



Executive Compensation and Corporate Governance Insights

SEPTEMBER 2019

2019 SAY-ON-PAY RECAP

Shareholders Find Their Own Voice

KEY 2019 SAY-ON-PAY HIGHLIGHTS

- **Russell 3000 Say-on-Pay Results Improve Slightly:** While shareholder support and say-on-pay results stayed effectively flat, Russell 3000 companies saw a decline in negative voting recommendations from Institutional Shareholder Services, or ISS, (274 “against” recommendations in 2019 vs. 303 in 2018) but only a slight reduction in the number of failed proposals (50 failed companies in 2019 vs. 53 in 2018). Overall, Russell 3000 companies averaged 90.67% support in both 2018 and 2019.
- **More Active Shareholder Voting:** Institutional investors are becoming less reliant on the voting recommendations of proxy advisors and performing their own due diligence and research on executive pay matters, signaling to companies the need for active engagement with shareholders and meticulous compensation disclosure.
- **Problematic Severance Provisions Continue to Drive Negative Voting Recommendations:** Companies that have a “low” concern under the pay-for-performance model almost always receive a favorable voting recommendation from ISS (the most influential of the proxy advisory firms). The main exception relates to companies that renew employment contracts without modifying previously grandfathered “problematic” provisions, such as excise tax gross-ups or “excessive” severance provisions.

2019 VS. 2018 SAY-ON-PAY RESULTS

While overall say-on-pay support stayed effectively consistent across industries, the companies in the Russell 3000 had a slight decrease in the number of failed companies, despite relatively consistent voting recommendations from ISS:

- The number of companies in the Russell 3000 that received negative ISS voting recommendations decreased almost 1%.
- The communication services industry received the highest percentage of say-on-pay proposal “against” recommendations from ISS in both 2018 and 2019.

- The consumer staples and utilities industries received the lowest percentage of say-on-pay proposal “against” recommendations from ISS in 2018 and 2019, respectively.
- Despite the overall decline in the number of “against” vote recommendations from ISS, the industrials, information technology and real estate industries saw a slight increase in “against” vote recommendations.

Industry/Index (by GICS Code)	Year	Average Support	ISS “Against” Vote Recommendations		Failed Say-on-Pay Proposals	
			#	% ¹	#	% ¹
Russell 3000	2019	90.67%	274	12.7%	50	2.3%
	2018	90.67%	303	13.5%	53	2.3%
Communication Services	2019	85.77%	13	21.7%	7	11.7%
	2018	86.99%	20	26.3%	5	6.6%
Consumer Discretionary	2019	91.27%	31	12.0%	2	0.8%
	2018	90.67%	36	13.0%	6	2.2%
Consumer Staples	2019	90.72%	6	9.7%	2	3.2%
	2018	90.90%	6	7.2%	3	3.6%
Energy	2019	89.34%	22	16.3%	3	2.2%
	2018	86.97%	28	22.6%	6	4.8%
Financials	2019	91.83%	51	11.9%	4	0.9%
	2018	90.98%	56	13.7%	7	1.7%
Health Care	2019	89.67%	39	12.8%	8	2.6%
	2018	90.69%	41	14.0%	5	1.7%
Industrials	2019	92.03%	33	10.3%	6	1.9%
	2018	93.18%	30	8.8%	5	1.5%
Information Technology	2019	88.48%	41	16.0%	14	5.5%
	2018	89.77%	39	13.0%	9	3.0%
Materials	2019	92.40%	10	8.9%	1	0.9%
	2018	90.59%	17	14.2%	3	2.5%
Real Estate	2019	90.02%	27	16.9%	2	1.3%
	2018	89.91%	24	15.3%	4	2.5%
Utilities	2019	92.76%	4	5.6%	1	1.4%
	2018	92.91%	6	8.5%	0	0.0%

(1) Total number of say-on-pay proposals each year may vary based on reporting companies; accordingly, the percentage listed may not coincide with the increase (decrease) in the number of companies year over year.

Source: ISS Corporate Solutions for data available as of July 31, 2019.

SHAREHOLDER VOTING PATTERNS

The guarantee of 95%+ shareholder support with a positive ISS recommendation is fading as investors and shareholders are more apt to formulate their own opinions on executive pay matters. Historically, a positive recommendation from a proxy advisory firm (e.g., ISS, Glass Lewis, etc.) signified that shareholders rarely examined a program before voting in favor of it. Over the past couple of proxy seasons, most large institutional shareholders have conducted their own due diligence in conjunction with their own independent policy positions, even if the proxy advisory firms recommended “for” a say-on-pay proposal. The most notable example of this paradigm shift occurred during the 2018 proxy season: CalPERS voted “against” 43% of say-on-pay proposals for US companies in the Russell 3000, while by comparison, ISS only recommended “against” for 13.5% of these companies.

In 2019, the number of Russell 3000 companies that received 95% + support dropped to 1155 companies (down from 1218 the previous year). Additionally, the number of Russell 3000 companies that received less than 80% shareholder support for say-on pay following a positive voting ISS recommendation increased to 62 (up from 50 the previous year) indicating the downward pressure experienced when deviating from policies of a particular institutional investor. The risk for companies with less than 80% support is in future years, if ISS or Glass Lewis recommends against their say-on-pay proposal, receiving majority shareholder support will likely prove to be much more difficult. Below is a snapshot of the shareholder approval distribution from 2018-2019:

Shareholder Approval	Russell 3000 Companies with Positive ISS Recommendation	
	2019	2018
> 95%	1155	1218
90% - 95%	476	478
85% - 90%	120	123
80% - 85%	64	68
< 80%	62	50

Notwithstanding this new pattern, mid-size and smaller institutional investors generally do not have the resources necessary to both review proxy statements on a large scale and continue to rely on the proxy advisory firms to filter their workload by identifying the companies with potential compensation-related concerns. While some of these mid-size and smaller institutional investors vote blindly with the recommendations of the proxy advisory firms, many conduct their own research and make independent decisions for only those companies with an “against” vote recommendation.

USE OF SUPPLEMENTAL FILINGS

As shareholders continue to vote more independently of ISS and Glass Lewis, more companies have found it worthwhile and advantageous to directly appeal to investors in response to a negative say-on-pay vote recommendation. While direct communication is typically preferred and most meaningful, given the limited window of time between the proxy advisory recommendation being made available and the shareholder meeting date, companies are responding with supplemental disclosure (typically a DEFA14A) to provide additional

context to the compensation programs and to ensure all shareholders have the opportunity to hear their counter arguments.

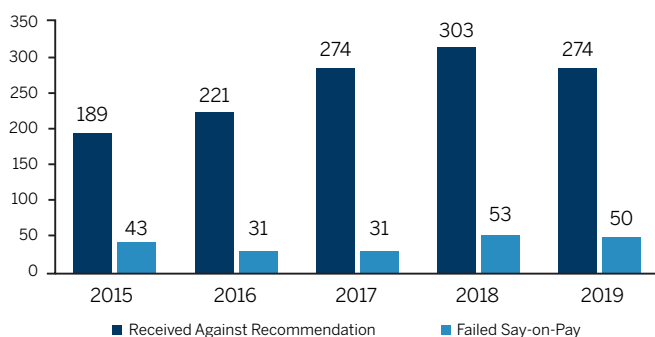
Of the 274 companies that received a negative ISS voting recommendation, approximately 25% (or 66 companies) filed supplemental proxy materials which did not result in a material difference in shareholder support. While the ultimate success of these filings was mixed, it is important to note that the supplemental information can result in ISS re-evaluating their initial voting recommendations, with some companies effectively persuading ISS to reverse their recommendations.

SNAPSHOT OF SAY-ON-PAY AT RUSSELL 3000 COMPANIES

Despite the immaterial shift in average say-on-pay support at Russell 3000 companies, say-on-pay proposals experienced an approximate 10% decrease in negative ISS voting recommendations – declining from 303 to 274 “against” voting recommendations from 2018 to 2019. Shareholder support is trending slightly downwards regardless of whether a company received a “for” or an “against” ISS voting recommendation.

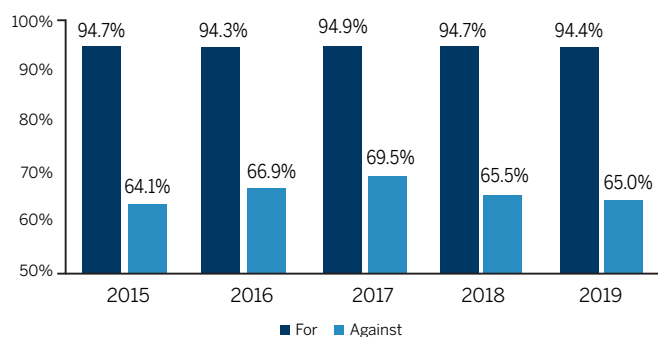
50 RUSSELL 3000 COMPANIES RECEIVED A NEGATIVE SAY-ON-PAY VOTING RECOMMENDATION IN 2019

Number of Russell 3000 Companies with an ISS Against Voting Recommendation vs. Failed Say-on-Pay Proposals



VOTING RESULTS AT RUSSELL 3000 COMPANIES REMAINED CONSISTENT

Average Support at Russell 3000 Companies based on ISS Voting Recommendation



SPOTLIGHT ON EQUITY PLAN PROPOSALS

During the 2019 proxy season, ISS added pressure to equity plan proposals to increase the number of shares reserved for compensation purposes. The foundation of ISS’s equity plan review is based on the points earned under the Equity Plan Scorecard, which evaluates plan cost, grant practices and plan features. In select circumstances, ISS has now begun issuing an adverse voting recommendation for equity plan proposals, even in situations when a company is above the 53-point threshold necessary under the scorecard, if:

- A pay-for-performance misalignment is identified in connection with the say-on-pay proposal; and
- Equity utilization is not considered “broad-based” and is heavily concentrated in grants made to the CEO and other NEOs (i.e., three-year average concentration ratio of grants is greater than 30% for the CEO or 60% for all NEOs, inclusive of the CEO).

While ISS issued 139 negative voting recommendations, only two companies in the Russell 3000 failed to approve an equity plan proposal.

FACTORS INFLUENCING ISS VOTING RECOMMENDATIONS

A pay-for-performance misalignment under the ISS model continues to be the main precursor of negative voting recommendations; however, an elevated score does not guarantee a negative recommendation. Additional qualitative concerns outside the quantitative model are generally necessary (e.g., rigor of incentive goals, one-time equity awards, etc.) for ISS to issue a voting-against recommendation. In contrast, a “low” concern will generally result in a positive recommendation, with one exception: if an amended employment agreement contains problematic severance provisions, this may override the “low” concern and result in an “against” recommendation (some companies with a “low” concern triggered negative recommendations based on severance provisions).

The most commonly cited factors influencing an against recommendation from ISS include (sorted by prevalence):



Rigor of the company’s performance goals (STI or LTI), including rTSR targets at or below median and uncapped payouts for negative absolute TSR



Outsized equity awards, either annual grants or **supplemental one-time awards**, often despite sustained TSR underperformance



Problematic severance-related provisions, including excise tax gross-ups, excessive severance and single-trigger equity vesting



Problematic STI (cash bonus) program design features, including largely discretionary plans or lack of pre-set financial metrics



Problematic LTI (equity) program design features, including annual performance periods, insufficient performance-based awards or retesting features



Outsized STI targets and/or **outsized base-salary amounts** (or significant increases without compelling rationale)



Provided **significant perks** – automobile-related or large, enhanced life insurance perks

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