Business View

Annual Say on Pay misses the mark

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Late last month the SEC issued its final Say on Pay and Say on Frequency rules, a result of the Dodd-Frank Act. The rules currently apply to all public companies with market caps of over $75 million. The requirement is that the separate Say on Frequency vote is to determine whether subsequent Say on Pay votes will be held annually or instead at intervals of two or three years. All votes are non-binding.

It is not clear what a "no" vote on Say on Pay will mean. Do shareholders voting no think the CEO is paid too much either in relationship to the company's performance or to his or her peers? Do shareholders think the relationship between short-term and long-term pay is inappropriate? It is also unclear what a "yes" vote means. How should the company that gets 55 percent in favor react?

Some boards have recommended a vote for every year. At Agilent Technologies, the company believes that "an annual vote allows our shareholders to provide us with regular and comprehensive input on important issues such as our executive compensation program and practices as disclosed in the company's proxy statement."

But with respect to frequency, a number of companies have come out with sound reasons for a vote every three years. At a number of companies, a substantial portion of the compensation of the named executive officers is based on the company's performance over a three-year performance measurement period. Because compensation plans are long-term in nature, an annual vote, in many cases, does not make much sense. And, to be realistic, annual meetings are generally held several months after the close of the fiscal year. The compensation plan for the current year has been set long before the vote and its disclosure. If there is a negative vote, the board needs time to understand shareholders' concerns and to deliberate on appropriate responses.

Yet, late last month, a total of 39 institutional investors, representing more than $830 billion in assets, issued a public call for companies to support an annual advisory vote on executive compensation in their spring proxy voting. While a board may not agree with the "one-size-fits-all" approach, board members do not want to be embarrassed by a negative shareholder vote. So, we will probably see a movement toward annual votes, forcing yet another dangerous short-term focus.

Rather than taking the easy way out and recommending annual votes, company leaders need to meet with shareholders not only to listen to their concerns but also to explain the company's thinking with respect to executive compensation. It is essential that more direct and regular ongoing communication with shareholders take place.

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