

EXCELLING AT ENGAGEMENT

A decade into Say on Pay, effective shareholder outreach is more critical than ever.

INCIDENTS OF SOCIAL UNREST,

climate-related natural disasters, a global pandemic—it's perhaps fitting that the events of 2020 gave companies plenty to talk about in a year that marks Say on Pay's 10th anniversary. As highlighted in "The Rise of Shareholder Outreach" (*Corporate Board Member*, Q2 2020), interest in more proactive engagement with proxy advisors and investors on compensation matters has been growing steadily over the past decade. The challenges of the past year only served to accelerate that evolution.

One reason is that while most companies refrained from modifying compensation plans during the throes of the pandemic, those that did so now feel compelled to explain their rationale, says James Park, a principal at FW Cook. "After Covid hit, some companies elected to modify their compensation programs, which kickstarted conversations about whether to bring investors into the loop and, if so, when," he explains. "Now, some companies are in a position to have to defend these pay actions, partic-

ularly those that fully recovered by year end. These companies may be judged with the unfair benefit of hindsight. They need to bring everyone back to what was going on in March 2020 and the factors that led to those decisions being made."

ENGAGING WITH INTENT

It's that type of situational engagement—compelled by the desire to explain extenuating circumstances—that most often prompts companies to consider outreach on compensation.

Companies aware that a compensation decision may be viewed negatively by investors can seek to preemptively address the issue by engaging with shareholders after the end of the fiscal year but prior to filing a proxy report. Often, however, it's negative vote recommendations from proxy firms or the reaction of a dissident activist investor during proxy season that trigger the need for engagement. This allows companies only a short window of time to conduct outreach before the annual meeting.

Given those time constraints, those

that see a potential need for engagement should be prepared to move quickly, notes Park. "Identify your biggest shareholders, review their voting history and proxy voting guidelines," he says, adding that directing communications to the right party is key. "Many large institutions have a stewardship team, separate and apart from the investment team, for discussions related to executive compensation and other proxy voting issues."

In the case of a negative vote recommendation, companies may also want to include proxy advisory firms in their engagement efforts. While overturning an "against" recommendation is unlikely unless there are significant factual errors to correct, Glass Lewis and ISS do communicate feedback from companies to their subscriber base, which provides context to investors.

SOLICITING MEETINGS

When requesting time with shareholders, companies should be prepared to make a strong case for getting an audience. "Not all investors have the bandwidth for direct engagement during the proxy season," says Park, who points out that proxy season is finite, and large institutions comb through thousands of shareholder proposals and engagement requests each year.

BlackRock, for example, recently reported that it held more than 3,000 engagements between July 1, 2019 and June 30, 2020 and votes at approximately 16,000 shareholder meetings in 85 markets each year. For the year ending December 31, 2020, Vanguard's Investment Stewardship team reported voting on more than 176,000 individual matters, engaging with 655 portfolio companies and meeting with thousands of executives and board members across the globe.

That increasing level of engagement on a widening spectrum of complex





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topics means companies must make a compelling case to win an audience with investors. “It’s important to state your objective, introduce the team who will be attending and lay out a detailed agenda for what you want to cover,” says Austin Lee, a partner at FW Cook, who explains that investors increasingly gauge how serious an issuer is about engagement based on board member participation.

“Having a robust participant list, including independent directors and members of the compensation committee, adds credibility to the discussion, as they are ultimately responsible for approving executive compensation decisions,” adds Park. “Some investors will outright decline an invitation to engage if a board member doesn’t participate.”

PREPPING FOR THE CONVERSATION

Prior to the meeting, companies should review the investor’s proxy voting guidelines and be prepared to discuss their business objectives, governance framework and compensation philosophy. It’s also critical to prepare talking points to demonstrate how the pay program supports business strategy and long-term shareholder value creation.

The engagement team should also be equipped to engage on broader governance issues, notes Park, who says shareholders are using this opportunity to expand beyond compensation to delve into other areas of interest. “Once you get in the room, they may ask questions like, ‘What’s your policy on gender pay equity? What is your company doing to address climate change risks?’” he explains. “Large institutional investors have made it clear that long-term value creation is supported by good governance and sustainable business practices. Companies must be prepared to discuss their view on social and environmental issues.”

During the discussion, it’s critical to avoid disclosure of any material non-public information that would have Regulation Fair Disclosure implications. If the engagement will benefit from discussing non-public information that hasn’t been communicated to shareholders, the company may want to file an 8-K with relevant engagement material that can be shared with all investors.

ASSESSING OUTREACH EFFORTS

During the outreach process, be sure to document who was solicited for engagement, which investors accepted the approach, whether it was successful at gaining support and any feedback about the pay program that it generated. In addition to informing internal discussion of whether any program changes are appropriate, that information can be used to help improve on future outreach efforts.

“You can’t please everyone. An evolving global investor base with conflicting views on corporate governance can present challenges for companies,” notes Park, who points out that companies may find themselves having to reconcile disparate perspectives. “So, evaluate what changes support the company’s long-term business strategy, or you may go through the entire process and decide there’s no need to change.”

Whatever the ultimate decision, it’s crucial for companies to follow up on engagements, acknowledging and

responding to what was heard. “That’s even more important if you choose not to make a suggested change,” says Lee. “You want to loop back sometime in the off-season and let them know, ‘Here’s why we didn’t go that route. And here’s why that decision aligns with our business strategy and the long-term interests of our shareholders.’”

Ideally, that conversation will be the start of an ongoing communication, enabling companies to build credibility with issuers over time. “Once you begin shareholder outreach, there’s a benefit to making a practice of reaching out to investors every year about the company’s business objectives and how the compensation program supports those objectives,” says Lee, who says regular shareholder outreach can lessen the probability of an investor having a knee-jerk reaction to an anomaly event or negative proxy advisor recommendation. “By demonstrating that you’re listening and responding to them, you’re building a level of trust.”



James Park is a principal at FW Cook with 20 years of experience assisting large complex organizations undergoing business transformation, facing challenged Say-on-Pay votes and conducting investor engagement.



Austin Lee, a principal at FW Cook, conducts market analysis on executive pay levels, designs performance-based annual and long-term incentive programs and evaluates the relationship between executive pay and company performance.