What’s Driving the Record Number of Say-on-Pay Failures This Proxy Season?

By Bill Hayes

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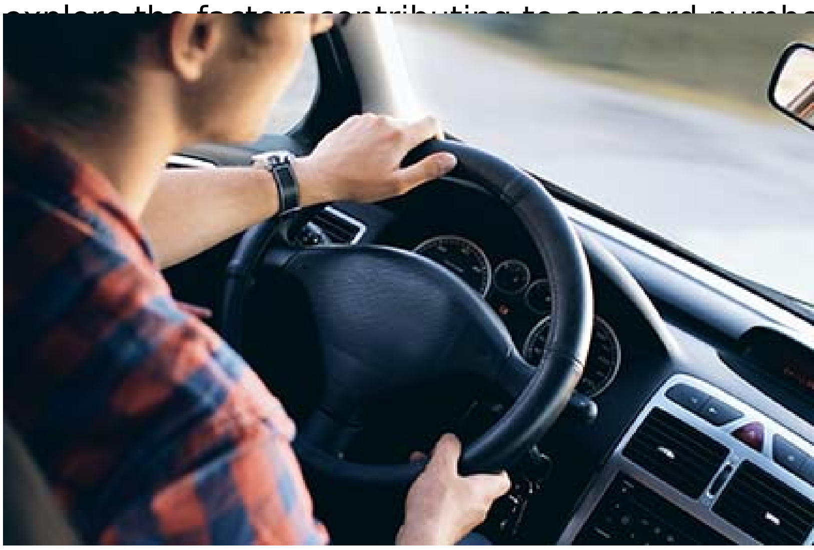
Investors prefer performance-based incentives and are skeptical of time-based awards for executives.

The 2022 proxy voting season sees say-on-pay failures at an all-time high, according to a recent article by Willis Towers Watson. As of Sept. 30, 2022, there were 78 say-on-pay failures for companies in the Russell 3000, an increase over last year’s previous record of 71. The increase indicates that pay adjustments made during the height of the COVID-19 pandemic are starting to get a heavy degree of scrutiny. We spoke with Brian Myers, governance team lead, North America, and director of executive compensation at Willis Towers Watson, to explore the factors contributing to a record number of say-on-pay failures, [illegible]centives and more.



***Directors & Boards*: To what do you attribute the record amount of say on pay failures for Russell 3000 companies in 2022?**

Brian Myers: We have scrutiny in the typical key areas, including rigor of incentive plan metrics, poor disclosures, one-time special awards, changes to in-cycle long-term incentives and responsiveness (or lack thereof). We continue to see investors adapt and tailor say-on-pay voting guidelines to consider issues beyond just a directional pay-for-performance evaluation. As the group of investors that take their own unique approach to evaluating say-on-pay expands and the issues that trigger against votes grows, we expect to see continued opposition to these votes relative to historical levels.

***DB*: What did the survey say as far as shareholder preference for performance-based incentives?**

BM: Investors largely prefer performance-based incentives versus time-based awards and will look with a skeptical eye at situations that appear to be “moving the goalposts” in the middle of the game. Investors continue to view adjustments in performance-based pay or supplemental compensation awarded in place of unearned incentives with a skeptical eye without very compelling rationale. The pandemic resulted in an environment where everyone generally understood the rationale if pay adjustments were made and could then evaluate pay outcomes and decisions on a case-by-case basis. It’s also important to note that in many cases, CEOs, the primary focus of say-on-pay decisions, took the brunt of any detrimental situations with pay during the pandemic via larger pay cuts, longer pay freezes and waiving incentive payouts. In a post-pandemic environment, pay adjustments are generally back to being universal across many executives, including the CEO, requiring explanation of the rationale for unusual adjustments or pay actions, which have reverted to factors more specific to each company.

***DB*: Is the increase in concern over named executive officer pay relatively new? Why do you think it has become more of a concern?**

BM: Not a new concern, rather a back-to-pre-pandemic-business approach. When we look back to late 2020 and early 2021 and review actions taken in the early stages of the pandemic, most companies and proxy advisors were focused on whether and how to exercise discretion in making executive pay decisions. The core notion was that making executives whole at the expense of broader stakeholders would be problematic. Though this seemed to be a fairly bright line in nature, we saw a true case-by-case approach with a willingness to examine company-provided disclosure and the rationale of actions taken in response to the pandemic and economic instability.

Fast-forward to 2022, and we have seen a back-to-pre-pandemic-business approach characterized by scrutiny in the typical key areas, including poor disclosures, one-time special awards, changes to in-cycle LTIs and responsiveness (or lack thereof). Companies with lackluster performance that continued COVID-

19 pay program adjustments or shifted to a lack of performance-based attributes for long-term incentive programs without strong and detailed rationale are being called out. While these stand as legacy issues for proxy advisors and investors alike, there has been a strong return to advocating for more performance-based incentives, as well as clear and compelling disclosures.

Though investors and proxy advisors understand the economic uncertainty in the market, there is also an expectation that companies have established guiding governance principles to move forward through the chaos. Further, the expectation is that compensation committees are using the principles to move away from the era of COVID-19 adjustments and getting back to business when it comes to pay for performance.

DB**: What is say on pay responsiveness, and why is it important for companies to be engaging their shareholders on the strictures of their compensation programs?**

BM: Say-on-pay responsiveness, especially in the face of prior-year low support, continues to be a hot-button issue for proxy advisors. This responsiveness is carried out via shareholder engagement, where companies can hear concerns directly from shareholders and further explain the compensation program's overarching narrative in a compelling way. Since the arrival of say-on-pay, we have seen more frequent and robust shareholder engagement, followed by clear and compelling disclosure in the compensation discussion & analysis. However, actions speak louder than words, which is why we see disclosure of the engagement response details. In the age of say-on-pay, if you make changes as a result of shareholder engagement, be sure to demonstrate responsiveness by describing it in the CD&A. Note that following strong engagement and disclosure efforts after a failed say-on-pay vote, the average year-over-year increase in shareholder support was above 30%. Companies that do not take this engagement opportunity seriously will see ongoing proxy advisor scrutiny around say-on-pay.

Proactive, ongoing dialogue helps both issuers and shareholders understand the preference and objectives of the other. Neither side of the proxy voting process likes surprises; though, when they do arise, it is helpful if there is a baseline of conversation and dialogue with key shareholders where overarching compensation objectives and principles have been established. When situations do arise, large or small, there is a basis of trust on both sides from which to work.