

Say-on-Pay Results Reflect Need to Understand Proxy Advisory Firm Methods

April 3, 2013 | Client Update | 2-minute read

According to the latest Semler Brossy [report](#), only three Russell 3000 companies (Nuance Communications, Digital Generation and Navistar) have failed their say-on-pay vote, with Navistar receiving only a startling 18% in favor. ISS has been recommending against companies about 9% of the time, and companies facing ISS opposition received 24% less support on average. Interestingly, ISS continues to reverse unfavorable recommendations. It did so for 17% of companies in 2012 and most recently for both Hewlett-Packard and Kaman Corp., after the company removed excise tax gross-ups from an executive's renewed change-in-control agreement.

In a recent [analysis](#), the consulting firm discussed why a company may encounter a significant reduction in votes from one year to next. While only a small number of companies see a truly meaningful reversal, the firm urges that "the low frequency of this event belies the significant risk companies may face if they become complacent in their approach. Garnering strong support in one year is certainly no guarantee for future Say on Pay success and no company is necessarily immune from such a reversal of fortunes." It concluded that when a company's TSR performance declined and pay was not adjusted accordingly, the more thorough qualitative review ISS conducted once companies failed the first quantitative review identified problematic practices that were probably in existence in prior years. Companies may be "caught off-guard," and therefore unprepared to respond, since those same practices that may never have even been mentioned in prior ISS voting reports were suddenly cited as the reasons that investors should vote against the proposal. Semler Brossy recommends being prepared, including "preemptive conversations" with the proxy advisers rather than making supplemental filings after-the-fact.

In our view, this reflects the need for companies to understand, as outlined in the somewhat dense ISS white paper on their say-on-pay analysis, that an initial quantitative screen by ISS represents exactly what it sounds like: a test of a few numerical-based factors focused on the size of the overall compensation paid and the company's TSR performance, relative to peers. A more holistic approach, the so-called qualitative review, to the company's compensation program is not undertaken unless ISS believes that the initial test reflects a "misalignment" between pay and performance. In other words, a favorable recommendation by ISS in any one year is not a wholesale endorsement of the company's compensation structure, and in fact, ISS may have many issues with those practices if it actually has to get to the next step of examining them.

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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