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On the board's agenda | US

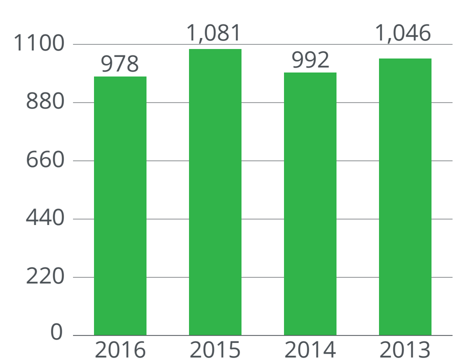
The results are in—A review of the 2016 proxy season

This issue of *On the Board's Agenda* examines the trends that have emerged from shareholder meetings held in the first half of 2016[1]. While some companies hold their annual meetings during the second half of the year, it is likely that the trends identified from the first half of the year represent what we can expect in the future.

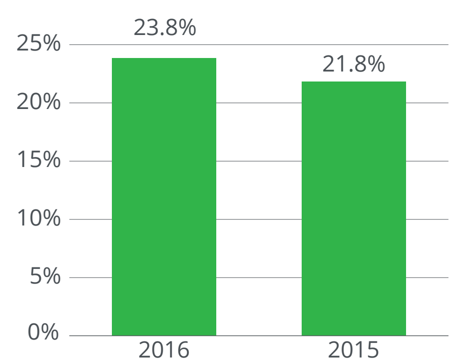
Fewer proposals and fewer passing votes

There were 9.5% fewer shareholder proposals submitted for meetings held in the first half of 2016, compared to meetings held in 2015, and average support for shareholder proposals increased by 9.2%, largely attributed to the voting results of proposals calling for proxy access. It is unclear whether the reduction in 2016 submissions represents the beginning of a trend, but it is noteworthy that the number of proposals peaked in 2015.

Number of proposals submitted



Average support

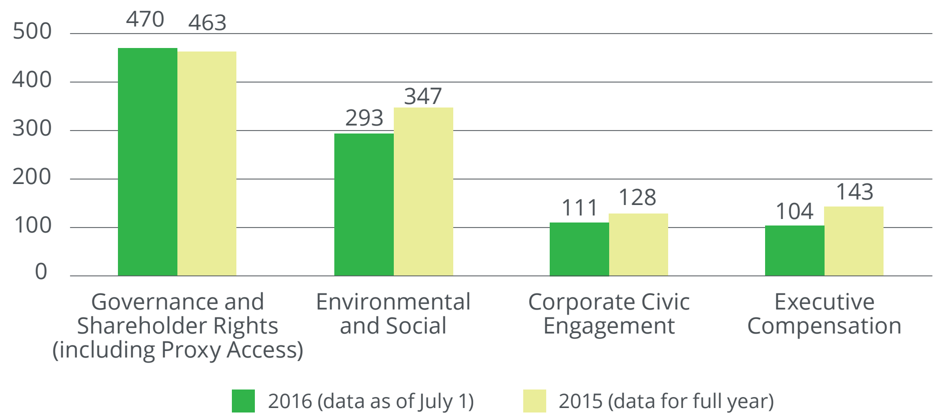


[1] Unless otherwise indicated, source of data is Alliance Advisors LLC. Data for 2015 reflect the full year; data for 2016 reflect information through July 1.

Overview of proposals

Governance and shareholder rights, including proxy access, dominated, representing 48.1% of the total number of proposals submitted for 2016. Although environmental and social proposals decreased 15.6% compared to 2015, they made up 30% of the overall proposals submitted. The greatest decrease however, was the 27% decrease in proposals regarding executive compensation matters.

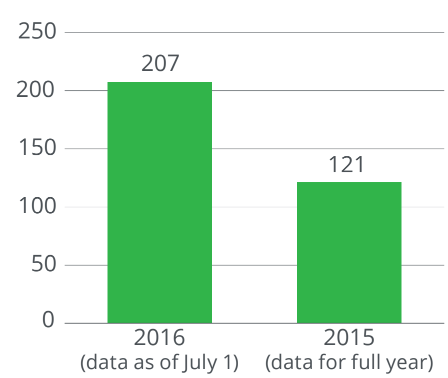
Overview of proposals



Proxy access—The elephant in the room

As shown in the graph below, proxy access proposals increased by 71% in 2016 as compared to 2015, including proposals to change proxy access bylaws that companies had previously adopted to make them more shareholder-friendly; for example, some companies whose bylaws require a shareholder to own 5% of its shares in order to exercise proxy access rights received proposals to reduce this threshold to 3%.

Proxy access proposals



Of the 207 proxy access proposals, 72[2] were submitted or co-submitted by the New York City Comptroller, and of these, 34[3] were designed to address existing proxy access bylaws as outlined above. Some of the remaining proposals were submitted by individual shareholders who had sought to submit proxy access proposals in 2015 but whose proposals were rejected by the SEC for various reasons; these individuals revised their proposals to comply with SEC rules and were able to submit them in 2016.

The voting results in 2016 year-to-date have been impressive. Of the 79 proposals that have gone to a vote, the average favorable vote was 51%. However, the average favorable vote was 56%[4] for companies that had no form of proxy access, versus 38.4%[5] for companies that had a form of proxy access (but whose proxy access bylaws may not have satisfied investors).

As of June 1, 2016, 36.8% of the S&P 500 companies and 48% of the Fortune 100 companies had adopted proxy access[6]. It is not possible to determine whether the adoption of proxy access was voluntary or resulted from investor pressure or to avoid putting a proxy access shareholder proposal on the ballot. Based on the data, it is likely that shareholder interest in proxy access will continue.

In this regard, it should be noted that the numbers and voting results discussed above reflect only shareholder proposals and do not include proposals submitted by companies seeking approval of proxy access bylaws.

Commonsense Principles of Corporate Governance

On July 21 2016, a group of executives and business leaders representing some of the largest US corporations and institutional investors released their collaborative point of view, Commonsense Principles of Corporate Governance. The principles, while not expected to be prescriptive, are intended to provide public companies with a framework for long-term oriented governance practices.

According an open letter put forth by the authors, they believe it is essential for public companies to manage and govern their business with a long-term approach. The authors also state that the principles are neither for nor against activists, proxy advisors, or special interest groups.

The eight principles cover areas such as board composition, director duties, shareholder rights, and disclosure.

Source: http://www.governanceprinciples.org/

[2] NYC Comptroller Board Accountability Project

[3] Boardroom Accountability Project 2016 Company Focus List—NYC Comptroller Board Accountability Project

[4] Shareholder Proposal Developments During the 2016—Gibson, Dunn & Crutcher LLP

[5] Shareholder Proposal Developments During the 2016—Gibson, Dunn & Crutcher LLP

[6] Shareholder Proposal Developments During the 2016—Gibson, Dunn & Crutcher LLP

Other governance proposals

Proxy access proposals constituted 44% of the 470 governance and shareholder rights proposals submitted to date for 2016. The others were as follows on the right.

It is interesting to note the decrease by over 50% in proposals for calling for board declassification. This decline may indicate that fewer large-cap companies have classified boards.

A new proposal emerged in 2016 related to auditor rotation; audit committees were asked to solicit proposals for new outside auditors every eight years. Fifteen such proposals were submitted, but all were excluded through the "no-action" process of the Securities and Exchange Commission.

Type of proposal	# Submitted in 2016	Average support	# Submitted in 2015	Average support
Proxy Access	207	51.1%	121	54.8%
Independent board chair	60	30.7%	84	29.5%
Eliminate supermajority voting provisions	29	59.5%	25	58.0%
Majority voting in board elections	23	76.5%	25	65.8%
Shareholder right to call special meetings	21	41.9%	31	42.4%
Shareholder right to act by written consent	20	41.3%	44	39.4%
Declassify board	15	69.2%	32	81.2%
Auditor rotation[7]	15	N/A	0	N/A
Other	80	33.5%	101	26.9%
TOTAL	**470**	**41.7%**	**463**	**35.4%**

Data for 2015 reflect the full year; data for 2016 reflect information through July 1.

Environmental and social proposals

Environmental and social proposals have been the second most prevalent type of proposals submitted for 2016. These proposals cover a broad scope of topics, ranging from diversity and climate change to various working conditions and human rights. These proposals were voted on substantially less often than was the case with governance proposals, and the level of support was generally far lower than for governance proposals. Year-to-date, 137 have gone to a vote, averaging support of only 16.9%.

Diversity topped the list for environmental and social proposals, with 11% of the total for 2016. The diversity proposals that have come to a vote, which pertained to promoting gender and racial diversity in both the boardroom and at the executive level, have averaged 24.8% support. The second leader of environmental and social proposals was climate change. These proposals focused on emissions reduction and reporting on risks relating to climate change. A new proposal seeking an annual assessment or report on the impact of the Paris climate conference generated average support of 36.4%[8] of votes cast; however, this may be due to the newness and limited number of such proposals.

Type of proposal	# Submitted in 2016	# Submitted in 2015
Diversity	31	32
Climate change	25	13
Supply chain sustainability	8	13
Renewable energy	26	13
Sustainability reporting	18	29
Human trafficking policies	5	0
Health-related matters	10	9
Recycling	11	7
Weapon sales	3	1
Other	156	230
TOTAL	**293**	**347**

Data for 2015 reflect the full year; data for 2016 reflect information through July 1.

An emerging proposal sought to have companies adopt principles regarding minimum wage reform. However, five of the six proposals[9] on this topic were successfully challenged under SEC rules as relating to ordinary business operations (i.e. "no action"), and one was withdrawn.

Notwithstanding the generally low levels of support, some proposals have passed thus far in 2016. The six successful proposals sought the following:

- A report on methane emissions
- A report on gender pay equity
- A policy to enhance board diversity
- Amendments to Equal Employment Opportunity Commission (EEOC) policy
- A sustainability report

[7] Per Alliance Advisors LLC, none of these proposals were voted on; therefore, there is no average approval.

[8] Shareholder Proposal Developments During the 2016—Gibson, Dunn & Crutcher LLP

[9] Shareholder Proposal Developments During the 2016—Gibson, Dunn & Crutcher LLP

Exploring say-on-pay further, under Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, most publicly traded companies in the United States are required to solicit advisory (i.e., non-binding) shareholder votes to approve the executive compensation program as described in the Compensation Discussion & Analysis (CD&A) and corresponding compensation tables. [1] This vote is commonly referred to as Say on Pay (SOP) and has been in place for annual shareholder meetings occurring on or after January 21, 2011. As of July 2016, over 400 of the S&P 500 companies have conducted their annual meetings and disclosed the results of their Say on Pay votes. Thus far, only five companies (1.2%) failed to gain a majority of shareholder votes for SOP, while 78% of companies received more than 90% support on SOP. This pattern of a low failure rate and high levels of support has been consistent since SOP began six years ago.

Not surprisingly, proxy advisory firms continue to have significant influence on the SOP vote at many U.S. companies. These firms have established compensation guidelines that identify acceptable and unacceptable compensation practices, and will call out compensation practices they believe warrant shareholder scrutiny. The proxy advisory firms also perform a series of quantitative analyses to evaluate the relationship between pay and performance along with a qualitative evaluation of the executive compensation program. Based upon their quantitative and qualitative evaluation, they will recommend that shareholders vote 'For' or 'Against' a company's SOP. We have observed, depending on the composition of a company's shareholder base, an adverse vote recommendation from one of the leading proxy advisory firms can influence the results of the SOP vote by 10 to 25 percentage points; an adverse vote recommendation from both firms can influence the results by 25 to 35 percentage points.

How can the board in general—and the Compensation Committee in particular—increase the likelihood of continued investor support for the executive compensation program and avoid an unwelcome decline in support at the annual shareholders' meeting? There are three areas Compensation Committees should consider focusing on when evaluating executive compensation programs. Fundamental to compensation program success is regular and proactive engagement with shareholders about the program. Other areas of focus include pay for performance and eliminating problematic pay practices and adopting appropriate compensation governance policies.

Compensation Committees should consider closely monitoring the alignment of executive compensation with both short-term and long-term company performance. They should also consider periodically evaluating whether the design of the program maintains an appropriate relationship between pay and performance during periods of both strong and poor stock price and financial performance. Shareholders expect to see proper alignment of pay and performance during periods of strong and challenging performance, and when a misalignment is evident, it can lead to a substantial decline in support for the SOP vote.

Additionally, Compensation Committees should consider reviewing the executive compensation program and consider eliminating any remaining problematic pay practices (e.g., excessive perquisites, an excise tax gross-up provision, single trigger acceleration of equity awards upon a change-in-control). Such changes are generally viewed favorably by both institutional investors and proxy advisory firms. In addition, if not already addressed, Compensation Committees should consider adopting compensation governance policies (e.g., meaningful stock ownership guidelines, a "clawback" policy, and a policy prohibiting the hedging and pledging of company stock by officers and directors) in order to demonstrate that the executive compensation program is aligned with leading practices in executive compensation.

Finally, Compensation Committees should consider directing management to conduct regular outreach with the company's largest shareholders and the leading proxy advisory firms on the executive compensation program in order to understand their views on the strengths and areas for improvement about the company's program. This process could provide the Compensation Committee with important feedback about the existing program and enable the Committee to consider potential changes to the company's executive compensation program that would be responsive to the concerns of the company's shareholders.

A focus on these three areas may help protect the company from stormy weather during the Say on Pay voting season.

[1] Under the Jumpstart Our Business Startups (JOBS) Act of 2012, companies that have conducted an initial public offering (IPO) on or after December 9, 2011 and qualify as an "emerging growth company" (EGC) have reduced executive compensation reporting requirements and are temporarily exempt from SOP.

Executive compensation

Two trends have emerged with respect to compensation proposals at 2016 shareholder meetings to date. First, the number of failed say-on-pay votes has decreased. Second, the number and levels of support for proposals relating to executive compensation matters have declined in 2016 as compared to 2015:

	2016	2015
Number	104	143
Average Support (% of votes cast)	15.0%	20.7%

Data for 2015 reflect the full year; data for 2016 reflect information through July 1.

These declines may result in part from declining CEO compensation and improved shareholder engagement. However, SEC rulemaking may also have taken some wind out of the sails of proponents; specifically, proposals seeking disclosure of CEO-to-employee pay ratios are no longer necessary due to the SEC's adoption of a pay ratio disclosure rule, and proposals seeking the adoption or disclosure of clawback policies may also have diminished due to the SEC's proposal of clawback rules—even though those rules have not yet been adopted.

The most frequently submitted compensation proposals submitted for 2016 have sought to limit accelerated vesting of equity grants; to link executive pay to social criteria; and to impose stock holding periods for executives.

Corporate civic engagement

These proposals—with the most common dealing with grassroots lobbying and corporate political contributions—continue to decline in number and levels of support, although two such proposals received majority votes:

	2016	2015
Number	111	128
Average Support (% of votes cast)	21.6%	17.8%

Data for 2015 reflect the full year; data for 2016 reflect information through July 1.

These declines may reflect the number of companies that have decided to provide reports on political contributions. According to the Center for Political Accountability, 301 companies are providing such reports and another 140 have agreed to do so in the future.

Conclusions

Despite the declines in numbers and levels of support for many types of shareholder proposals, it may be imprudent for companies to assume that these represent longer-term trends. The rise of proxy access proposals has blurred the picture, and as more and more companies adopt proxy access—either "voluntarily" or due to the passage of shareholder proposals—proponents who have traditionally submitted and supported more conventional governance proposals, as well as environmental and social proposals, may return to those areas. Executive compensation proposals may experience a resurgence due to factors such as regulatory changes which will result in increased executive compensation disclosures for the 2017 proxy.

In recent years, proposals on many of these matters—particularly governance and environmental and social matters—have been submitted to larger companies; mid- and small-cap companies have been overlooked as empowered investors have focused on their larger counterparts. As a result, governance reforms such as annual elections of directors, majority voting for directors, and others have become the norm at many large companies, and those companies have also been more aware of their role in environmental and social matters. While we anticipate continued focus on the large companies who have not yet addressed these shareholder proposals, it stands to reason that small and mid-cap companies may see increased investor pressure in these areas, in the form of shareholder proposals or otherwise.

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