict exactly how this trend will develop with the majority of companies following the early filers,'' Fetzer said.

Meanwhile, according to a Jan. 3 Latham & Watkins LLP memorandum on 2011 say-on-pay vote recommendations, whether a public company should subject its compensation practices to an annual, biennial, or triennial say-on-pay vote depends on the unique facts and circumstances surrounding each company's pay practices and relations with its shareholders, ISS and other proxy advisors, and other circumstances.

Some Companies May Prefer Triennial Votes. According to Fetzer, the fact that a fair number of companies have made early filings with the SEC indicating their choice of a three-year option for say-on-pay vote frequency may embolden other companies to do the same as well.

''On the other hand, many other companies will simply not want to fight against the recommendations made by their large institutional shareholders and will likely opt for the annual vote provision,'' Fetzer said. ''I do have a feeling that most companies will carry the trend towards the one-year vote provision. Companies that would likely be the ones recommending triennial voting would be ones that are performing well and have had good performance over the last few years,'' he said.

However, some smaller institutions that have been performing well and have maintained good corporate governance measures will also likely be able to convincingly recommend a three-year voting provision, Fetzer said.

There are various arguments highlighting the benefits and detriments of both annual and triennial voting provisions, according to Fetzer. Some proponents of triennial voting argue that annual voting does not allow enough time for companies to examine their compensation practices, he said.

''Others, however, argue that company performance and other factors may change too quickly for a three-year voting cycle to adequately and effectively address these developments,'' Fetzer said.

Certain Disclosures Need Special Attention. Companies would be wise to include a comprehensive executive summary in the proxy statement if they are not already doing so, Fetzer said.

''The executive summary should provide shareholders with the information needed to make informed say on pay votes, as well as explanations for any recommended policies,'' Fetzer said.

Companies should consider using the executive summary to address features that are being identified by proxy advisors such as stock ownership requirements and clawback provisions, Fetzer said. ''If companies keep any possibly controversial pay policies they believe are justified, they need to discuss them and explain the benefits of the policies,'' he said.

Also, with executive summaries, companies need to discuss how their executive pay aligns with their financial performance and compares to the compensation programs and financial performance of peer group companies as well, Fetzer said.

Early Trends Emerge in Proxy Statements. According to the Latham memo, ''The bottom lines are that U.S. public companies are generally required to hold say on pay and frequency votes at their first meetings of shareholders occurring on or after January 21, 2011.''

''Heading into the 2011 proxy season, trends have started to emerge in both institutional guidance and filed proxy statements with regard to say on pay votes and frequency votes,'' the memo said. With say-on-pay votes, as of December 31, 2010, 73 companies had filed proxies recommending approval of their executive compensation plans in the 2010 calendar year, or a fiscal year ending late in 2010, it said.

Also, a number of proxy advisors and institutional shareholders have publicly adopted formal voting policies stating their preferences for annual say on pay votes, the memo said. Just how insistent these groups are about achieving their preferences generally will be unknown until further in the season when companies can see what the groups actually recommend and how they vote their shares in specific cases, it said.

''Recently filed proxies also reveal certain trends in the language used in both the say on pay and frequency vote proposals,'' the memo said. Many large accelerated filers have also included an executive summary of their compensation discussion and analysis section to assist shareholders in reviewing the company's executive compensation before casting their votes, it said.

Companies Need to Form Recommendations. One of the most important actions for public companies this coming proxy season will involve determining what recommendations to make to shareholders regarding the future frequency of say on pay votes, the memo said.

Companies that do not have a preference or view on the best frequency for them—or that may not want to bias their shareholders—may decide not to make any recommendation to shareholders on the frequency vote, the memo said.

''Boards should be encouraged to think through these issues and make a recommendation, if for no other reason than to make it clear to their shareholders that they thoughtfully considered the issues, asserted ownership of the issues and have not abdicated the good governance playing field to proxy advisors,'' the memo said.

According to the memo, ''Further, shareholders who are used to seeing company recommendations may be confused by the lack of a recommendation, which may result in more no votes with regard to the frequency vote.''

Also, by now, companies should have reviewed their pay practices and eliminated any unjustifiable practices, the memo said. ''Companies should review records on prior shareholder votes and proxy advisory recommendations on equity plans and the reelection of compensation committee members to identify any potential problems for their say on pay votes,'' it said.

By Tina Chi

The Latham alert is available at http://www.lw.com/upload/pubContent/_pdf/pub3872_1.pdf.

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