

## FACT SHEET: Administration's Regulatory Reform Agenda Moves Forward Say-On-Pay

Today, as part of its push for comprehensive regulatory reform, Treasury delivered draft "say-on-pay" legislation to Congress that would require all publicly traded companies to give shareholders a non-binding vote on executive compensation packages. Say-on-pay legislation – which was co-sponsored by then-Senator Obama in 2007 and also passed the House that year – would encourage greater accountability and better disclosure in setting compensation. The Administration is eager to support Chairman Dodd and Chairman Frank – both long-time advocates for say-on-pay – as they begin consideration of this legislation, which would:

- **Require a non-binding annual shareholder vote on compensation for all public companies.** All public companies will be required to include a non-binding shareholder vote on executive compensation as disclosed in the proxy for any annual meeting held after December 15, 2009.
  - ***Compensation subject to the vote includes pay packages for senior executive officers.*** The disclosures that would be subject to the say-on-pay vote include tables summarizing salary, bonuses, stock and option awards and total compensation for senior executive officers, as well as summaries of golden parachute and pension compensation and a narrative explanation of the board's compensation decisions.
  - ***This proposal is similar to say-on-pay rules that have found success in Britain.*** The legislation delivered today requires votes similar to those mandated in Britain since 2002. According to Yale corporate governance expert Stephen Davis, "A surprisingly broad consensus of corporate directors, shareholders and government in Britain sees 'say on pay' acting as a driver of corporate value, making public corporations more competitive and, by raising confidence in governance integrity, lowering risks for investors."<sup>1</sup>
- **Mandate a separate vote on golden parachutes in the case of a merger or acquisition, with a clear and simple disclosure of the amounts executives will receive.** While golden parachutes are meant to align the interests of executives and shareholders in the event of a merger, managers may still be able to use their leverage to re-negotiate a larger payout – with one NYU study finding that 27 percent of target CEOs received special cash payments newly granted at the time of the merger.<sup>2</sup> By providing for a separate vote on golden parachutes, this legislation would allow shareholders to vote on any payments to executives, while requiring companies to disclose, in a clear and simple format, the exact amounts senior executive officers will receive if the merger occurs – amounts that often aren't clear in earlier disclosures that go before a vote.

### **Say-on-pay: The U.K. Experience**

In 2002, the United Kingdom adopted the Directors' Remuneration Report Regulations, which mandated an annual non-binding vote on pay. Since the U.K. adopted say-on-pay, similar policies have been instituted in the Australia, Sweden, Norway, and the Netherlands.<sup>3</sup>

- **Say-on-pay in the U.K. has led to substantially increased dialogue between firms and shareholders on compensation.** A 2004 Deloitte survey of U.K. shareholders found that active consultation increased for 93% of respondents (with 60% reporting it increased "to a large extent") after the enactment of say-on-pay. In addition, a major pension fund association, after recording on average 20 outreach efforts per year prior to say-on-pay, engaged in 150 instances of

such dialogue in 2005 and 130 in 2006.<sup>4</sup> Such dialogue has been accompanied by flurries of activity both by boards and by shareholder groups to improve compensation practices. For boards, Yale's Stephen Davis has noted that "pay panels now meet more frequently; engage in design-stage consultation; ... utilize more information; and hire independent outside advice."<sup>5</sup> Moreover, shareholder groups such as the Association of British Insurers and the National Association of Pension Funds have developed detailed compensation guidelines that improve practices and systematize the consultation process.<sup>6</sup>

- ***This increased dialogue has led directly to a modification of compensation practices.*** The most notable example of such changes occurred with GlaxoSmithKline, which acknowledged it "instigated a major shift" in its compensation policies in response to a negative vote.<sup>7</sup> But a negative vote is not needed to create changes – the consultation process and the threat of a negative vote are often sufficient to affect the behavior of management and boards. Indeed, a study by Fabrizio Ferri and David Maber at Harvard Business School lists numerous examples in which companies noted in their annual reports how the consultation arising from say-on-pay led them to modify certain compensation practices.<sup>8</sup>
- ***The awareness of a potential "no" vote and the subsequent change in practices has led to an empirically-verified tightening of the link between pay and performance.*** Several studies analyzing say-on-pay in the United Kingdom have concluded that it has improved the link between pay and performance. The Ferri and Maber study found that, after controlling for firm performance, size and other factors, CEO pay was significantly more sensitive to poor performance after 2002.<sup>9</sup> The increased sensitivity was especially pronounced for firms receiving substantial voting opposition. Another study by Kym Sheehan of the University of Sydney concluded after empirical analysis that "outrage via the advisory vote is having an effect on remuneration practice."<sup>10</sup> Finally, Mary Ellen Carter and Valentina Zamora at Boston College found "some evidence that boards selectively respond to negative votes by curbing excess salary and dilution of stock option grants as well as improving pay-performance links."<sup>11</sup>
- ***The U.K. experience has not borne out many of the fears raised by critics of say-on-pay.*** Despite concerns that say-on-pay would lead to investor uprisings, negative votes have been rare and shareholders have generally exercised restraint. One prominent shareholder service firm, for example, urged "no" votes at less than 13% of 1,817 annual meetings.<sup>12</sup> Likewise, contrary to worries that say-on-pay will encourage "capital flight," public authorities and the London Stock Exchange have touted say-on-pay for providing London with a competitive edge in attracting capital with "better planning by corporations, fewer surprises, [and] better dialogue with investors."<sup>13</sup> Finally, despite criticism that say-on-pay would lead to cryptic, unexplainable "no" votes that would not help boards fix compensation practices, where significant displeasure is noted, firms in the U.K. have reached out to large shareholders or used media and other means to determine what needs to be addressed.<sup>14</sup>

### **Say-on-pay: The U.S. Experience**

While shareholder interest in say-on-pay has increased significantly and some U.S. companies have adopted it, other companies have declined to permit shareholders to vote on executive pay, even when shareholders have voted to ask the company for that right:

- ***Some companies have chosen to institute say-on-pay voluntarily.*** In 2007, Aflac became the first publicly traded company to adopt say-on-pay. As Aflac CEO Daniel Amos explained his decision, "Our shareholders, as owners of the company, have the right to know how executive

compensation works...An advisory vote on our compensation report is a helpful avenue for our shareholders to provide feedback on our pay-for-performance compensation philosophy and pay package."<sup>15</sup> The subsequent say-on-pay vote passed with 93% of shares voting in favor.<sup>16</sup>

- **Shareholders are increasingly asking American companies for the ability to have say-on-pay votes.** While reports of exact numbers vary, shareholder proposals requesting that their companies adopt the practice of holding say-on-pay votes have increased from over 50 in 2007, to over 80 in 2008, to over 100 in 2009. These proposals, which are usually non-binding requests to institute say-on-pay votes in the future, enjoy support from a growing number of shareholders – with average vote totals increasing from 42.5 percent in 2007 to 46.7 percent so far this year<sup>17</sup>, despite the potential opposition from “insider” or conflicted investors who may own substantial amounts of shares. In 2009, proposals requesting say-on-pay have garnered majority support at no fewer than 19 companies, up from roughly 14 in 2008 and 8 in 2007.<sup>18</sup>
- **While some companies have responded to shareholder proposals by instituting say-on-pay, others have not, even when such proposals receive majority support.** In response to investor proposals, roughly 15 companies provided shareholders with say-on-pay in 2009,<sup>19</sup> and a handful of other firms have announced plans to hold say-on-pay votes in future years. However, some firms have chosen not to institute say-on-pay even when a majority of shareholders have expressed support for their company holding annual say-on-pay votes.<sup>20</sup> In addition, even if a firm does choose to institute say-on-pay in response to a shareholder vote, shareholders must typically wait at least another full year before an up-or-down vote on compensation is actually placed on the proxy.

---

<sup>1</sup> Testimony of Stephen Davis, Yale School of Management, before the House Financial Services Committee (March 8, 2007).

<sup>2</sup> Jay Hartzell, Eli Ofek, and David Yermack, *What's In It For Me? Personal Benefits by CEOs Whose Firms Are Acquired* (March 2000).

<sup>3</sup> Jie Cai and Ralph Walkling, *Shareholders' Say on Pay: Does It Create Value?* (April 2008).

<sup>4</sup> Davis testimony.

<sup>5</sup> Id.

<sup>6</sup> Deloitte, *Report on the Impact of the Director Remuneration Report Regulations* (November 2004).

<sup>7</sup> GlaxoSmithKline, *Annual Report FY03*.

<sup>8</sup> Fabrizio Ferri and David Maber, *Say on Pay Votes and CEO Compensation: Evidence from the UK* (March 2009).

<sup>9</sup> Id.

<sup>10</sup> Kym Sheehan, *Is the Outrage Constraint an Effective Constraint on Executive Remuneration? Evidence from the UK and Preliminary Results from Australia* (January 2009).

---

<sup>11</sup> Mary Ellen Carter and Valentina Zamora, *Shareholder Remuneration Votes and CEO Compensation Design*, (January 2009).

<sup>12</sup> Davis testimony.

<sup>13</sup> Id.

<sup>14</sup> Ferri and Maber.

<sup>15</sup> Press Release, *Aflac Adopts Non-binding “Say on Pay” Shareholder Vote* (February 14, 2007).

<sup>16</sup> Press Release, *Aflac Shareholders Have Their “Say-On-Pay”* (May 6, 2008).

<sup>17</sup> RiskMetrics, “Say on Pay Wins Majority Support at Supervalu,” (June 26, 2009).

<sup>18</sup> Compensia, *Shareholder Advisory Votes on Executive Compensation – A “Say on Pay” Primer* (June 22, 2009).

<sup>19</sup> Id.

<sup>20</sup> Regan Adamson and Daniel Lumm, *Shareholder Democracy and the Say on Pay Movement: Progress, But How Do You Define Success?* (2009).