All quiet? Keep it that way

Say-on-pay support was up this year and proxy advisers had fewer beefs. Rather than be complacent, boards should build on this goodwill by stepping up shareholder communications and engagement

By Ken Hugessen with Michelle Tan

Anyone reading the headlines during the 2015 proxy season might think recent efforts to reform executive compensation in Canada have suddenly fallen off the rails with this year's multiple say-on-pay failures. But judging by shareholder votes, we see that the vast majority of companies appear to have compensation well in hand and it is only a few high-profile say-on-pay failures and low director election results causing most of the furor. In the face of such contradictory information, developing a complete communication and engagement strategy is the best way for companies to understand their say-on pay results, stay abreast of the evolving environment and be prepared for potential issues.

With 47 TSX 60 companies now providing a say-on-pay vote, the average level of support has hovered around 90% of votes cast. In fact, as adoption has spread, the percentage of companies with greater than 90% support has generally increased, reaching a record 85% in 2015. Consistent with this result, the number of proxy adviser recommendations against TSX 60 say-on-pay votes is lower in 2015 than each of the past two years.

With such high support levels why should companies worry? In most cases a drop in shareholder support follows a negative recommendation from a proxy adviser. Furthermore, a favourable recommendation one year is by no means a guarantee for the next year even when the company's approach to compensation is unchanged.

While a negative recommendation on its own is unlikely to lead to a failed SOP vote even for issuers unfortunate enough to have both ISS and Glass Lewis recommend "Against" in the same year, it does have an impact. Among widely held Canadian companies, our research shows that a negative recommendation from one adviser is generally associated with a 15-30% dip in shareholder support.

There are also cases of lower levels of shareholder support when both of those proxy advisers recommend in favour. It is evident that at least some institutions are applying a different standard in determining their own voting decisions.

And then there are the rare but growing number of cases where large, mainstream Canadian institutional shareholders publicly disclose their votes against a say-on-pay in advance of the company's voting deadline, which contributed to some of the highest-profile say-on-pay failures of 2015. In a recent *Listed* article Stephen Davis coined the acronym "i2i" in reference to the engagement and relationships between various activists and pensions funds regarding proxy contests. This same investor-to-investor network also plays a role in the determining say-on-pay results, with such peer-to-peer discussions increasing shareholders' resolve in opposing certain voting decisions.

Given the disparate views of the shareholder community, it can be hard for directors to decipher the true message from their say-on-pay result. Incorporating proactive, director-led engagement into the company's communication strategy is one way to hear the concerns and expectations of shareholders and allow the company to identify those with legitimate issues. To be effective, a good communication and engagement program includes the following:

- Leadership and involvement of the board chairman and chairman of the compensation committee;

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- Relationships built with governance and investment reps before the hectic proxy season;
- Clear disclosure of pay-for-performance rational which sets the groundwork for future discussions with shareholders.

The key for issuers looking to attract and retain institutional investors and remain out of the proverbial compensation doghouse is to keep your finger on the pulse of the major shareholders. The benefits of good communication are particularly valuable for a board looking to position its pay-for-performance narrative against a potentially conflicting story told by a proxy adviser, while engagement allows a company to fully understand the nuances behind a say-on-pay result and to communicate directly with their shareholders if required.

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