Top 10 Topics for Directors in 2015: Executive Compensation

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- *Proxy Advisory Firm Recommendations*. Proxy advisory firms can be a key driver of the outcome of a vote on say-on-pay or an equity plan proposal. Companies need to analyze their shareholder base to determine the level of influence proxy advisors have on their investors. If a proxy advisory firm gives a negative recommendation on a proposal, companies need to consider whether they want to refute the recommendation through supplemental proxy filings or direct engagement with major shareholders.

  In a move that should increase the accuracy of ISS' analysis of equity compensation plan proposals, companies now have an opportunity to review and verify key data points that ISS uses to evaluate a company's equity plan proposal and to formulate its voting recommendation on such plan. ISS' new Equity Plan Data Verification portal gives companies approximately two business days after the data has been posted to review the data and request modifications.[ii]

  Companies also need to stay abreast of changes in the voting recommendation policies of proxy advisory firms. For 2015, when evaluating equity compensation plans, ISS will use a new "balanced scorecard" model, incorporating a range of positive and negative factors relating to the cost of the plan, plan features and the company's historical grant practices, which factors will be weighted based on company size and status. Currently, ISS applies a series of standalone pass/fail tests focused on cost and certain egregious practices to determine an "against" recommendation.[iii]

- *Shareholder Outreach*. Shareholder outreach is an effective way for companies to learn about and address shareholder concerns and lessen proxy advisory firm influence on investors. Whether this engagement should involve a company's management or its directors is debatable. According to a recent survey, 73 percent of directors believe it is at least "somewhat appropriate" for the board to engage in executive compensation discussions with shareholders, while the remaining 27 percent believe it is "not appropriate."[iv]

- *Pending Dodd-Frank Regulations.*Much to the delight of companies, the SEC continues to lag in its rulemaking on several provisions required by the Dodd-Frank Act. While there were rumors that the SEC was pushing to deliver certain final and proposed rules by the end of October 2014, that deadline has come and gone and the SEC is now targeting a deadline of October 2015. In any event, companies should be planning how they will implement and comply with the new rules once adopted.

- *Pay disparity disclosures*. In September 2013, the SEC proposed rules that would require public companies to disclose the ratio of a CEO's annual total compensation and the median total annual compensation of all other employees of the company (including part-time, seasonal, temporary and foreign employees).[v] The proposed rule provides companies with flexibility in determining the median compensation for employees by permitting the use of statistical sampling in order to ease the compliance burden. With CEOs making on average over 331 times the average worker's salary, it is not surprising that this proposal has sparked quite a bit of controversy.[vi] The SEC has received more than 128,000 public comment letters on this proposal.[vii] Detractors question the rule's utility and bemoan anticipated compliance burdens while proponents tout the rule as providing meaningful information to shareholders. Whenever final rules are adopted, the SEC will allow companies some transition time to figure out how they will comply. Some companies, however, are being proactive. According to a recent survey, 33 percent of director respondents reported that their boards have already taken steps to comply with the looming disclosures.[viii]

- Pay for performance. Another contentious provision in the Dodd-Frank Act calls for companies to disclose in their annual proxy statements the relationship between executive compensation and the company's financial performance. Although the SEC has yet to propose rules on this topic, most companies are paying closer attention to pay for performance alignment. According to a recent survey, 60 percent of companies have conducted a pay-for-performance analysis comparing the company's performance and executive pay with those of its peers in the marketplace.[ix] Only one third of such companies, however, disclosed the findings of their analysis, as most other companies said they were waiting for SEC rules to be issued.[x]

- Clawbacks. The Dodd-Frank Act also calls for the SEC and stock exchanges to implement rules requiring companies to develop and disclose clawback policies for the recovery of incentive-based compensation granted to any current or former executive officer during the three-year period preceding an accounting restatement that is based on erroneous data corrected in the restatement. The language in the statute is broader than the clawback provisions in the Sarbanes-Oxley Act, which apply only to the CEO and CFO, have only a one-year look-back and require misconduct. While some companies are sitting on the fence waiting to see what the new rules look like before adopting a policy, more and more companies are going ahead and adopting some form of clawback policy to appease investors and proxy advisory firms, which favor clawback policies.

This post was excerpted from our annual Top 10 Topics for Directors in 2015 alert. To read the full alert, please click here.

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[i] Farient Advisors, "Proxy Season 2014: A Mid-Year Look at What's Hot and What's Not," (July 14, 2014).

[ii] See ISS Equity Plan Data Verification for U.S. Companies, located here; and ISS Equity Plan Data Verification FAQs, located here.

[iii] ISS United States Proxy Voting Guideline Updates 2015 Benchmark Policy Recommendations (Nov. 6, 2014).

[iv] PwC's 2014 Annual Corporate Directors Survey, at p. 46.

[v] Pay Ratio Disclosure Proposed Rule, SEC Release Nos. 33-9452; 34-70443 (Sept. 18, 2013) located here.

[vi] Kathryn Dill, "Report: CEOs Earn 331 Times as Much as Average Workers, 774 Times as Much as Minimum Wage Earners," *Forbes* (April 15, 2014).

[vii] Barry B. Burr, "SEC Eyes Adopting CEO Pay Ratio Rules," Pensions and Investments (Aug. 1, 2014).

[viii] 2014 BDO Board Survey (Sept. 2014), at p. 5.

[ix] Towers Watson, "Many U.S. Companies Performed Executive Pay-for-Performance Analyses but Did Not Disclose in 2014 Proxies, Towers Watson Survey Finds," (Oct. 30, 2014).

[x] *Id.*

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