REPORT 2

IR magazine

Corporate Secretary
THE GOVERNANCE, RISK AND COMPLIANCE MONTHLY

Say on pay

When do IROs and corporate secretaries get involved in say on pay?

What impact does it have on workload?

Where is say on pay headed?

Ahead of the 2012 proxy season, IR Insight asked US IROs and corporate secretaries about the impact say on pay had last year, both on their companies and on themselves.

Respondents also gave their views on the need for greater interdepartmental cooperation and their predictions for this year's round of shareholder voting.

A total of 181 US companies took part in the survey, represented by 80 IROs and 108 corporate secretaries.

IRInsight

RESEARCH REPORT

A RESEARCH REPORT FROM *IR INSIGHT*

MARCH 2012

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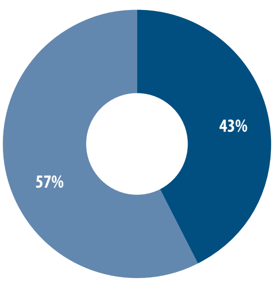
Respondent profile



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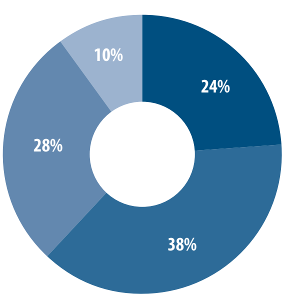


Headline findings

Say on pay means two different things for IROs and corporate secretaries. For now, only a minority of IROs are involved in the discussion, in any capacity, whereas it is rare for a corporate secretary not to be central to the process.

Those IROs involved in say on pay tend to play a supporting role to their corporate secretary colleagues, sharing shareholder sentiment, reviewing the disclosure language in the proxy form or helping to arrange meetings and calls with top shareholders. Corporate secretaries, by contrast, advise the compensation committee of the board, liaise with proxy solicitors and proxy advisers and take responsibility for drafting the disclosure language.

PERCENTAGE INVOLVED IN SAY ON PAY:
92% OF CORPORATE SECRETARIES
41% OF IROs

The effect of these different experiences and levels of involvement is borne out in the occasionally contrary opinions and attitudes of IR professionals and corporate secretaries toward say on pay.

A say-on-pay vote added a moderate amount of work to the average corporate secretary's schedule last year. For IROs, meanwhile, say on pay had little or no noticeable impact on the amount of work they had to do. Understandably, therefore, corporate secretaries are more open to increased involvement in say on pay from departments other than IR.

Turning to this year, both IROs and corporate secretaries doubt say on pay will increase in importance, albeit corporate secretaries feel more certain of this view than IR officers.

Say on pay 2011

The companies in the sample had similar say-on-pay experiences last year to corporate America as a whole. Even so, they attracted a noticeably higher percentage of 'no' recommendations from proxy advisers.

98% OF PAY PLANS APPROVED

Almost all companies in the survey (98 percent) had their executive pay plans approved by at least a bare majority of their shareholders. Only [two] companies suffered a no vote. This corresponds with data that just 38 Russell 3000 companies and eight in the S&P 500 failed say on pay votes in 2011*.

What's more, 87 percent of companies obtained a 'yes' vote from 70 percent or more of their shareholders, also in broad alignment with data from the Russell 3000 and the S&P 500 (92 percent and 90 percent, respectively).

**Source: GovernanceMetrics International's Say on Pay Review, November 2011*

55% USE PROXY SOLICITORS

A bare majority (55 percent) of companies used proxy solicitors in 2011. The companies that didn't use a proxy solicitor last year received higher support from shareholders than those companies that did, if only marginally (87 percent and 85 percent, respectively). Just 7 percent of respondents who don't currently use a proxy solicitor plan to do so in the future.

76% OF COMPANIES ARE SUBJECT TO PROXY ADVISER RECOMMENDATIONS

The pay plans of three in every four companies (76 percent) received a recommendation from a proxy adviser like ISS or Glass Lewis. A slim majority of companies (58 percent) received a recommendation for a 'yes' vote, less than a fifth (18 percent) of companies had proxy advisers recommend a 'no' vote against their pay plan and the remaining quarter (24 percent) had no proxy adviser recommendation of any kind.

24% OF RECOMMENDATIONS WERE 'NO'

A quarter (24 percent) of proxy adviser recommendations were to vote 'no'. This is noticeably higher than the percentage of 'no' recommendations (11.3 percent) issued by ISS in 2011, according to ISS itself.

20% MARGIN BETWEEN 'YES' AND 'NO' RECOMMENDATIONS

Pay plans with a 'yes' recommendation passed the say-on-pay vote with an average of 91 percent shareholder support. That high level of shareholder support drops to 70 percent where a proxy adviser has recommended a 'no' vote.

By the same token, no proxy advisers recommended a 'yes' vote for a company in the sample that eventually received less than 70 percent approval for its pay plan. Moreover, all but two of the votes that obtained less than 70 percent of shareholder support were subject to a 'no' recommendation from a proxy adviser. The remaining two companies were not subject to any recommendation at all.

But a negative recommendation from a proxy adviser is by no means a definitive indicator of which way the shareholder vote will go. Of all the pay plans that received a recommendation to vote 'no' from a proxy adviser, an equal number ended up receiving shareholder support above and below 70 percent.

91% OPT FOR ANNUAL VOTE

Looking forward to 2012, more than nine in 10 companies (91 percent) have opted for an annual vote on executive pay. The majority of those companies cite spring 2012 as the timing of their next say-on-pay vote.

IR Insight: Size matters

Large and mega-cap companies are more likely to employ a proxy solicitor, receive a proxy recommendation and hold an annual say-on-pay vote than their small and mid-cap counterparts.

The average percentage for employing a proxy solicitor across the sample (55 percent) rises to two in three (65 percent) for large and mega-cap companies but drops to half of small and mid-cap companies (49 percent).

Similarly, the likelihood of a pay plan getting the thumbs down from proxy advisers increases with company size. Just over one in 10 small and mid-cap companies (12 percent) had a negative recommendation, rising to more than one in four large and mega-cap companies (26 percent).

The difference here is partly explained by the closer attention proxy advisers give to the pay plans of large and mega-cap companies: 27 percent of small and mid-cap companies had no recommendation of any kind compared with 20 percent of large and mega-cap companies.

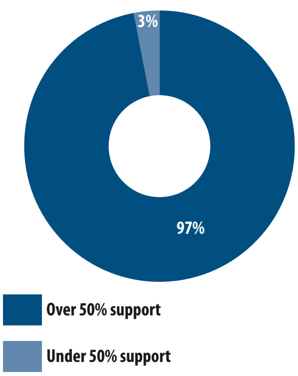
Yet it remains the case that proxy advisers favor the pay plans of smaller companies. Looking at only the companies in the sample that were the subject of a recommendation from a proxy adviser, the ratio of 'yes' to 'no' recommendations for small and mid-cap companies is 84 percent to 16 percent. At large and mega-cap companies the same ratio is 68 percent to 32 percent. This suggests the tendency for proxy advisers to recommend against a pay plan increases along with company size.

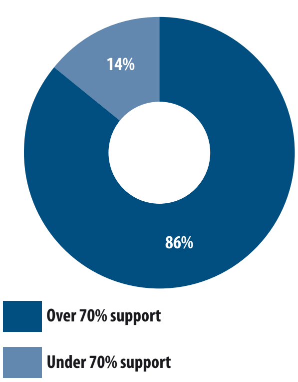
When it comes to scheduling the shareholder vote on pay, the likelihood of a company holding it annually also increases with market cap size. Almost all large and mega-cap companies (98 percent) plan to hold an annual shareholder vote. That is 7 percentage points above the sample average (91 percent) and 15 percentage points higher than small and mid-cap companies (83 percent).

IR Insight: Proxy solicitors and proxy advisers

Companies that engage a proxy solicitor for shareholder outreach are more likely to receive a recommendation from a proxy adviser... *see back page*

Respondent pay plan votes





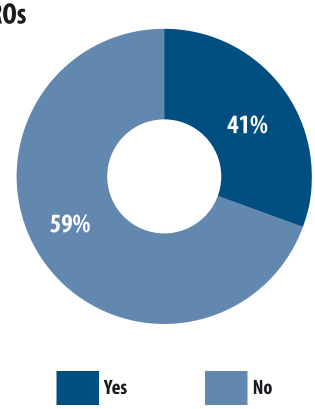
Top three contributions to say on pay

IROs
1. Investor sentiment
2. Investor outreach
3. Reviewing the CD&A

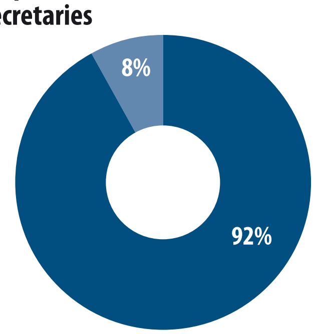
Corporate secretaries
1. Drafting the CD&A
2. Advising the compensation committee
3. Investor outreach

Have you been involved in say on pay?

IROs



Corporate secretaries



IROs and corporate secretaries

While say on pay is part of the job for most corporate secretaries, IROs tend not to be involved. When IR professionals *are* involved, they usually work closely with corporate secretaries in a supportive function, drawing largely on their knowledge of, and contact with, the top investors and shareholders in the company.

In practical terms, cooperation between IROs and corporate secretaries tends to focus around shareholder outreach and preparing the compensation discussion and analysis (CD&A).

Last year, say on pay had more of an impact on corporate secretaries than IROs. Still, both groups believe say on pay is unlikely to increase in importance this year.

Involvement in say on pay

The overwhelming majority of corporate secretaries (92 percent) were involved in the say-on-pay voting process in 2011. This trend of participation is the same across all market cap sizes. Conversely, well under half (41 percent) of IROs took part in the say-on-pay round last year, in any capacity.

There is no indication that the involvement of IR in the say-on-pay process has either a positive or negative impact on the shareholder vote. The average shareholder vote across the whole sample was 86 percent, almost identical to the average shareholder vote at companies where the investor relations department was involved (85 percent).

Of the majority of IROs who did not get involved in the say-on-pay vote, 55 percent are aware their company has a say-on-pay strategy and 52 percent conducted conversations with investors about the general issue of executive compensation.

Type of involvement

The IROs who did get involved in say on pay last year unanimously worked together with the corporate secretary or general counsel on this issue, and almost half of IROs described the level of cooperation as close or hand-in-hand.

Nonetheless, the general trend is for IROs to take a back seat to corporate secretaries when it comes to dealing with the issue of say on pay. A typical scenario might see a corporate secretary take the lead in a conversation with the proxy decision maker at an institutional investor or with the compensation committee of the board, while an IR professional shares market knowledge and awareness if and when requested.

The specific areas where IROs and corporate secretaries contribute to say on pay are a reflection of this relationship. Corporate secretaries describe their most significant contributions to say on pay as follows (in descending order of number of mentions by survey respondents): drafting the CD&A in the proxy form; supporting the compensation committee of the board; conducting investor outreach; monitoring proxy advisers' vote recommendation patterns; advising on rule changes; working with proxy solicitors; carrying out peer group benchmarking.

IROs, meanwhile, have had a narrower involvement so far. Their most common contributions, listed by order of mentions, are: insight on investor sentiment; investor outreach; reviewing the CD&A; peer company reviews.

The most common overlap between the roles of the IRO and the corporate secretary is on investor outreach. When it comes to communicating with significant institutional investors, the corporate secretary leads the call while the IRO identifies the relevant investors and often facilitates the call, but takes a back seat in discussions.

This is likely because the discussions are with the governance group at the institutional investor rather than the portfolio managers who ultimately make the investment decisions. IR professionals often look over the CD&A language, too, once the corporate secretary has drafted it.

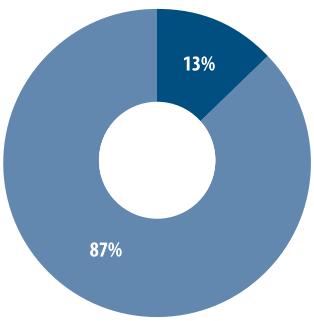
Impact of the 2011 proxy season

Most of the IROs (57 percent) who did get involved in say on pay feel it had only a minimal impact on their workload. The increased contact with significant shareholders is the main reason for the perceived extra workload.

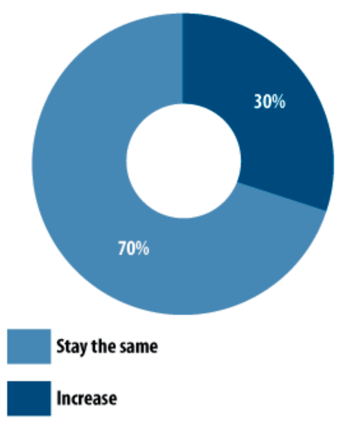
Departmental cooperation

Should the level of inter-departmental cooperation on say on pay increase, decrease or stay the same?

IROs



Corporate secretaries



By contrast, the majority (59 percent) of corporate secretaries feel say on pay added a moderate amount of extra responsibility to their existing workload. Taking a closer look at the CD&A in the proxy statement is the most common reason for this, followed by more work with the proxy solicitor.

Cooperation between IROs and corporate secretaries

The vast majority of the IROs and corporate secretaries who have been involved in say on pay (74 percent) believe inter-departmental cooperation on say on pay should stay the same (nobody said decrease).

But corporate secretaries are more willing than IROs to share the burden with colleagues in other departments. Of the IROs who have not been involved in say on pay, 87 percent think IR should be involved and just over half (53 percent) have found the conversation comes up with investors.

Future of say on pay

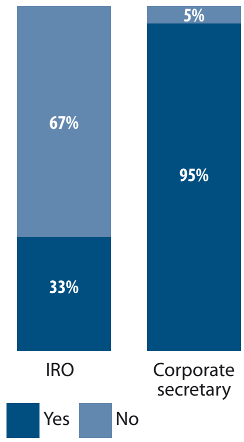
The importance of say on pay will either remain the same or decrease in importance in the coming years, according to three quarters of the respondents (74 percent) who expressed an opinion on the issue.

A continuance of the status quo is the single most popular answer to the question (42 percent), with the view being more common among IROs (46 percent) than corporate secretaries (41 percent).

Otherwise, more respondents think the issue is likely to decrease in importance (32 percent) than increase (26 percent). Clearly, however, experience counts for something here: the latter figure more than doubles to 50 percent for those IROs and corporate secretaries who work at companies with pay plans that received less than 70 percent of shareholder support last year.

The main difference in the outlook of IROs and corporate secretaries is the extent to which they believe say on pay will increase or decrease in importance: more IROs believe it is set to increase in importance (29 percent) than decrease (25 percent), whereas the opposite is true of corporate secretaries (25 percent and 34 percent, respectively).

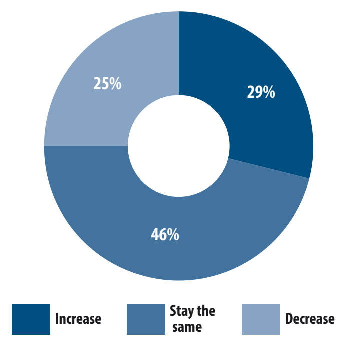
Are you involved in preparing the CD&A?



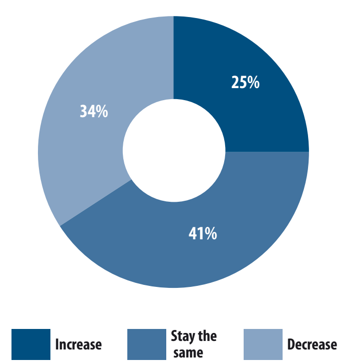
Continuing importance

Will the importance of say on pay increase, decrease or stay the same?

IROs



Corporate secretaries



'It's not enough just saying you are aligned because you have lots of equity and have performance measures you believe relate to shareholder value'

The expert view

IR Insight talks say on pay with Robin Ferracone of Farient Advisors about the outlook for the issue in 2012

The number of 'no' votes in the 2011 say-on-pay round turned out to be low: as the research in this report confirms, just two companies from a sample of 181 had their pay plans voted down by shareholders. Investors were pretty forgiving last year, says Robin Ferracone of Farient Advisors. This year, however, institutional investors are all set to grade companies' pay plans a lot harder, she warns, or at least they were planning to do so as of autumn last year, when she spoke to a significant number of institutional investors.

Since then the markets have turned upward, ending the year on a positive, and those same investors admit to giving more scrutiny to the pay plans of executives at poorly performing companies. Hence, if the economy continues to pick up there will be fewer companies in the say-on-pay headlights. In other words, the investor 'hardness' of the autumn may have softened up by the spring.

Lessons learned?

The recovery may still falter, however. In the meantime, investors have honed their say-on-pay criteria since 2011 and proxy advisers such as ISS and Glass Lewis are going to be on the lookout for companies that received a bad grade in 2011 but have not adapted accordingly. It would be a foolish company that chooses to ignore the lessons of last year.

The first thing to note is that egregious pay packages are by and large a thing of the past, says Ferracone. Investors are no longer on the lookout for generous tax gross-up clauses, for instance, as they have been all but rooted out. Rather, they will focus more closely on the parameters for how pay is determined. 'Investors reported that the primary reason they voted 'no' last year was the lack of alignment between pay and performance,' she recalls.

As a result, investors are going to be even more eager to see companies cogently demonstrate that they have paid appropriately for performance – that is in spite of the SEC's hesitation in coming out with its rules around pay for performance. 'This year the focus will continue to be on pay and performance alignment, but with more sophistication than there was last year,' Ferracone explains.

By this, she means more use of objective criteria such as benchmarking and third-party diagnostic tools. 'Companies are going to need to diagnostically test whether they are achieving alignment,' she explains. 'It's not enough just saying you are aligned because you have lots of equity and have performance measures you believe relate to shareholder value.'

Specifically, peer groups and the reasonableness of pay awards will come in for closer attention in 2012. For a long while, companies have benchmarked their executive pay against their peers and written all about it in the proxy, but when such peer groups are determined by the company it is easy to see how a flattering group of companies with comparable pay packets could be put together. ISS now has a methodology that chooses the peer group for the company, based on certain parameters, which is surely going to throw out some different results to the company-assembled group.

Being reasonable

The even looser concept of 'reasonableness' – a highly subjective measure more familiar to a jury of 12 in a courtroom than a packed AGM conference room – will be tested by investors in accordance with the tools being made available by the likes of ISS and Farient Advisors.

Speaking before the Apple AGM, Ferracone thought the Californian company's vote could have been interesting in this regard, since CEO Tim Cook was given a 'mega-package' when he took over from Steve Jobs in August 2011. As it turned out, the advisory vote passed with little fanfare, perhaps offering further proof that investors have little appetite to question the reasonableness of executive compensation at performing companies. In Apple's case the timing of the shareholder vote came only a week after the share price pushed past $500 for the first time.

After all, investors are looking for returns, rather than punishing well-paid CEOs. For that reason, last year's other big protest against bumper pay packets – the Occupy movement – is unlikely to have much of an effect on investors this year. The same can be said of the tax furor whipped up around US presidential hopeful Mitt Romney.

The one thing that *is* on the radar at executive level and under great debate at the moment is the ratio of CEO pay to median worker pay, which was written into Dodd-Frank, says Ferracone. 'It has been hotly contested because neither companies nor investors see the value of putting out that statistic,' she explains. 'That's clearly a politically motivated move. What will actually get written into the rules by the SEC is still in question.'

The current debate notwithstanding, she doubts the issue will get much attention this year. A ratio more likely to attract attention is the one put out by ISS comparing CEO compensation with that of the next four executives in the company. It's a more useful measure of whether companies have a succession plan in place, she explains, with a clear stepping stone for executives to move up internally. What's more, it is a red flag for the out-of-fashion 'imperial' CEO.

Clawback rules

One recurring theme, already touched on above, is the slowness of the SEC in publishing its set of rules implementing Dodd-Frank. This is true around disclosure as much as it is around clawback rules. Such regulatory caution is partly understandable, says Ferracone, since the 'devil is in the detail', but this has not stopped companies from getting ahead of the SEC.

Most of the companies in the Fortune 500, for instance, have now written in clawback provisions because they think it is the right thing to do for shareholders. On balance, Ferracone would prefer to see a standardized approach set out by the SEC. In the meantime, it is no bad thing for firms to get ahead of the rule makers. 'We are seeing evolution here,' she points out.

Looking ahead to the 2012 proxy season, Ferracone's advice on say on pay is threefold: firstly, prove the case for alignment of pay for performance; secondly, use objective tools to address the 'reasonableness' question; finally, conduct open and transparent communications around pay.

This means in the proxy, of course: Ferracone gives the example of one client that put a Q&A in its proxy with a favorable impact on the eventual vote. But it also means throughout the year, and it is in that area where she has noticed IR getting increasingly involved behind the scenes.

'IR knows the investors best and not all investors are the same,' she explains. 'If you have certain investors with certain sticking points, it is very important for IR to identify those and bring them to the attention of HR, the compensation committee and the CFO, so that they can be dealt with. It's not just about talking a good game but also about changing a few things in order to satisfy those investor concerns.'

Senior management

The overwhelming majority of IROs (96 percent) believe senior management's current view of the importance of IR has either gone up or stayed the same when compared with the previous year. Opinion is almost evenly split between these two, although slightly more IROs (51 percent) believe management outlook has not changed than feel it has gone up.

Looking ahead to the 2012 proxy season, Ferracone's advice on say on pay is threefold: firstly, prove the case for alignment of pay for performance; secondly, use objective tools to address the 'reasonableness' question; finally, conduct open and transparent communications around pay

ABOUT IR INSIGHT

IR Insight is the research arm of *IR magazine*, the leading voice in global investor relations. We regularly engage with the IR community and the investment community through extensive studies, surveys and detailed interviews with corporate IROs, investors and analysts.

The results of our rolling surveys of more than 1,000 IR professionals located in every major business center across the world provide us with an unrivaled global perspective on the latest IR trends and industry best practices.

Our research publications include in-depth investor perception studies, which we produce in conjunction with *IR magazine*'s highly regarded annual awards in the US, Canada, Europe, Asia and Brazil. Each year, in each of these markets, we ask thousands of buy-side analysts, sell-side analysts and portfolio managers the same question: which company has the best IR? The reports we produce uncover and explain the reasons for successful IR, as well as the key drivers of investor sentiment.

To generate customized reports on your global peer group, please visit: www.InsideInvestorRelations.com/research.

IR Insight

IR Insight: Proxy solicitors and proxy advisers

Companies that engage a proxy solicitor for shareholder outreach are more likely to receive a recommendation from a proxy adviser

As the chart below illustrates, 81 percent of companies that used a proxy solicitor also received a recommendation from a proxy adviser. That number falls to 69 percent for those companies that didn't use a proxy solicitor. When it came to the actual recommendation, more than a quarter (26 percent) of the companies employing a proxy solicitor received a 'no' recommendation, whereas only a fifth (20 percent) of firms without a proxy solicitor did so. This doesn't mean using a proxy solicitor for shareholder outreach will *cause* a company to be more likely to have a recommendation against its pay plan, however. Rather, it's more likely these two factors run in tandem; that the kind of tight, contentious vote environment that can produce a recommendation against is the same type of situation where more active shareholder outreach is required.

Proxy flow chart