SAY-ON-PAY PROMPTS YEAR-ROUND DIALOGUE

To obtain institutional shareholder feedback, synthesize opinions, and make any structural changes to your company's compensation plan, you now need a year-round communication strategy.

By Margo Vanover Porter

SAY-ON-PAY has turbocharged shareholder communications, says Ron Schneider, senior vice president, Phoenix Advisory Partners. "The heightened focus anticipating Say-on-Pay and the intelligence gained caused companies to really focus on how they disclose information, ensuring they tell a clear, understandable story to investors."

Stephen Brown, director, corporate governance and associate general counsel, TIAA-CREF, agrees. "This is a new environment, an environment where you want to connect with shareholders to understand what issues they have and also to help shareholders make a decision on how to vote," he explains. "What we have seen in the run-up to last year's proxy season was an increased effort by issuers to reach out to large institutional shareholders to review their comp program well before proxy season."

Traditionally, IROs tell their company's financial story to investors, points out Jim Kroll, senior consultant, Towers Watson. "Now, Say-on-Pay has heightened the awareness that companies have to tell the governance story. IROs are gathering an understanding of investor policies and views and explaining why a company's decisions are appropriate for the company in a way that investors can understand. There is a new engagement process around pay that I don't think existed five years ago."

What all of this means, executives agree, is that IROs now need a shareholder communication plan that spans the entire year. "Engagement is no longer episodic," Kroll says. "It's ongoing."

The need for continuous engagement becomes obvious, Schneider says, when you consider how long it takes to obtain feedback, synthesize opinions, and make structural changes.

"The best time for companies to get good intelligence on their investors' views is not after they voted against but before you decide what's going in your proxy next year and develop your compensation plan," he says.

"The best time to get good intelligence is when there's time to act on it. These things take time. If you are going to make any changes in your compensation practices that are disclosed in March or April, you need to know what the investor views are back in the fall, at the latest. That's year-round engagement."

Year-round communication also becomes essential from the point of view of institutional shareholders, Kroll adds. "Proxy advisors and institutional shareholders are now voting on thousands of companies looking at pay," he says. "They're not trying to say, 'We don't want to have dialogue,' but the logistics of having so many quality conversations in a small time is driving ongoing activity. The parties are saying, 'If we're going to talk to you, the best time is during the summer and fall.' It's creating an annual process. The engagement to address concerns has widened the calendar to a year-round event."

Sit Down Off-Cycle

For some companies, such as Cardinal Health, ongoing shareholder engagement isn't really a new requirement. "For the past four years, we have been reaching out twice a year to proxy voting officials at our top 25 shareholders," says Sally Curley, senior vice president, investor relations. "We conduct outreach in the spring, which is off-cycle since we are on a June fiscal year, to gather feedback on any upcoming key issues. Then we speak with constituents again in the fall.

"Because there are no proxy proposals on the table, these governance experts freely share their thoughts with us in a way that is different than if we were talking about a specific proxy filing and vote," she continues. "Both parties can be more open and candid about the issues. The conversations are very dynamic and help inform our May and August board meetings regarding governance plans."

When the preliminary proxy is filed in mid-September, Curley gets back in touch with proxy officials at the top 25 investors, using the record date as a guide to identifying that list of holders. Those ensuing conversations are targeted more specifically to the preliminary proxy filing. "While occasionally the investor base will change from spring to fall, the majority of investors remain the same," she says.

"Discussions around key topics – like Say-on-Pay and Say-When-on-Pay – just became part of the natural discussion that we would have on hot topics back in the spring. Those conversations were then aggregated and views developed, which were relayed back to our various board members."

She believes that IROs should schedule investor outreach well in advance of proxy season. "I would sit down off-cycle from your company's annual meeting," she advises. "Don't wait to start creating your plan for your shareholder meeting cycle until a few months before the meeting. You want to know ahead of time who your shareholders are, who the governance contacts are at those firms, and whether or not your investor contact within the firm wants to be involved. Some do and some don't, so it is best to be aware of any sensitivities."

Taking the Right Steps

The secret to successful governance outreach is also doing your homework, according to Towers Watson's Kroll. "Like anything in life, preparation is key. Many IROs are familiar with their investors, maybe from an investment style. From a governance perspective, not all IROs know the preferences of their shareholders, whether they follow very closely the policies of the proxy advisor or whether they have their own independent views on certain pay programs. That's a step in which IROs can play a role. You can find out their policies and hot buttons. Do your homework before any meeting or conference call."

You have to remember that institutional investors are covering hundreds of companies, says Kenneth Bertsch, president and chief executive officer, Society of Corporate Secretaries and Governance Professionals. "There is resistance by some investors to calls that begin 'Do you have any concerns about us?' It's better to have some perception of your vulnerabilities and then target the conversation to those issues."

TIAA-CREF's Brown cites the example of General Electric. "The executives at GE in governance have made a deep commitment to having robust discussions with shareholders. When they come into meetings, they have read our material. They have read our policy statement on corporate governance. Sometimes they come with pages dog-eared and paragraphs underlined. That's so helpful. They're not asking 'What's your policy on X?' They already know it. They've made the commitment to understand our policies so we can have a deep dialogue."

Executives agree that IROs can take a number of additional steps to improve year-round governance outreach:

Offer flexibility in scheduling. Recognize you are one company," Curley says. "Yes, they may be your largest shareholder and you may be an important company for them but on the governance side, they are voting on tens of thousands of proxies from all over the world. Be willing to work with them on timing of a conference call and be extremely efficient with your time. Most of the conversations we can now do in 15 to 20 minutes."

The Votes Are In – What Now?

FINALLY. THE SAY-ON-PAY VOTE IS FINISHED…AND YOU WON. "If you won your vote by 75 percent and above, you're in the sweet spot," says Stephen Brown, director, corporate governance and associate general counsel, TIAA-CREF.

What if your company garnered enough votes to pass—but less than 75 percent? "You should be concerned," he advises. "Just like those who failed their votes, you need to reach out and get a handle on the issues." He cites the example of a company that squeaked by on its vote and is now resting on its laurels, showing no commitment to going back out into the field to find out why a high percentage did not vote yes.

"I wouldn't recommend that strategy. This is a vote that, for the most part, happens every year. We don't know what the future holds, but just because you passed last year, doesn't mean you will pass next year—especially if you're in that gray zone."

If your company failed its Say-on-Pay vote, your job is pretty clear, says Ron Schneider, senior vice president, Phoenix Advisory Partners. "You probably know the reason driving most of the negative votes," he says. "If not, you can ask your larger investors what caused them to vote against. If you know what the issue is, you have the ability to either make changes or to more clearly explain why the current practices are appropriate for your company and deserve shareholder support."

Schneider recommends that companies with a large percentage of "no" votes take action—or else. "Those investors that voted against this year almost universally have flagged that company for greater scrutiny next year," Schneider says. "They will expect to see some changes addressing their concerns. They may even decide that `We're

She recalls a compliment from a very large shareholder during a recent phone conversation. The head of the proxy compliance department commented, "I will always take your call because I know you will cut to the chase right away and it will be a 10-to-15-minute conversation and I will get what I need."

Add an executive summary to your compensation discussion and analysis. "Companies are adding executive summaries to their CD&As to really help investors understand company programs and hopefully drive favorable Say-on-Pay outcomes," Kroll says. "Some companies are looking for more opportunities to add visual elements to improve the storytelling. Charts and graphs help break up the pages of text and make it more understandable. Most investors are not looking to vote against portfolio companies. IROs can help the company tell the story in a very concise way that helps the shareholder reach a favorable conclusion."

Keep legalese out of your proxy. "The principal way of communication is through the proxy statement," Bertsch says. "That core document has been too much under the control of lawyers writing a compliance document. You still need to meet the SEC requirements, but there is a big emphasis on making the proxy an effective communication document. In truth, in the U.S., that's where people look for information first."

Find out who voted no and why. "We take a no vote very seriously," Brown says. "Before we vote no, we want to make sure we've done a careful analysis and believe that management does not warrant support on this particular issue. The number-one issue is not having a rational link of pay for performance. The second part of that is actually showing us that compensation awarded to an executive is for his or her marginal effort. It's not simply riding an upside that has nothing to do with the effort of that executive."

Invite the right people to your party. Before you set up a governance road show, find out who from the institutional investor will be voting on Say-on-Pay and ensure those folks, as well as the equity analyst that covers your company, are invited to the meeting. "The analysts covering your company may or may not be the person who actually casts the votes," Brown says. "Part of having a good dialogue is making sure you have the right people in the room." From the company's side, he suggests the IRO, chief governance officer, and a senior executive in charge of compensation who can speak to the ins and outs of your comp plan.

Tim Smith, senior vice president and director of ESG shareowner engagement, Walden Asset Management, points out that Intel for years has been sponsoring successful road trips to cities such as Washington, DC, New York, and Boston to talk to interested investors about governance, environmental, and social issues. The agenda is one that investors create, along with the company. "We get to cover the issues we both think are important," Smith says. "It's a sign of respect by Intel that it wants to hear what investors think."

Consider sending a knowledgeable director on the road. "It can be most impressive when a director who is well versed with the plan joins these conversations and talks about how decisions were made," Brown says. "It's a great confidence build."

One company that used this strategy effectively, according to Smith, is Occidental Petroleum. After experiencing a "no" vote on Say-on-Pay, the company scheduled investor meetings in several cities, where the chair of the compensation committee listened to concerns and interpreted the company's action. The next vote was positive, Smith says, because the company took the investor vote seriously, engaged with shareowners, and made changes.

Get innovative with feedback. Smith gives high marks to the shareholder engagement efforts of Intel, which set up an electronic forum prior to the annual meeting where shareholders could post questions or comments. He also praises Prudential, which recently encouraged shareholders to write on the back of their proxy cards if they had any questions about Say-on-Pay or other issues—and received an enthusiastic response.

Adopt a positive attitude. "Speaking to your shareholders on a variety of issues is the way forward," Brown says. "A few companies view this as a nuisance or merely a compliance issue, thinking 'What do we have to do to win our vote? We'll figure it out just before our vote each spring.' Those companies are not embracing this in the right way. They are the ones that will have problems. Take a deep breath and embrace communication with shareholders as a meaningful way to create a long-term dialogue. Once you do that, the dialogues are easy." IRU

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not just going to vote against Say-on-Pay since it doesn't appear you have listened to our concerns. We're going to withhold votes from members of the compensation committee as well.'"

Tim Smith, senior vice president and director of ESG shareowner engagement, Walden Asset Management, concurs. "What is unacceptable is for shareowners to vote on Say-on-Pay, thus sending a message to a company, but that company either has its head in the sand or is unresponsive and decides not to make changes or engage investors. Say-on-Pay is a platform for feedback, but it's also a platform for change."