



GMI's Say on Pay Review: Say When on Pay: The Frequency of the Say on Pay Vote

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Say When on Pay: The Frequency of the Say on Pay Vote

As is well-known, part of the Dodd-Frank Reform and Consumer Protection Act requires public companies to implement a nonbinding shareholder advisory vote on executive compensation, also known as "Say on Pay." In addition, the Act requires companies to ask shareholders to "Say When on Pay", calling for a management proposal at least once every six years to ask whether Say on Pay votes should occur every one, two, or three years. GMI maintains that an annual advisory vote on compensation provides the highest level of accountability to shareholders. As proxy statements are filed annually, this vote allows shareholders to provide input on the most recent compensation disclosures.

Executive Summary

This analysis was conducted on 2,176 companies in the Russell 3000 index with frequency advisory votes collected from SEC filings through the end of July 2011. Along with the first-ever mandatory Say on Pay vote, shareholders were also asked in 2011 to vote on how often advisory votes should be taking place. At nearly three-quarters of companies, shareholders voted to have annual input on compensation. Management recommendations were in favor of annual voting as well, though by a less definitive margin, just over 50%.

Key findings of the report include:

- 42% of management recommendations to shareholders were for a triennial vote policy.
- Just 13% of companies saw a plurality of shareholders vote in favor of triennial voting.
- At 72% of companies, shareholders voted for annual Say on Pay voting.
- Half of boards surveyed in the Russell 3000 have implemented an annual vote on pay plans.
- Just 10% of boards have adopted a triennial vote policy.
- 256 companies decided to adopt an annual vote against a triennial management recommendation
- Two companies, Annaly Capital Management and American Reprographics, instituted a triennial vote policy after shareholders voted overwhelmingly for annual voting.

Say When on Pay Dodd-Frank Overview

Effective April 4, 2011

The new Section 14A of the Securities Exchange Act of 1934 requires companies to conduct a separate shareholder advisory vote to determine how often an issuer will conduct a shareholder advisory vote on executive compensation.

The vote is non-binding.

Frequency was to be determined from every one, two, or three years. Shareholders could also abstain.

A new Say When on Pay vote to be taken every six years.

Shareholders may call for a new Say When on Pay vote, or a more frequent Say on Pay vote, only if the company has not adopted a policy in line with the majority of the votes originally cast for frequency.

"At nearly three-quarters of companies, shareholders voted to have annual input on compensation."

Introduction

These Say on Pay frequency vote proposals are unusual in several respects. First, although management may recommend a particular Say on Pay frequency, shareholders may still record a vote for any of the three options (rather than voting simply for or against the board's recommendation, as is typically the case with management proposal options). Secondly, although they are put forth by management, the frequency vote proposals are non-binding, and therefore results do not automatically lead to the adoption of a certain policy. The board decides on policy only after shareholders cast their votes. The 2011 proxy season was the first in which these frequency vote proposals were included in company proxies.

Say on Pay Vote Frequency Recommendations

In a review of 2,176 companies in the Russell 3000, 53% of management recommendations were for annual Say on Pay voting. Interestingly, 42% of companies recommended shareholders vote just once every three years on executive compensation. The remaining 5% of companies made a recommendation for a biennial vote or made no recommendation at all.

The fact that 42% of companies recommended a triennial Say on Pay vote to shareholders stands in stark contrast to how shareholders actually voted on the issue. Indeed, shareholders favored triennial voting at less than 13% of companies, in the Russell 3000, while shareholders at 72% of companies voted in favor of annual Say on Pay voting.

Companies recommending to hold the vote only once every three years most often cited the need for sufficient time to evaluate compensation programs, to review shareholder input, and to be given time to react and implement changes. Below is an example from Broadcom Corporation's annual proxy:

We believe that every three years is the optimal frequency for the Say-on-Pay vote for several reasons. As our compensation program is designed to incent performance over not just the short term but also the long term, shareholder input on executive compensation would be most useful if the effectiveness of our compensation program is evaluated and judged over a multi-year period. Additionally, a three-year vote cycle will provide the Board and Compensation Committee with sufficient time to consider the results of the advisory vote and to implement any changes to our compensation practices. A three-year cycle will also provide sufficient time for the implementation of any changes before shareholders must evaluate their effectiveness in conjunction with our related business results.

Adopting a Policy on the Frequency of Say on Pay Voting

As mentioned above, companies are under no obligation to implement the outcome of the shareholder frequency vote. Management makes a recommendation in its proposal and shareholders vote on the policy some six weeks later before the board decides on policy. After a tally of shareholder votes, 50% of boards have adopted annual Say on Pay voting, 10% have implemented a triennial vote, and 40% of companies surveyed have yet to decide which policy to adopt.

At PacWest Bancorp, the company recommended a triennial vote while shareholders voted in favor of annual voting. Five months after the advisory vote, the board implemented an annual pay vote policy.

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At the Annual Meeting, the Company held an advisory vote on the frequency of a stockholder vote on executive compensation. As previously reported in the Original Report, a plurality of the Company's stockholders recommended holding an advisory vote on executive compensation every year. In light of, and consistent with, the voting results, the Company's Board of Directors has determined that the Company will hold future advisory votes on executive compensation annually until the next stockholder vote on the frequency of say-on-pay votes is required ... or until the Board of Directors otherwise determines that a different frequency for such votes is in the best interests of the Company's stockholders. - PacWest Bancorp 8-K

Management Recommendations Versus Adoption of Policy

Chart 1 in the margin displays management frequency recommendations to shareholders while Chart 2 shows what boards have actually adopted as policy. The majority of company management recommendations were for annual Say on Pay voting and about half of the Russell 3000 has already implemented an annual vote as policy.

Despite more than 40% of companies recommending a three-year vote to shareholders, just 10% of boards adopted the triennial vote. With shareholder votes so overwhelmingly in favor of annual Say on Pay voting, at nearly 75% of the Russell 3000, companies hoping to implement a three-year vote policy could be facing an uphill battle.

Companies Recommending Triennial Voting

Chart 3 in the margin shows what policy has been adopted after a management recommendation of triennial voting. In total, 907 companies in the Russell 3000 sample recommended a triennial vote to shareholders. About half of these companies have yet to adopt a frequency voting policy. Boards at 256 of these companies decided to adopt an annual vote, against a triennial management recommendation, after tallying shareholder votes. Indeed, of the companies with management recommending a triennial vote, less than a quarter implemented it as policy. Nearly 30% of these companies adopted an annual Say on Pay vote.

Conclusion

Expressing displeasure over executive pay packages has been difficult for shareholders in the past. Withholding votes for directors, especially compensation committee members, has been one course of action, but the message of the withhold votes is not always clear. Furthermore, classified board elections have made it difficult for shareholders to react with expedition to faulty compensation policy because, for example, compensation committee members might not be up for election in the year when objections to compensation policy are raised. Also, plurality voting standards have made it difficult for shareholders to remove directors of whose actions they disapprove. A Say on Pay vote provides shareholders with an immediate channel to express concern over compensation and start a dialogue on the issues with management.

Companies where a majority of shareholders have voted for an annual Say on Pay vote have largely complied with adopting this as policy, possibly due to concerns about reputation and potential backlash by investors. Two companies, however, have already rejected shareholder majority tallies for an annual vote and instead implemented a three-year vote policy, as they had originally recommended.

Chart 1: Management Recommendation

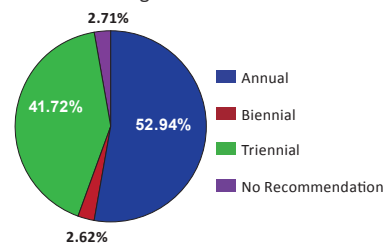


Chart 2: Frequency Policy Adopted

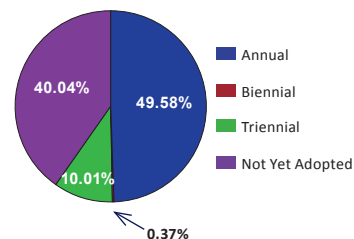
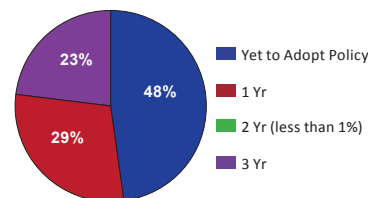


Chart 3: Policy Adopted After 3 Year Management recommendation



"The vast majority of companies GMI surveyed implemented a frequency vote commensurate with the outcome of the shareholder vote."

Case Study 1: Allstate

The Allstate Corporation was among those companies urging shareholders to adopt a three-year vote on executive pay. As part of the reasoning, Allstate stated in its proxy:

The Compensation and Succession Committee evaluates and approves executive compensation plans annually. All committee members are independent and they are assisted by an independent third party compensation consultant.

The majority of Allstate's Compensation and Succession Committee members are long-tenured with four members, including the chairman, serving for at least the past decade. One director on the committee was a board member at UAL Corporation when it filed for Chapter 11 Bankruptcy protection and another was flagged for his tenure at Sprint Corporation when it accelerated \$1.7 billion in stock options following a proposed merger with Worldcom in 2000 that ultimately failed.

As part of the shareholder proposal, Allstate promised to abide by the vote of the shareholders:

Stockholders will be able to specify one of four choices for this proposal: three years, two years, one year, or abstain. Stockholders are not voting to approve or disapprove the Board's recommendation. While this advisory vote is non-binding on the Board of Directors, the Board intends to adopt the frequency that receives the support of stockholders.

Nearly 60% of Allstate shareholders voted for an annual Say on Pay vote while about 30% of shareholders thought the triennial management recommendation would suffice. The company responded:

In accordance with the voting results the Registrant's Board of Directors has decided that the Registrant will hold an annual advisory vote on the compensation of named executive officers until the next stockholder advisory vote on the frequency of the advisory vote to approve the compensation of the named executive officers.

Ultimately, shareholders made several significant statements to Allstate management at the 2011 annual meeting. In addition to a clear preference for annual voting, shareholders nearly rejected compensation packages, providing only 57% support on pay plans. On top of this, a stockholder proposal allowing action by written consent received majority support from shareholders for a second straight year. Finally, each member of the 11-person board received withhold votes ranging from 31.10% to 46.59%, at an average of 38% per director.

Case Study 2: Annaly Capital Management

The vast majority of companies GMI surveyed implemented a frequency vote commensurate with the outcome of the shareholder vote. Some companies postponed setting a policy while a couple of companies, including Annaly Capital Management Inc., denied explicit shareholder preferences.

When Annaly Capital released its proxy statement in April 2011, management laid out arguments in support of triennial Say on Pay votes:

In determining to recommend that the stockholders select a frequency of once every three years, our board of directors considered how an advisory vote at such frequency will provide our stockholders with sufficient time to evaluate the effectiveness of our overall compensation philosophy, objectives and practices in the context of our long-term business results for such period, while avoiding overemphasis on short-term fluctuations in compensation and business results that could occur over shorter periods of time. An advisory vote occurring once every three years will also permit our stockholders to fully observe and evaluate the impact of any changes to our executive compensation philosophy and objectives which have occurred since the last advisory vote on executive compensation, including any changes in response to the outcome of a prior advisory vote on executive compensation.

Nevertheless, when shareholders voted on the frequency of the vote the following month, they were decidedly in favor of annual voting; results were as follows:

Proposal 4. A vote on the recommendation, by a non-binding advisory vote, on the frequency of advisory votes on the Company's executive compensation.

One Year	Two Years	Three Years	Abstentions	Broker Non-Votes
268,356,247	8,934,691	101,908,271	2,103,905	331,539,387

Slightly more than 70% of shareholders voting at Annaly Capital desired to have an annual Say on Pay vote despite the company's triennial recommendation. Shortly after the shareholder votes were released, Annaly issued this statement that the board had decided to hold the vote just once every three years and would evaluate this decision annually:

The Board has considered the appropriate frequency of future non-binding advisory votes regarding compensation awarded to its named executive officers. Among other factors, the Board considered the voting results at the Company's 2011 Annual Meeting with respect to the non-binding advisory vote regarding the frequency of non-binding advisory votes regarding compensation awarded to its named executive officers. The Board has determined that future non-binding advisory votes regarding compensation awarded to its named executive officers will be submitted to shareholders of the Company every three years. The Board will continue to evaluate this decision annually.

Compensation packages at Annaly Capital received almost 75% support from shareholders in 2011, despite two executives receiving some of the largest salaries (\$2.7 million) and bonuses (\$20.1 million) in the Russell 3000. We won't know until 2012 whether the board's refusal to implement an annual Say on Pay vote, as strongly preferred by shareholders, will have any effect on future support for executive pay plans.

Case Study 3: American Reprographics

Shareholders at American Reprographics also passed compensation packages in 2011, by a whopping 99%, yet only about 26% of these shareholders wanted a triennial Say on Pay frequency vote. Despite more than 70% of shareholders requesting an annual pay vote, the company chose to go with a vote once every three years, addressing the issue straightaway with the annual meeting vote results:

The Company's stockholders approved, on a non-binding advisory basis, to vote annually on the compensation paid to the Company's named executive officers. The results of the non-binding advisory vote were as follows:

One Year	Two Years	Three Years	Abstentions	Broker Non-Votes
26,344,232	159,838	10,871,558	8,792	4,508,485

The Company has considered the outcome of the stockholders' non-binding advisory vote on frequency of future stockholder advisory votes on executive compensation. As previously disclosed, the Company has recently renewed, or entered into, binding employment contracts with its named executive officers with three-year terms expiring in 2014. The Company believes that any attempt to modify the terms of those contracts prior to expiration could pose an executive retention risk to the Company. In addition, the Company has not historically engaged in problematic pay practices. Rather, compensation paid to the Company's named executive officers in prior years reveals a practice of curtailing executive compensation in response to a challenging economic environment. A three-year frequency cycle will also allow stockholders to continue to evaluate the effectiveness of the Company's executive compensation program on long-term performance of the Company. For these reasons, and those set forth in the Company's 2011 proxy statement, the Company has decided to conduct future stockholder advisory votes on executive compensation every three years until the next required advisory vote on frequency of stockholder advisory votes on executive compensation.

While the level of support for Say on Pay would seem to back up the company's claim that it has not engaged in problematic pay practices, it also reinforces the assumption that shareholders would continue to support compensation decisions even if they were allowed to do so annually. It is unclear why American Reprographics thinks the first thing shareholders would do is attempt to modify recent employment agreements. As they are non-binding, the most shareholders could accomplish is to convey dissatisfaction with the contracts.

Unlike at Annaly Capital, where the board vows to revisit the frequency issue each year, Reprographics simply says they will hold a triennial vote "until the next required advisory vote on frequency of stockholder advisory votes on executive compensation". In other words, American Reprographics won't revisit the issue again for six years.

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