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Using Good Disclosure Models Helps In Drafting Proxy Statements, Speakers Say

Public companies preparing executive compensation proxy disclosures should make sure that no part of their story is misunderstood and that it is accessible to key readers, a corporate governance consultant says.

Rhonda Brauer, senior managing director of corporate governance for the New York-based consulting firm Georgeson Inc., said in a webinar Jan. 15 that telling the company's story is particularly important this year because investors and proxy advisory firms will be "even more stretched" for time to review proxy statements.

In 2014, in addition to smaller reporting companies whose exemption from say-on-pay expired Jan. 21, 2013, this is the second year that triennial voters will be coming up for a vote, adding another 650 or so companies, she said.

"There is no guarantee you will get an audience with your investors during the proxy season," she said. "Get your story straight, accessible and understood."

Brauer spoke during a webcast titled "2014 Proxy Season: What You Should Know as You Draft Your Proxy Statement and Prepare for Your Annual Meeting," sponsored by the law firm Latham & Watkins LLP and Georgeson.

Final rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act require public companies to hold a say-on-pay vote at least once every three years. A majority of companies (about 82 percent) hold votes annually, with just 17 percent voting every three years, according to a survey of say-on-pay votes in 2013 by the consulting firm

Towers Watson (28 CCW 119, 4/10/13).

Proxy Advisory Firm Update

The two main proxy advisory firms, Institutional Shareholder Services Inc. (ISS) and Glass Lewis & Co. LLC, have updated their proxy guidelines, Brauer said.

On Jan. 13, ISS issued frequently asked questions on how it will view director qualification and compensation bylaws, she said.

ISS also made adjustments to its pay-for-performance metrics by revising the first of its quantitative tests by making the relative degree of alignment test focus on a three-year basis (28 CCW 389, 12/18/13).

Program speaker James Barrall, a partner with Latham & Watkins in Los Angeles, said the change is "beneficial" because "it makes sense to measure pay-for-performance alignment on a longer term period" of three to five years. It will hurt some companies "that have had some flat TSR [total shareholder return] years in the past and then had a big pop in 2013," he said.

ISS makes a case-by-case determination and "companies should run the test to show how they will do" he said.

ISS also clarified its policy on responsiveness to majority votes on shareholder proposals and failed director elections, Brauer said (28 CCW 389, 12/18/13). The clarification "provides ISS analysts with more discretion, on a case-by-case basis to consider how they should look at board responsiveness" to majority-supported shareholder resolutions, she said.

For failed director elections, ISS "will focus on whether the company has addressed the issues that caused the failed election," she said.

Negative Voting Recommendation

Glass Lewis updates include its policy on board responsiveness to majority shareholder proposals seeking board declassification, she said. Brauer said that if a company doesn't implement declassification "by the next annual meeting, [Glass Lewis] may recommend against all board nominees who served through the year."

"I asked Glass Lewis if it would suffice to avoid an 'against' recommendation if a company submitted a proposal to declassify at its next annual meeting," Brauer said.

The proxy firm's response was that "it would suffice," she said. "Even if it is not implemented by next annual meeting, as long as you have a management proposal to declassify this year," that should be sufficient to avoid a negative voting recommendation, she explained.

A "classified" board staggers the terms of its board members, for example, limiting turnover to one-third of the directors at each annual meeting.

Glass Lewis also has new policies on hedging and pledging of company stock. Both will be factors on say-on-pay recommendations, Brauer said. In Glass Lewis's view, companies should adopt strict anti-hedging policies. ISS's view "is that hedging is a risk factor that may perhaps lead to a negative recommendation for one or more directors," she added.

Pledging, for Glass Lewis, is "more of a facts-and-circumstances" test, in which the proxy adviser will look at several factors, she said.

Practical Concerns

Barrall said he was expecting, and surprised not to have already, proposed rules on pay-for-performance under Section 953(a) of Dodd-Frank, which requires dis-

closure of the relationship between executive compensation disclosed in a company's proxy statement and the company's financial performance (28 CCW 362, 11/27/13).

"Every indication is that we will get those this year," he said.

As a practical matter, and from his personal point of view, Barrall said that "while summary compensation pay is not the best theoretical measure of pay for measuring alignment of CEO pay and company performance, it works for most companies." For most companies, use of the ISS metrics and the summary compensation table (SCT) pay definition "keeps them out of danger," he added.

If a company is doing well, and has done well in the past, there "probably is no reason to jump into supplement definitions," he said. "The key is companies should be doing their own simulations in advance of drafting the

proxy statement to see how they do" under the ISS test to determine whether they have alignment problems, and "if so, then they can consider supplemental pay definitions," he said.

CEO Pay

In addition, if a company is going to state in its proxy that its CEO pay aligns with company performance, it should say how the company determined that alignment, he said.

If the company's assessment is based on supplemental definitions of pay, it is "critical that it be accurate," and that the company explain how it is defining terms and "why it thinks that its definition of pay is a better measure of pay for determining pay-for-performance alignment," Barrall said.

"The SEC is fine with the use of supplemental definitions, but they don't want anyone to think those

definitions supplant the SCT," he said. "They are happy to let you use them, but you must not deviate in the SCT," Barrall said.

The National Association of Corporate Directors recently issued a proposal on standardizing supplemental pay definitions (29 CCW 1, 1/1/14).

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The webcast and materials are at

<http://w.on24.com/r.htm?e=704198&s=1&k=0608B39070970D6EBD339245EDC90316>

Text of the ISS Jan. 13 update is at <http://www.issgovernance.com/files/directorqualificationcompensationbylaws.pdf>.