

Good, Bad, or Indifferent? An Objective Look at Proxy Advisors

Compensation Committee Series Webinar
Presented by Pearl Meyer and NACD

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Meet the Presenters



Leah Rozin (moderator) is the senior manager of research at the National Association of Corporate Directors (NACD). Prior to joining NACD, she was vice president at ISS Corporate Solutions (ICS) working with corporate clients to help improve disclosure practices and understanding of the environmental and social landscape. Prior to ICS, Rozin worked with investor relations executives at the Corporate Executive Board.



Rainer Gawlick is a director with Protolabs, where he is a member of the audit committee and chair of the compensation committee. He is also on the boards of Progress, Meltwater, ChyronHego, and SingleDigits. For each company, he is either a member or the chair of the compensation committee. Rainer has held executive sales and marketing positions at a broad range of technology companies and served as a consultant with McKinsey & Company, advising clients in the electronics, telecommunications, and biotechnology and software sectors.



Terry Newth is a managing director in Pearl Meyer's Boston office. He consults on the design, development, and assessment of executive compensation programs that support each organization's business objectives, long term business strategy, and culture. His clients range from Fortune 500 organizations to pre-IPOs to private companies in a wide range of industries.

Submit a question and receive your answer directly from Pearl Meyer, either during today's webinar or as a follow-up. You will also be opted-in to receive future executive compensation thought leadership from Pearl Meyer.

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- Presentation slides are available today at www.pearlmeyer.com/proxy-advisors and within the webinar console.
- The replay will be available early next week at www.NACDOnline.org/webinars and www.pearlmeyer.com/proxy-advisors.

- Current environment surrounding compensation governance
- Evaluating when it's best to follow proxy advisors (or not)
- Strategies for engaging proxy advisors and key shareholders
- What private companies can take away from proxy advisor guidance
- Future predictions

Primer on Proxy Advisors



- Two primary firms for U.S. public companies
- Both provide broad corporate governance solutions for investment professionals (e.g., asset managers)
- Both develop research and recommendations on public company compensation programs to facilitate proxy voting decisions

	Institutional Shareholder Services (ISS)	Glass Lewis & Co.
Global Coverage	44,000 meetings annually	20,000 meetings annually
Clients	2,000	1,300
Employees	1,800	360

Source: company websites

Proxy Advisor Sphere of Influence

- Proxy advisors generally have influence over the following key areas

Say-on-Pay

- Pay and performance alignment
- Compensation design
- Compensation decisions

Equity Plan Requests

- Size of new share authorization and impact on share / economic dilution
- Equity plan practices
- Equity plan features

Compensation Governance Scores

- Some overlaps with say-on-pay and equity plan request areas
- Also includes compensation risk, disclosure practices, and other areas
- For ISS, this is known as the QualityScore

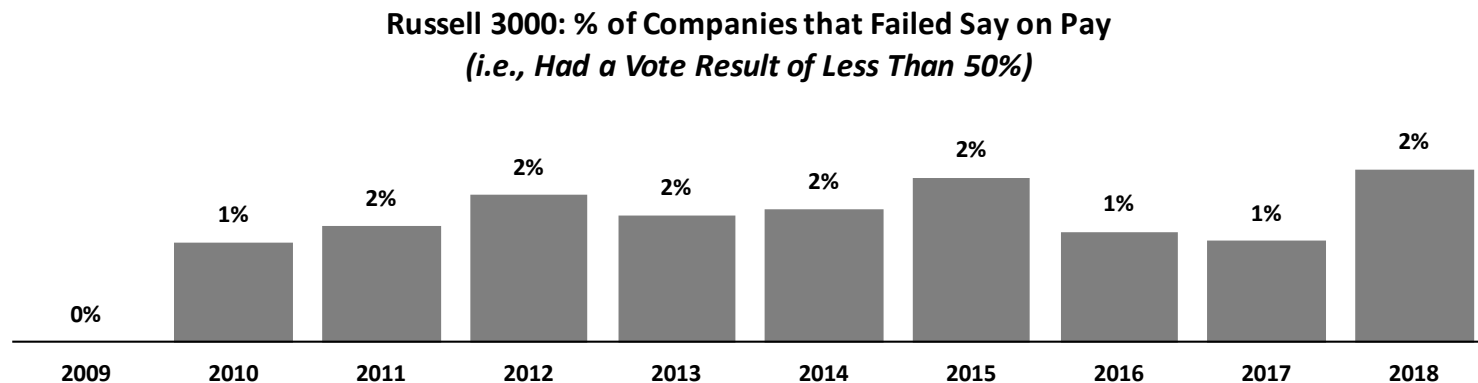
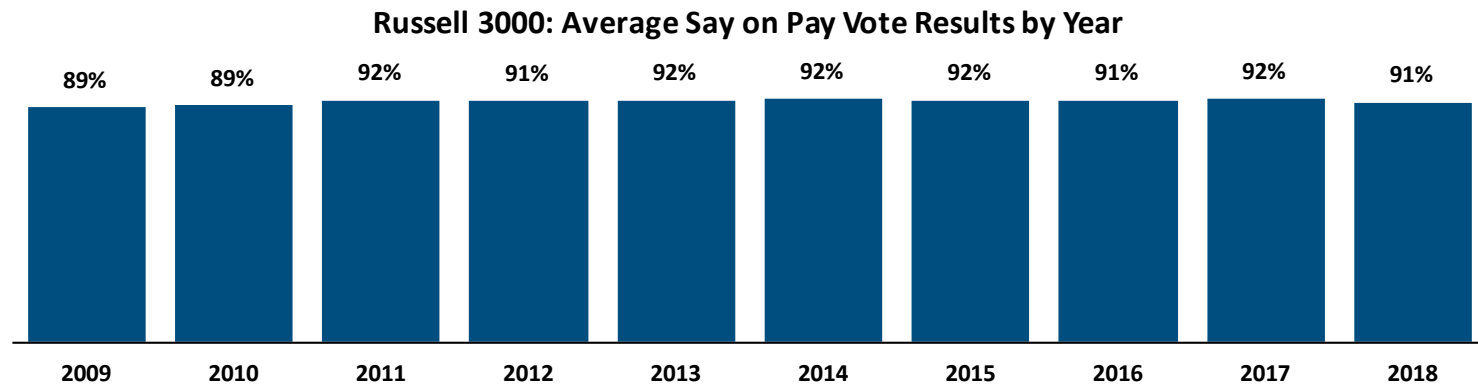
[NEW] Director Compensation

- ISS only at this point
- Looks at pay magnitude – targeting top 2-3% of comparable companies
- Issue if company is an outlier with no compelling rationale

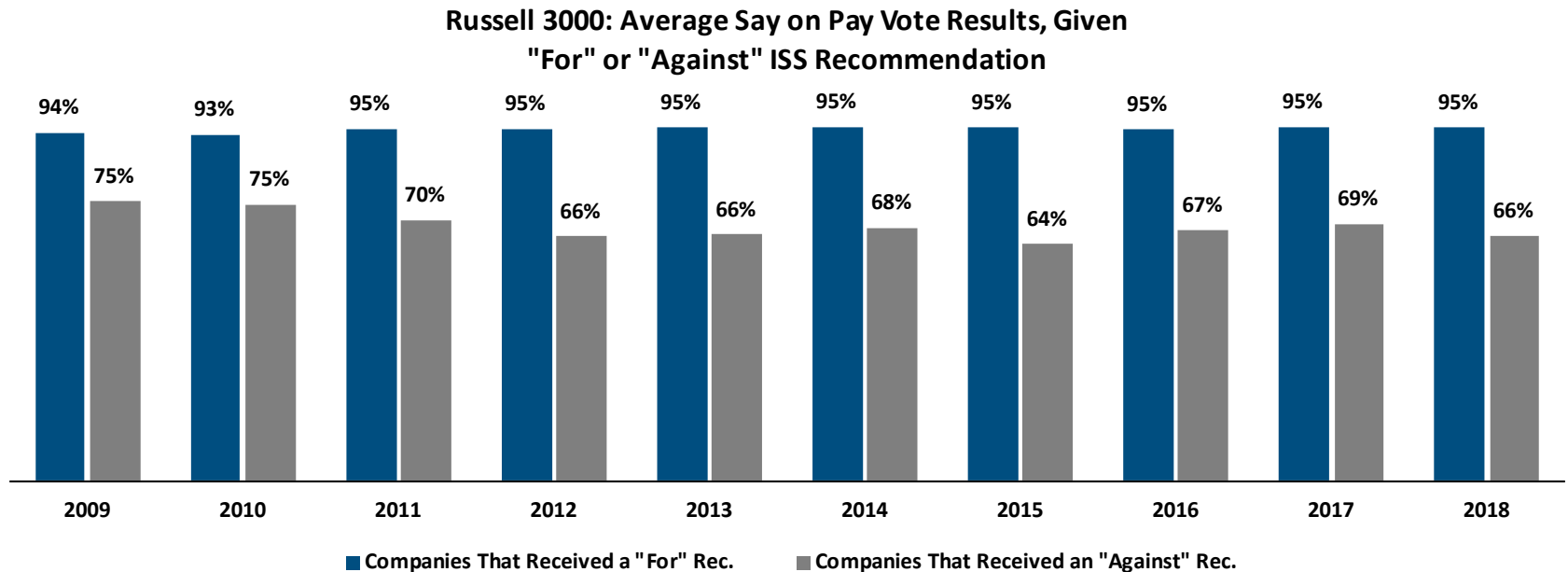
Shareholder Support Say-on-Pay



- Investor support for U.S. pay programs is overwhelmingly positive...



- ...but proxy advisors do carry weight in investor voting on pay

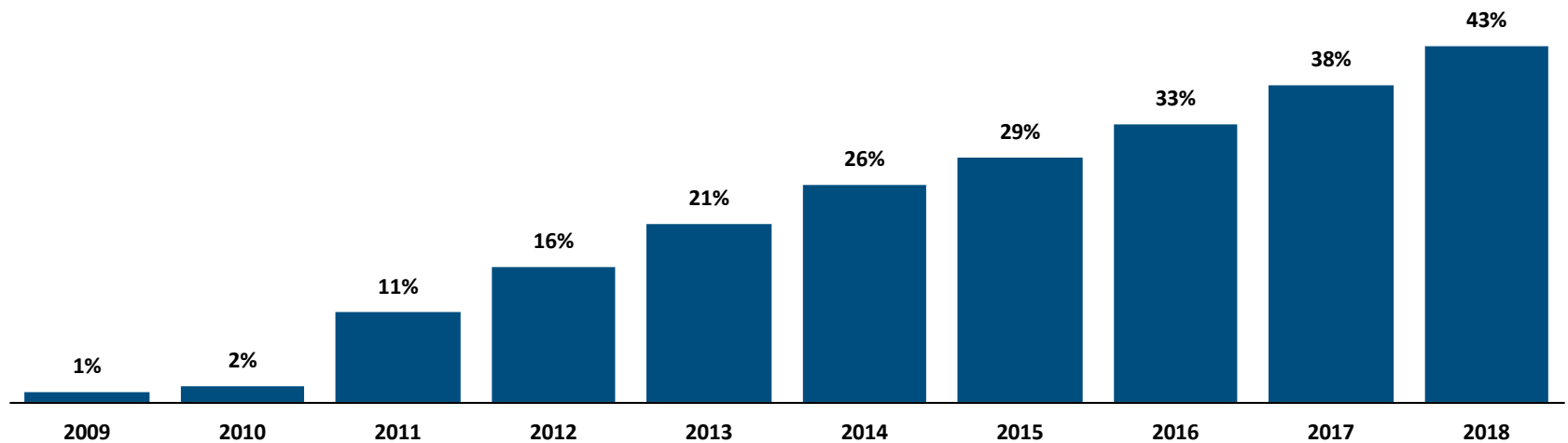


Proxy Advisor Adverse Vote Recommendations



- Each year the list of companies that receive an adverse vote recommendation for say-on-pay from ISS grows

% of Russell 3000 Companies with at Least One ISS "Against" Vote Recommendation Since 2009

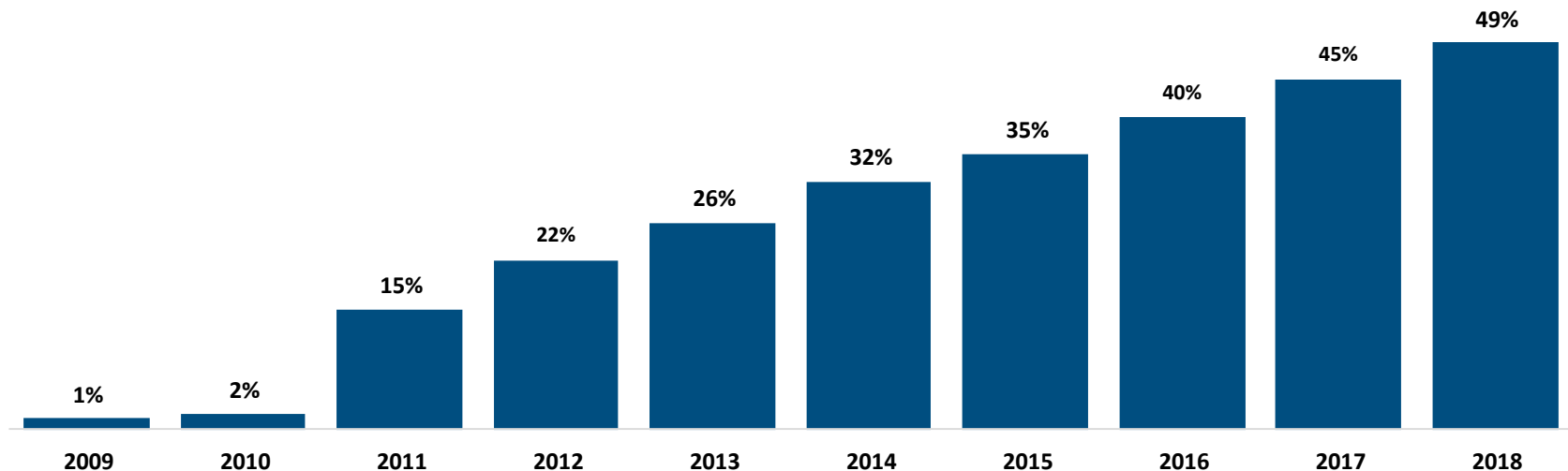


Proxy Advisor Adverse Vote Recommendations (cont.)



- If we use <85% as a proxy for a negative SOP vote recommendation from one of the major proxy advisors, the results grow to ~50%

% of Russell 3000 Companies with at Least One Say-on-Pay Vote Result of <85% Support Since 2009



- A “conformity trap” is one of the unintended consequences of companies reacting to their influence

Areas of Conformity

- Peer group development
- Pay levels (regression to the median)
- Pay elements (e.g., elimination of perquisites)
- Plan / contract provisions (e.g., double trigger on equity)
- Incentive leverage
- Incentive metric groupings (e.g., earnings)

Areas of Differentiation

- Long-term incentive mix
- Explicit incentive metrics (e.g., EPS vs. net income vs. EBIT)

Polling Question 1

Q: In your experience, in which of the following areas are proxy advisors' decisions *most* influential?

1. *Say-on-Pay*
2. *Equity Plans*
3. *Director Compensation*
4. *None of the above*
5. *Don't Know / Unsure*

Evaluating Proxy Advisory Influence for your Company

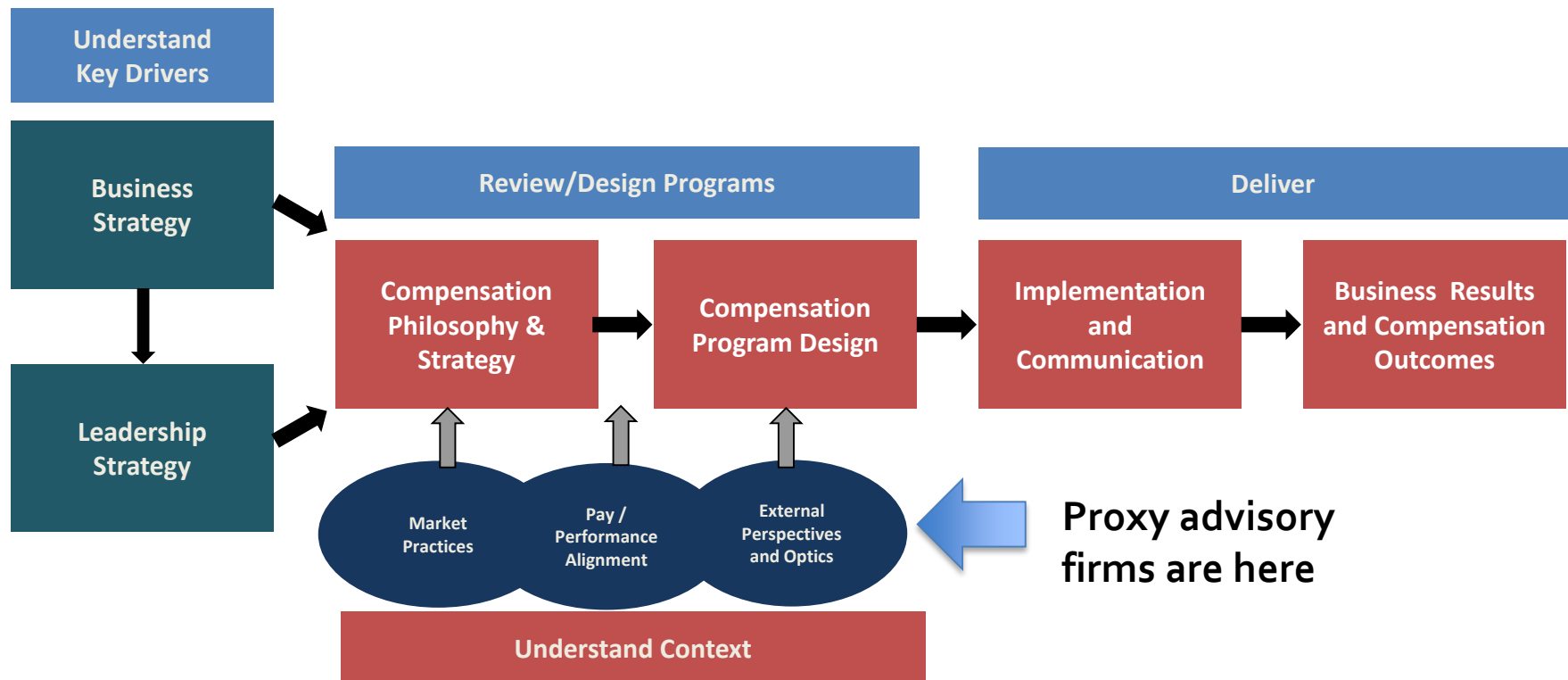


- Public companies should understand and align on the proxy advisors influence on compensation decisions based on a set of factors

Internal	External
<ul style="list-style-type: none">• Company profile• Business / leadership strategy• Performance• Say-on-pay vote history• Governance risk tolerance	<ul style="list-style-type: none">• Shareholder profile• Shareholder relationships• Recent proxy advisor reports• Policy overlap• “Hot button” or not

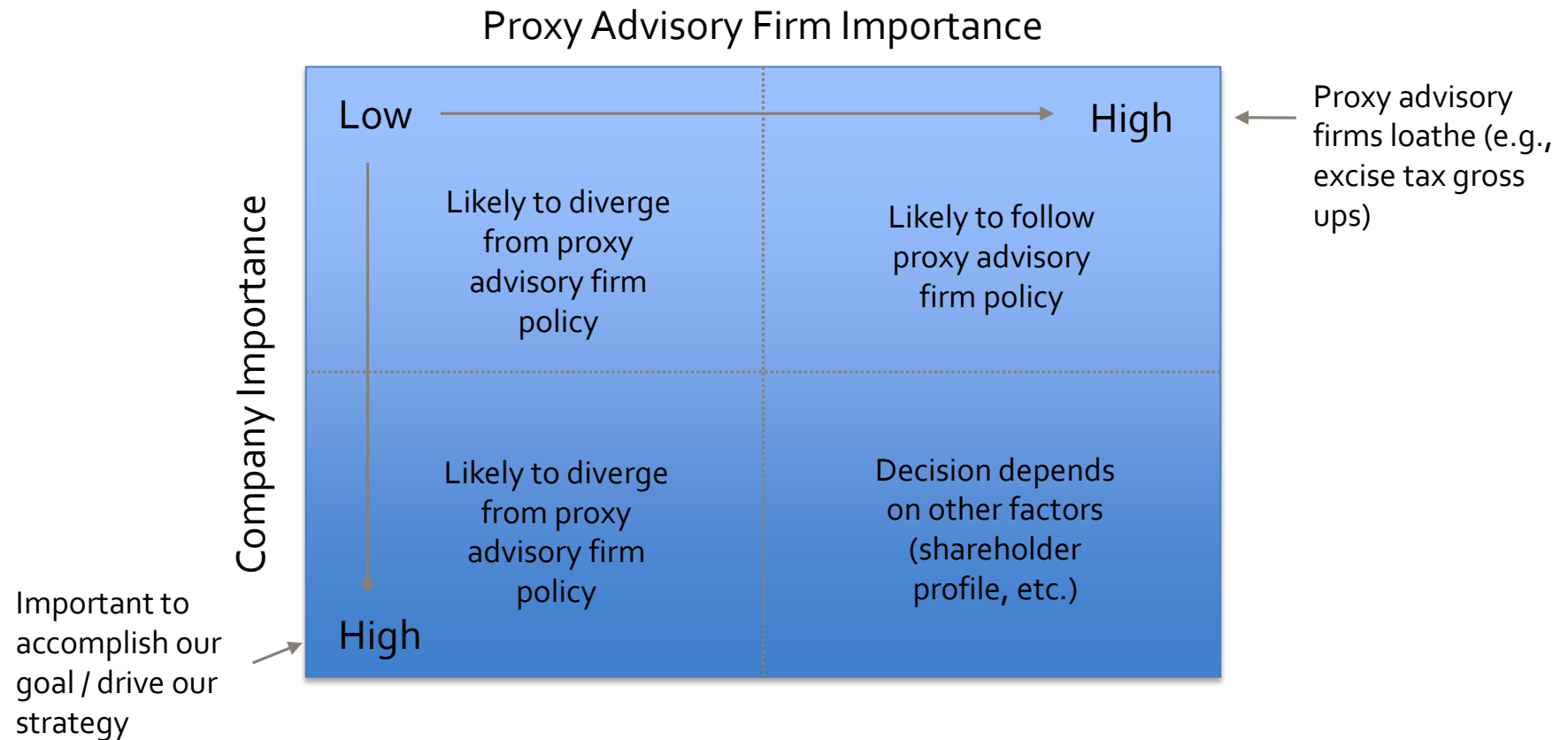
Compensation Drivers

- Optimally, proxy advisory firm views will help inform decisions, but business and leadership strategy will drive the process



Topic Importance

- Understanding the relative importance of an action to both the proxy advisory firms and the company is also critical



List of Hot Button Issues for Proxy Advisors

- Below is a list of some (not all) proxy advisor hot button topics

Generally Avoid	Be Careful
<ul style="list-style-type: none">• Excise tax gross ups• Evergreen share replenishments• Excessive severance protection• Excessive perquisites• Guaranteed bonuses for multiple yrs.• Resetting incentive goals• Non-responsiveness to a poor say-on-pay vote outcome	<ul style="list-style-type: none">• Above market compensation without link to performance• Targeting above median• Discretionary payments• Short-term performance period for long-term incentives• Duplicate metrics in incentive plans

Shareholder Profile (Say-on-Pay)

- Understanding your shareholder profile is helpful in understanding the influence a proxy advisory firm has on the vote



Investor	Shares Held	% Common Shares	Aggregate "For" Say on Pay Votes	Proxy Advisor Influence	
				ISS "Against" Match	GL "Against" Match
Wellington Management	6,252,699	13.62%	92.9%	30.1%	44.2%
Vanguard Group	4,036,437	8.79%	93.6%	38.3%	26.9%
BlackRock	3,208,945	6.99%	91.8%	39.5%	31.6%
The Hartford Mutual Funds	2,697,905	5.88%	89.4%	33.3%	94.1%
BNY Mellon	1,466,119	3.19%	59.2%	87.2%	63.9%
Waddell & Reed Investment Mgmt	1,452,848	3.16%	98.2%	9.1%	8.8%
Jennison Associates	1,183,461	2.58%	88.9%	32.1%	74.6%
Invesco Advisers	1,098,307	2.39%	86.3%	72.0%	46.9%
Fidelity Management and Research	978,953	2.13%	93.9%	30.1%	24.0%
State Street	893,614	1.95%	86.9%	48.1%	31.2%

SAMPLE

Source: Proxy Insight

Policy Overlaps

- Developing a matrix of the overlap between proxy advisor policy view and your shareholder policy views will help in understanding traps

	Wellington Management	Vanguard Group	BlackRock	The Hartford Mutual Funds	BNY Mellon	Waddell & Reed Investment Mgmt	Fidelity Management and Research	State Street
Institutional Shareholder Services (ISS)								
Above-median benchmarking		X	X					
Guaranteed bonuses	X					X		X
Significant retention awards			X		X			
Equity-based vesting upon CIC				X				
Gross-ups for CIC payments	X		X	X	X		X	
Liberal CIC definition and vesting risk		X						
Excessive Dilution		X	X					X
Evergreen Share Replenishment	X			X	X	X	X	X

ILLUSTRATIVE

- A company's ability to ignore proxy advisory firm policies depends on their facts and circumstances



Polling Question 2



Q: How frequently does your company engage on compensation issues with proxy advisors?

1. *Frequently*
2. *At times*
3. *Not at all*
4. *N/A*

- Both ISS and GL have engagement protocols
- Engaging with them can be helpful to:
 - Hear policy details and views straight from the horses mouth
 - Communicate the rationale for your program
 - Avoid misunderstanding
- Tips for engagement
 - Plan ahead, they don't always take meetings depending on the time
 - Recognize that this does not replace having to disclose the program, decision, etc.
 - Recognize that a positive meeting does not mean a positive vote recommendation
 - Keep it to the important items you want to convey
- In certain cases, companies can purchase subscriptions to their services as well, giving the company access to their tools and advisors

Polling Question 3

Q: How frequently does your company engage on compensation issues with shareholders?

1. *Frequently*
2. *At times*
3. *Not at all*
4. *N/A*

- **Define the outreach team and their associated roles**
 - Could be HR, Legal, IR, Finance, external advisors, BoD
- **Define the scope of the outreach**
 - Who the company would like to reach out to
 - What the purpose of the outreach should be (i.e., just compensation, governance, etc.)
- **Understand your stockholder voting guidelines before engaging**
- **Develop materials to serve as a conversation starter**
 - Keep to publicly-available information to avoid disclosure of material non-public info
 - Cover background on the company, key highlights of the program, policies, decisions, etc.
- **Disclose your outreach and engagement efforts**
 - Disclose the summary points of your outreach efforts in your next proxy

- Be prepared! Proxy advisory have no influence now, but could in the future if there is an IPO exit
- Proxy advisory firm policies can be a useful way to understand compensation practices or decisions that may be irritating to shareholders
- Developing a point of view on why your company does not follow certain policies can be a helpful exercise
- Engagement with important shareholders on compensation related matters can be helpful to overall good governance and relations

- Proxy advisors will continue to expand their sphere of influence
- SEC oversight of proxy advisors likely given current influence trajectory, leading to:
 - More complex (but transparent) policies
 - Vote recommendations becoming more quantitative, with less discretion
 - More time for companies to review draft reports
- Institutional investors will also increase the complexity of their policies
- Each year companies will inch towards alignment with proxy advisor policies
- European governance model (binding SOP) will be evaluated

Q&A

You can submit a question in the top-right corner of your webinar console.

Additional Reading

- <https://www.pearlmeyer.com/knowledge-share/article/ten-years-of-say-on-pay-data-show-your-against-vote-is-coming>
- <https://www.pearlmeyer.com/knowledge-share/article/escaping-the-conformity-trap-aligning-executive-pay-programs>
- https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf
- <https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf>
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