

Say-on-Pay Update

Background

Say-on-Pay was a direct result of The Dodd-Frank Wall Street Reform and Consumer Protection Act, which is a federal statute signed into law by President Obama on July 21, 2010.

Say-on-Pay is designed to improve board accountability and better align compensation with long term value creation for shareholders. The movement resulted from the perception by activist shareholders that executive compensation was/is excessive, specifically when executive compensation policies reward failure. Executive Compensation rose sharply in the 1980s and increased continuously through the years. Say-on-Pay is a relatively new trend in the US, with AFLAC becoming the first US Corporation to voluntarily give shareholders an advisory vote on executive compensation in 2007. The UK became one of the first countries to enact Say on Pay legislation in 2002.

Some highlights of Say-on-Pay include:

- the SEC is authorized to require non-binding Say-on-Pay votes for all public companies
- companies must include a proxy resolution on shareholder approval of executive compensation; and
- companies must include a shareholder resolution to determine the frequency of executive compensation approval by shareholders, either every one, two, or three years.

Update

When the financial crisis hit in 2008, there were excessive complaints of Executive Compensation. As a result, Say-on-Pay legislation was introduced. The expected result of Say-on-Pay was a decrease in Executive Compensation. The results, however, were quite the opposite. During the 2011 Proxy season, investors have overwhelmingly endorsed companies' pay programs. The majority of the business sectors had over 80% average support, with the energy sector receiving the lowest level of support; however it was still above 80%.

Four S&P companies received significant opposition: Pfizer, Johnson & Johnson, ConocoPhillips and ExxonMobil. The concerns at Pfizer consisted of a large exit package for the CEO, despite lagging shareholder returns during the CEO's tenure. ConocoPhillips provided for the payment of excise tax gross-ups in severance arrangements with two new executives and continued the practice of crediting certain executives with additional years of service under its supplemental retirement plan.

Even though the full effect of Say-on-Pay will not be known for a few years, there are some preliminary observations that can be made. First, the media may have hyped

shareholders' dissatisfaction of executive compensation, perhaps due to the fact that companies took a proactive approach in disclosing more within their Compensation and Discussion Analysis in their proxies. It also could have been due to the fact that many individual investors did not vote because of lack of knowledge or expertise. The majority of the votes that were cast were those of institutional investors.

Another reason of voter approval of Say-on-Pay could be due increased proxy disclosures. Voters better understood the stance a company took on executive compensation. Companies took the initiative to carefully and explicitly disclose compensation, in some cases even utilizing graphs. Some companies filed supplemental proxy materials following a negative vote recommendation by proxy advisory firms. This could have very well changed voters' Say-on-Pay position.

The positive effects of Say-on-Pay are that companies are carefully reviewing their performance-based compensation plans. They are addressing items that were of shareholder concern such as: excessive severance; perks; federal income tax payments, and pensions. Additionally, Say-on-Pay has brought more transparency between executives and shareholders. Shareholders now feel more empowered over the companies that they invest in. Companies are significantly more engaged in executive compensation plans.

Since Say-on-Pay has only been in effect for the past year, it is too early to analyze the true effect of the legislation. Many responsive changes have been to the types of compensation rather than the amount of compensation. It will, however, take a few years to determine the true impact of the legislation on Executive Compensation.

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