Say on Pay

Navigating the Frequency of Say-on-Pay Voting

By Michael Powers and Jeff Keckley

This year marks the sixth year in the United States of say on pay, the rule that allows shareholders to cast non-binding votes that voice their approval—or disapproval—of a company's executive compensation programs. Shareholders cast votes based on the perceived degree of alignment between executive pay and company performance, and achieving a high level of support from investors continues to be a top priority for boards and management.

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires most public companies to hold an advisory vote on the compensation of top executives. Companies subject to say-on-pay rules are also required to hold a vote to determine the frequency of say-on-pay voting. Companies have proposed an annual, biennial, an triennial say-on-pay voting cycle, and shareholders opined through another non-binding vote.

When say-on-pay voting was introduced in 2011, annual voting was the norm, with well over 90 percent of the S&P 500 opting to put executive pay progams to a shareholder vote every year. This remains the predominant practice. However, Dodd-Frank requires companies to hold a vote no less than once every six years to determine if a say-on-pay vote will take place every one, two, or three years. Since the majority of companies held their vote on frequency in 2011, they will need to conduct another vote next year.

Is holding an annual say-on-pay vote appropriate? Should companies consider holding a vote on a biennial or triennial basis? Boards will need to weigh the advantages and disadvantages of holding a say-on-pay vote less frequently, and determine if a less frequent vote would be beneficial for the company and its investors.

The answer will vary by company, but boards should at least consider holding say-on-pay voting less frequently. To date, over three-fourths of S&P 500 companies that put say on pay to a vote in 2016 garnered support in excess of 90 percent for their executive compensation programs. Say-on-pay voting requires the company to draft additional communications and solicit shareholder feedback, in addition to administrative burdens, all of which can be lessened with triennial voting. And for companies with overwhelming say-on-pay support and an established process for shareholder engagement, a shift away from annual votes to a more in-depth review every three years may be welcomed by investors.

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Although most institutional investors disclose a preference for annual say-on-pay voting in their proxy voting guidelines, this is not a universal stance. For example, BlackRock supports triennial say-on-pay voting and acknowledges in its current proxy voting guidelines that annual votes are not necessary since a vote on compensation committee members essentially serves the same purpose. In addition, annual voting results may be misleading since the subsequent year's compensation plans are most likely established before the current year's vote is tallied. Therefore, companies often can't implement significant changes as a result of low say-on-pay support until the following fiscal year.

Boards should also weigh the potential disadvantages of a biennial or triennial vote. Proxy advisory firms such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co. recommend an annual say-on-pay vote, proclaiming that annual voting provides a consistent communication channel for shareholders.

In the absence of a say-on-pay vote, ISS may target directors to voice disapproval of the executive compensation program. In instances where ISS would recommend a "no" vote on say-on-pay but a vote is not held, ISS's policy is to recommend a vote "against" or "withhold" from members of the compensation committee. In addition, a biennial or triennial vote may result in greater scrutiny if investors are dissatisfied with aspects of the pay program and have fewer opportunities to voice concerns.

The conclusion may be to stay the course with an annual say-on-pay vote, but boards should consider the alternatives as the opportunity to propose a change that may not present itself for another six years.

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