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EXECUTIVE COMPENSATION

Say-On-Pay Frequency: Is It as Easy as 1, 2, or 3?

Many public companies will be conducting a shareholder "say-on-frequency" vote in the upcoming 2017 proxy season. In evaluating which frequency to recommend to shareholders, boards will need to consider the views of their institutional shareholders, among other things.

By William M. Libit and Todd E. Freier

Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) requires, among other actions, that

> [n]ot less frequently than once every 6 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the [SEC] require compensation disclosure shall include a separate resolution subject to shareholder vote to determine whether [the say-on-pay vote] will occur every 1, 2, or 3 years.[1]

This shareholder vote is not binding on a company or its board of directors.[2] Since most public companies conducted their first so-called "say-on-pay frequency" shareholder vote in 2011, the upcoming 2017 proxy season will be the second time that such advisory vote will take place on the minimally required six-year voting cycle.

This article: (1) provides general background information regarding say-on-pay frequency, including arguments a board may consider when determining which say-on-pay frequency it should next recommend; (2) summarizes the current say-on-pay frequency policies and positions of several large asset managers and pension funds, leading proxy advisory firms and certain corporate governance advocates, to provide insight into the expectations of these entities with respect to say-on-pay frequency; and (3) presents practical considerations for boards to help facilitate discussion on the frequency with which say-on-pay is submitted to shareholder vote.

Background

Dodd-Frank requires that public companies offer their shareholders an advisory vote, at least once every six years, on whether shareholders should vote to approve the company's executive compensation (the so-called "say-on-pay" shareholder vote) once every year, every two or every three years.[3] In 2011 (the year of the first say-on-pay frequency votes), the following percentages of boards at Russell 3000 companies recommended these frequencies: annual—56 percent, biennial—2 percent, triennial—39 percent, and no recommendation—2 percent.[4]

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Despite those initial board recommendations and very likely in response to shareholder voting results on those 2011 say-on-pay frequency resolutions, a 2016 survey of Russell 3000 companies revealed that 82 percent of those companies currently provide their shareholders with an annual say-on-pay vote, while 1 percent and 17 percent provide such vote biennially and triennially, respectively.[5] Although annual advisory say-on-pay shareholder votes likely will continue to be the norm, it is anticipated that in the upcoming 2017 proxy season some boards again will make the case for either a biennial or a triennial frequency vote.

A recent survey reveals the following results with respect to certain investor and non-investor preferences regarding say-on-pay frequency:[6]

Say-On-Pay Frequency	Investor Respondents	Non-Investor Respondents
Annual	66 percent	42 percent
Biennial	11 percent	7 percent
Triennial	7 percent	19 percent
Depends on Company Factors	17 percent	31 percent

Arguments Supporting Frequency Options

Although most boards have had six years to evaluate whether the current frequency of their company's advisory say-on-pay shareholder vote satisfies the needs of the company and its shareholders, the following arguments may be considered in determining which vote frequency the board should next recommend.[7]

Positions of Institutional Investors, Proxy Advisory Firms, and Corporate Governance Advocates

There is no one-size-fits-all approach to corporate governance, including the frequency with which shareholders are permitted an advisory say-on-pay vote. The unique characteristics of the company, the complexity of the industry in which it operates, the needs of company stakeholders, including shareholders, and the adoption of corporate governance policies the company and its board feel are essential in generating long-term shareholder value should inform, in part, the frequency of such vote.

Annual Vote	Biennial or Triennial Vote
■ enhances transparency and gives shareholders a voice to express support or opposition to the company's executive compensation program every year	■ provides shareholders (retail and institutional) with a more realistic ability to analyze every company's executive compensation plan in their portfolios, as they may not have the resources to conduct an annual analysis
■ facilitates shareholder engagement and provides the board and compensation committee with closer to real-time and more direct feedback on the company's compensation practices	■ discourages shareholders' short-term thinking with respect to executive compensation
■ allows the board and compensation committee to receive annual shareholder validation of changes to executive pay (and not wait two or three years)	■ aligns more closely with the company's long-term award cycles and its long-term approach toward executive compensation
■ makes it easier for the board and compensation committee to analyze voting trends/shareholder views on the company's compensation program	■ allows shareholders to more carefully evaluate whether executive compensation was adequately linked to company performance and whether the compensation committee's intent in granting compensation, as disclosed in the company's proxy statement, is aligned with shareholder interests
■ lends itself to administrative and procedural consistency year to year and, therefore, is easier and more efficient than preparing for a vote once every two or three years	■ gives shareholders an opportunity to monitor and evaluate the effectiveness of significant changes to and the long-term components of the executive compensation program (which often require more than a single year to evaluate)

Continued

Annual Vote	Biennial or Triennial Vote
■ takes pressure off director elections, as shareholders may vote against the say-on-pay resolution instead of board or compensation committee members over perceived problematic executive pay practices	■ helps minimize the timing disconnect between compensation committee compensation determinations and the say-on-pay vote
■ eliminates the possibility of shareholder proposals for more frequent say-on-pay votes	■ avoids reactionary shareholder votes responding to short-term stock price drops or unusual company events
■ has become routine and adopted by a majority of Russell 3000 companies	■ may be preferred if the company already has a comprehensive shareholder engagement program in place
■ is preferred by a majority of institutional investors, proxy advisory firms and many corporate governance advocates (see discussion below)	■ is preferred by certain large institutional investors (see discussion below)

As boards evaluate which vote frequency is best for their company and shareholders, it may be helpful to understand the current frequency vote policies and positions of large institutional investors, leading proxy advisory firms and certain corporate governance advocates, as this provides insight into the general corresponding expectations of these entities. A select summary of those policies and positions is provided below.

Asset Managers

- *BlackRock, Inc.* generally opts for a triennial vote on say-on-pay (since shareholders should undertake an annual review of executive compensation and express their concerns through their vote on the members of the compensation committee) but may support an annual say-on-pay vote where, for example, it concludes that a company has failed to align pay with performance.[8]
- *State Street Global Advisors* believes that shareholders should have the opportunity to assess whether pay structures and levels are aligned with business performance on an annual basis.[9]
- *The Vanguard Group, Inc.* maintains that it is important for board members and management to regularly seek input from shareholders regarding compensation; to that end, annual advisory votes provide shareholders with a consistent channel through which to provide input on compensation decisions.[10]
- *American Century Investment Management, Inc.* generally supports the triennial option for the frequency of say-on-pay proposals but will consider management recommendations for an alternative approach.[11]

Pension Funds

- *California Public Employees' Retirement System* recommends that companies submit executive compensation policies to shareholders for non-binding approval on an annual basis.[12]
- *California State Teachers' Retirement System* asserts that an annual advisory vote on compensation should always be submitted for shareholder approval.[13]
- *New York State Common Retirement Fund* supports annual advisory votes on compensation with the view that it is the responsibility of an independent compensation committee to dispense executive compensation policies and practices focused on ensuring long-term sustained performance for the company and its shareholders.[14]
- *Colorado Public Employees' Retirement Association* strongly believes that compensation packages should be performance based and allow for an annual advisory shareholder vote.[15]

Proxy Advisory Firms

- *ISS* supports annual advisory votes on compensation, which provide the most consistent and clear communication channel for shareholder

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concerns about companies' executive pay programs.[16]

- *Glass, Lewis & Co., LLC* believes that (1) companies should submit say-on-pay votes to shareholders every year (since the time and financial burdens to a company with regard to an annual vote are relatively small and incremental and are outweighed by the benefits to shareholders through more frequent "accountability") and (2) implementing biennial or triennial votes on executive compensation limits shareholders' ability to hold the board accountable for its compensation practices through means other than voting against the compensation committee, and unless a company provides a compelling rationale or unique circumstances for say-on-pay votes less frequent than annually, will generally recommend that shareholders support annual votes on compensation.[17]

Corporate Governance Advocates

- *National Association of Corporate Directors* (advocating on behalf of directors), although it has not publicly disclosed a formal say-on-pay frequency policy, believes that executive compensation is an issue of particular concern for many shareholders and that the board and the compensation committee should consider ways for shareholders to communicate their views and concerns regarding executive compensation and should take these views and concerns into account, recognizing that ultimately the board as fiduciary must make compensation decisions.[18]
- *Council of Institutional Investors* (advocating on behalf of shareholders) asserts that all companies should provide annually for advisory shareholder votes on the compensation of senior executives.[19]
- *The Business Roundtable* (advocating on behalf of management) notes that shareholders should be able to determine whether, and how often, to hold advisory votes on executive compensation for their company; however, any federal mandate on say-on-pay should not require advisory votes any more frequently than every three years, as many company incentive plans are based on three-year performance periods, and requiring shareholders to evaluate such proposals on any more than an every-three-year basis would be extremely burdensome.[20]

Considerations for Boards of Directors

To facilitate discussion among board members as to whether the current frequency of their company's advisory say-on-pay shareholder vote satisfies the needs of the company and its shareholders and other stakeholders, and which vote frequency the board should next recommend, directors may consider the following.

Evaluate Effectiveness of Current Say-On-Pay Frequency Policy

Prior to a board of directors recommending a say-on-pay frequency policy in the company's 2017 proxy statement, the board and its compensation committee should evaluate the effectiveness of its current frequency policy. Such evaluation may include analyzing:

- shareholder voting results from the board's first say-on-pay frequency vote (presumably in 2011) and actual say-on-pay votes since 2011;
- feedback from shareholders and other stakeholders (e.g., employees, community leaders, regulators) over the past six years on the board's current frequency policy;
- input from the compensation committee as to whether the current frequency of shareholder feedback on its executive compensation program is valuable and meets its needs;
- arguments for and against keeping the current policy versus changing to a different frequency;
- the administrative aspects and efficiencies of the current frequency policy (versus having a different frequency); and
- the extent to which the current frequency policy has been formally adopted and integrated throughout the company's other corporate

governance policies and practices (e.g., the company's corporate governance guidelines, the compensation committee's charter or other internal corporate policies and procedures) and whether changes to the frequency policy will require formal amendments to such other policies and practices

Analyze Frequency Policies and Positions of Major Shareholders

The board should undertake an analysis of the frequency positions of its largest shareholders to determine what, if any, support and/or oppose the board's current frequency policy or would be amenable to a potentially different frequency should the board consider such a change.

Consider Shareholder and Other Stakeholder Engagement on Upcoming Frequency Recommendation

Regardless of whether the board will recommend the same or a different say-on-pay frequency, the board should be prepared to engage with major shareholders and other stakeholders to explain the board's rationale behind its recommendation. Such engagement is even more crucial if it is determined that the board's recommendation differs from those of its major shareholders. Since this advisory vote is mandated only once every six years, it is critical that companies obtain the necessary perspectives and issues or concerns of their stakeholders regarding say-on-pay frequency so that boards may make an informed frequency recommendation.

Benchmark Say-On-Pay Frequency

Companies should consider benchmarking their current and proposed say-on-pay frequencies against those of their peers and the industry in which they operate (as an outlier may become the target of activist shareholder campaigns or be identified by institutional investors as an organization with potentially problematic shareholder engagement and/or executive compensation practices). If a majority of peer companies' say-on-pay frequency policies differ from the company's current policy, the board should analyze the reasons behind this and determine whether a different frequency might be in the best interests of the board, the company and its shareholders as well as other stakeholders.

Report Shareholder Say-On-Pay Frequency Voting Results and Disclose Other Related Matters

Companies are required to report on Form 8-K (1) their say-on-pay frequency voting results (including the total number of votes cast in favor of holding a say-on-pay vote every year, every other year and every three years, in addition to abstentions) along with the results of other matters voted upon within four business days of their annual meetings of shareholders and (2) the company's decision in light of such vote as to how frequently the company will include an advisory say-on-pay shareholder vote in its proxy materials until the next required frequency vote. If that decision is not disclosed in the initial Form 8-K filing after the annual meeting, the Form 8-K is required to be amended to state the company's decision regarding the frequency of the say-on-pay vote.[21] Further, whenever a company is required to provide a shareholder vote pursuant to SEC Rule 14a-21 (e.g., a say-on-pay or say-on-pay frequency vote), the company also must disclose in its proxy statement (1) that it is providing such vote as required pursuant to Section 14A of the Exchange Act, (2) a brief explanation regarding the general effect of the vote (such as whether the vote is non-binding) and (3) when applicable, the current frequency of its say-on-pay vote and when the next such vote will occur.[22]

Think Ahead to 2023

Although 2023 is seemingly years away, boards and their compensation committees should memorialize the procedures and analysis undertaken this upcoming proxy season as part of their say-on-pay frequency evaluation and recommendation in order to streamline and make the undertaking more efficient for purposes of the next frequency vote (most likely in 2023). Consider formalizing that evaluation process

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(e.g., by way of written procedures or an internal memorandum) for future directors and compensation committee members. As a cautionary note, however, say-on-pay, say-on-pay frequency and other Dodd-Frank-related corporate governance mandates should be monitored over the ensuing months, as there has been discussion that legislation may amend or repeal Dodd-Frank in whole or in part.[23]

Notes

1. Section 14A(a)(2) of the Securities Exchange Act of 1934, as amended (Exchange Act). *See* also Securities and Exchange Commission ("SEC") Rule 14a-21(b), noting that companies are not required to use a specific form of say-on-pay frequency resolution in their proxy statements nor does it provide a nonexclusive example of such resolution (unlike the say-on-pay vote requirements in SEC Rule 14a-21(a)). A say-on-pay frequency resolution presented for shareholder vote may include language to the following effect:

   RESOLVED, that the shareholders of the Company indicate, by their vote on this resolution, whether the vote on the compensation of the Company's named executive officers, pursuant to Rule 14a-21(b) of the Exchange Act, should take place every one year, every two years or every three years.
2. Section 14A(c) of the Exchange Act.
3. Section 14A(a)(1) of the Exchange Act states that "[n]ot less frequently than once every 3 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the [SEC] require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the compensation of executives, as disclosed pursuant to [Item 402 of Regulation S-K], or any successor thereto," which such shareholder vote shall not be binding on the company or the board of directors. Instructions to SEC Rule 14a-21(a) note that the following is a non-exclusive example of a resolution that would satisfy the requirements of the advisory say-on-pay shareholder vote:

   RESOLVED, that the compensation paid to the Company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED.
4. *Executive Compensation 2011 Year in Review*, Frederic W. Cook & Co., Inc. (March 23, 2012).
5. *U.S. Executive Pay Shareholder Votes, 2015 Results for the Russell 3000*, Willis Towers Watson (February 2016).
6. *2016-2017 ISS Global Policy Survey, Summary of Results*, Institutional Shareholder Services Inc. ("ISS") (September 29, 2016). As used by ISS, "Investor Respondents" include such entities as institutional investors, asset managers and investor coalitions or consultants, "Non-Investor Respondents" include such entities as corporate issuers, board members and company consultants or advisers, and "Depends on Company Factors" include such factors as financial performance, the presence or absence of recent problematic pay practices and the level of shareholder support for recent say-on-pay votes.
7. Empirical evidence suggests that the say-on-pay frequency recommendation set forth by the board is associated with a 26 percent increase in shareholder voting support for that frequency, which is approximately the same percentage of influence attributed to proxy advisors' recommendations. *Management Influence on Investors: Evidence from Shareholder Votes on the Frequency of Say on Pay*, Fabrizio Ferri and David Oesch (July 10, 2015).
8. *Proxy Voting Guidelines for U.S. Securities*, BlackRock, Inc. (February 2015).
9. *Proxy Voting and Engagement Guidelines – United States*, State Street Global Advisors (March 2016).
10. *Our Governance and Executive Compensation Principles*, The Vanguard Group, Inc. (2016).
11. *Proxy Voting Policies*, American Century Investment Management, Inc. (2016).
12. *Global Governance Principles*, California Public Employees' Retirement System (March 14, 2016).
13. *Corporate Governance Principles*, California State Teachers' Retirement System (July 14, 2016).
14. *Proxy Voting Guidelines*, New York State Common Retirement Fund (January 2015).
15. *Proxy Voting Policy*, Colorado Public Employees' Retirement Association (March 21, 2014).

16. *United States Summary Proxy Voting Guidelines – 2016 Benchmark Policy Recommendations*, ISS (February 23, 2016). The *U.S., Canada and Latin America Proxy Voting Guidelines Updates (2017 Benchmark Policy Recommendations)* published by ISS on November 21, 2016 do not update or revise ISS's position regarding say-on-pay frequency.
17. *2017 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice (United States)*, Glass, Lewis & Co., LLC (November 18, 2016).
18. *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies*, National Association of Corporate Directors (September 1, 2011).
19. *Corporate Governance Policies*, Council of Institutional Investors (September 30, 2016).
20. *Letter to The Honorable Christopher J. Dodd, Chairman, United States Senate Committee on Banking, Housing and Urban Affairs*, Alexander M. Cutler, Chair, Corporate Leadership Initiative, The Business Roundtable (December 2, 2009).
21. SEC Form 8-K, Item 5.07 (Submission of Matters to a Vote of Security Holders).
22. SEC Schedule 14A, Item 24 (Shareholder Approval of Executive Compensation).
23. For example, *see* Section 443 of the Financial CHOICE Act of 2016, H.R. 5983, 114th Congress (introduced September 9, 2016) (which would amend Section 951 of Dodd-Frank to require an advisory say-on-pay vote only "each year in which there has been a material change to the compensation of executives of [a company] from the previous year").

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