

Issuer Engagement with Institutional Investors - Advice from Donna Anderson at T. Rowe Price

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Engagement with shareholders plays an increasingly important role in strengthening issuers' corporate governance practices. With proxy season around the corner, we turn to Donna Anderson, a vice president of T. Rowe Price Associates, Inc., and global corporate governance analyst in the U.S. Equity Division of T. Rowe Price., for her perspective on company efforts. In her current role, Donna leads the policy-formation process for proxy voting, shepherds the firm's engagement efforts with portfolio companies, and is co-chair of the Proxy Committee. She joined the firm in 2007, has 15 years of investment experience, and was recently named one of the "People to Watch" in the NACD Directorship 100.

Davis Polk: Part of the difficulty companies sometimes have with investor engagement is finding the right person to talk to, since institutions operate under different structures. We understand that at T. Rowe Price, proxy voting responsibility is assigned to each fund manager, with recommendations from the industry analyst and the governance analyst. What role do you play in voting decisions, and who should companies interact with in the first instance when they have an issue they want to discuss?

Donna Anderson: We encourage companies to contact us however they wish. Typically, dialogue begins with a call from the IR department to our industry analyst or from the corporate secretary's office to me. Either way, we make every effort to have these discussions jointly. We believe it's important to incorporate the investment context and the governance perspective when it comes to our voting decisions.

I would not want to leave you with the impression that our fund managers are equally engaged in every proxy voting decision. We do not expect them to be familiar with every corporate governance issue in every country where they invest. This is why we've deployed internal resources in this area, to support our managers' ability to make these decisions. Generally speaking, our fund managers tend to follow the standard T. Rowe Price guidelines when it comes to the more arcane areas of corporate governance (certain shareholder proposals, takeover defenses, bylaw changes, forum selection provisions, etc.). By contrast, they tend to be quite engaged and opinionated in the areas of director elections, compensation, equity plans, M&A, contested elections, and the like.

Davis Polk: What are some of the issuer engagement efforts that you find to be useful, and what in particular would you advise companies to focus on, or even to avoid?

Donna Anderson: Our approach is an open-door policy. If a company wishes to speak with us about corporate governance matters, we will gladly take the meeting. The objective of this type of engagement should be establishing a two-way dialogue about substantive issues. Once a relationship has been established, some companies find there's no need to meet on a regular schedule (once or twice a year). Other companies prefer regular, periodic contact as a way of collecting up-to-date feedback from their shareholders. We are flexible about the method, but I would say that incorporating some level of proactive outreach to shareholders into a company's governance program is an investment that pays off when the company encounters the inevitable setback. It is frustrating for us to receive those panicked phone calls 48 hours before a shareholder meeting when the votes are flooding in and the company finally realizes its shareholders have serious concerns.

Another tactic I'm not sure is useful is placing the burden of engagement on shareholders. We receive a surprising number of form letters every year saying, in essence, "We at XYZ Corp. care about corporate governance. If you have anything you'd like to discuss, give us a call." We would not characterize this as proactive outreach. While we would like to have the time to respond to open-ended requests, the companies offering specific agenda items for discussion are the ones we put at the top of the priority list.

Sometimes an issue doesn't arise until the midst of proxy voting season, and we understand that. We are always willing to have shorter, targeted discussions about particular voting issues. In this regard, we found this year's supplemental proxy disclosures to be quite helpful. We did read them, and we thought they were effective and efficient vehicles for communication.

Davis Polk: Tell us what issuer engagement was like during the 2011 proxy season, with say-on-pay being the primary focus as we were all learning in this first year. Did you find companies prepared and ready to discuss issues or did you find that engagement was mostly reactionary? What are you expecting now from companies with respect to their say-on-pay votes? Are you currently inundated with requests for discussions?

Donna Anderson: I know some institutional shareholders are inundated, but that has not been our experience. We can tell from the call volumes that many calendar-year-end companies are drafting next year's proxies now, but we do not experience nearly the level of inbound calls that some larger asset managers do.

This year, I found companies were well prepared for compensation-related discussions, by and large. We heard from companies who knew (or suspected) they would have a rough time getting through their first say-on-pay votes, and we heard from companies with very modest, well-constructed plans who simply wanted to know how their shareholders felt about their CD&A disclosures. For the more complex compensation discussions, we find it helpful when someone from the company's HR team is on the line, but we're not as comfortable speaking with external compensation consultants.

Davis Polk: Recognizing that ISS recommended against the say-on-pay votes for 11% of the companies they covered while the rate of failed votes was much lower, at less than 2%, it appears that institutional investors approached the vote using their own independent analysis. How does T. Rowe use proxy advisory services? Should companies facing negative recommendations from proxy advisory services address those issues head-on with their investors, and if so, how should they engage in those discussions?

Donna Anderson: I've studied this year's results, and there is no question in my mind that shareholders exhibited a lot of independent thinking on say-on-pay this year. It's not just the small number of failed votes relative to ISS recommendations. There were also a couple of dozen companies that saw support levels for their pay votes in the 50's and 60's even with favorable ISS recommendations. I think each say-on-pay outcome reflects a unique concoction of past pay decisions, stock performance, shareholder characteristics, company size, proxy advisor recommendations, company outreach, and the quality of the compensation disclosure.

For our general voting guidelines, T. Rowe Price employed a scorecard approach to say-on-pay votes. Our view is, we shouldn't be voting against pay plans when we only have one or two concerns. Our "no" votes should reflect a persistent pattern of concerns that we believe have not been adequately addressed. Our scorecard for this year included a 25% weight on our proxy advisors' recommendations. We found their recommendations to be helpful in the many instances where our quantitative screening process identified situations that needed a more qualitative review. There were many occasions (on both positive and negative recommendations) where we agreed with the ISS or Glass Lewis analysis. In other instances, we thought they placed too much weight on short-term considerations (year-over-year changes in pay, for example) or one-off pay practices such as single triggers.

From a company's perspective, I understand the impulse to react aggressively to a negative vote recommendation. I hope that, after this year, companies will see the proxy advisor recommendation as just one factor in the mix. Every company should be able to gain at least some new insight from an expert outsider's review of their pay program, shouldn't they? Why not react to their analysis in a more constructive, open-minded manner? Also, companies should not assume all their shareholders follow ISS's guidance. It's not a great use of time, especially during proxy season, for a company to launch into a 10-minute monologue on all the reasons ISS has it wrong, only to find out that the shareholder subscribes to a different advisor or has a customized approach to pay. My advice to companies in this situation would be to remain calm, issue an 8-K if you feel the facts have been misinterpreted, initiate an outreach effort to your largest shareholders, and find out what their say-on-pay triggers are before you spend time on rebuttal.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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