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Corporate Governance

This is the third of a three-part series on corporate governance changes contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Say-on-Pay Votes Change, Enhance Role of Proxy Advisory Firms, Many Agree

NEW YORK—Practitioners may differ on just how much influence proxy advisory firms wield in corporate proxy matters, but all agree that companies do take seriously the advisory firms' recommendations on say-on-pay votes, practitioners and others told BNA in June interviews.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203) required for the first time, beginning in the 2011 proxy season, that public companies hold nonbinding shareholder votes on executive pay. In addition to other services, proxy advisory firms make recommendations on whether shareholders should vote ''yes'' or ''no'' on these say-on-pay votes.

While two of the most influential U.S. proxy advisory firms, Institutional Shareholder Services Inc. (ISS) and Glass Lewis Co. LLC, have recommended shareholders vote ''no'' on about 14 percent of say-on-pay votes during the 2012 proxy season, just 2.7 percent of companies failed their say-on-pay votes as of June 20, according to Semler Brossy Consulting Group LLC data.

But, the practitioners said, companies holding say-on-pay votes still must reckon with the advisory firms, claiming the advisory firms can swing a vote by as many as 30 percentage points or even more.

Influence of Firms Debated. Proxy advisory firms offer their clients, for a fee, research and analysis on company proxy materials, including recommendations on how shareholders should vote on proxy matters.

Practitioners interviewed for this report said the advisory firms have grown more prominent with Dodd-Frank enactment because the firms make say-on-pay vote recommendations. However, the practitioners disagreed on whether the firms' influence has grown, decreased, or stayed about the same.

''I'd say the proxy advisory firms have significant influence. I think their influence has been ascending,'' Deloitte Consulting LLP principal Michael S. Kesner told BNA in June.

Others agreed.

''I think it's growing because of the say-on-pay votes. It takes enormous resources for investors to do the analysis and make thousands of voting decisions on an annual basis,'' Georgeson Inc. senior managing director (corporate governance), Rhonda Brauer, told BNA June 21.

For that reason, many investors may be relying more on proxy advisory firms for their analysis, or for outsourcing their voting decisionmaking completely. Under these circumstances, the proxy advisory firms are likely to continue to be influential, she said.

Dealing With Proxy Materials. Some had a different view.

While there are certainly cases where the advice of proxy firms dictates votes because investors do not have the resources to review all proxy materials themselves, these firms mainly provide additional analysis and perspective that supports investors as they consider how to cast their votes, Semler Brossy principal Todd Sirras told BNA.

The sheer volume of proxies that large institutional investors must review means that those investors may rely heavily on the proxy advisory firms for basic research, as well as complex analysis and recommendations on say-on-pay votes, Sirras said.

If anything, the firms have gained attention because of the establishment of the say-on-pay votes, Sirras said. ''I wouldn't say they are gaining influence, I'd say they are influential in something that has become prominent,'' he said.

Others agreed.

''I would say they are just as important today as they were a few years ago, in terms of influencing the debate on all of these issues. I don't anticipate that changing any time soon,'' one corporate governance lawyer said.

Glass Lewis Response to Changes. Glass Lewis chief policy officer Robert McCormick told BNA June 19 that, since Dodd-Frank enactment, his firm, in response to client requests, has enhanced the types of information it presents to clients so they can make better informed decisions on say-on-pay votes.

Specifically, Glass Lewis has provided ''more basic data to our clients on the compensation practices at companies on a qualitative basis so they can understand exactly what is going on'' regarding companies' executive pay regimes, he said.

Before Dodd-Frank, Glass Lewis comparatively limited its executive compensation analysis to a company's compensation committee and its board of directors, he said.

He also said, while say-on-pay votes may have increased his firm's workload, the Dodd-Frank requirement for companies to hold say-on-pay votes has not created more ''opportunity'' to increase its business or profitability.

Glass Lewis has not ''tracked our influence'' regarding say-on-pay votes; in any event it would be difficult to do so, McCormick said. If Glass Lewis recommends a ''no'' vote, a shareholder might vote ''no'' for entirely different reasons than those provided by Glass Lewis analyses, he said.

''[I]t is very difficult to figure out if that vote is being driven solely by the recommendations or if it's whatever concerns we have are being shared by the institutional investors,'' he said.

Company Outreach to Advisory Firm. One change that Glass Lewis has noticed is an uptick in the number of companies that contact the advisory firm to discuss its say-on-pay recommendation, he said.

At those meetings, Glass Lewis is ''always very cautious not to make any specific suggestions because every company is different, and they should really design what makes sense for themselves,'' he said.

The result? ''What we've seen is much better disclosure provided by companies on compensation as a result of engaging certainly not just with us—maybe maybe that's a part of it—but more broadly with their shareholders,'' McCormick said.

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An ISS spokeswoman did not respond to telephone and email messages seeking comment.

Impact on Votes. There is no dispute that advisory firms may have an effect on say-on-pay votes.

ISS's influence has increased to the point where its recommendation can lead to a 30 percentage point swing in a say-on-pay vote, University of Delaware finance professor and corporate governance specialist Charles M. Elson told BNA.

''So they are clearly influential. It doesn't mean a company will fail the vote with a negative ISS recommendation, but ISS will drive down the vote,'' Latham & Watkins LLP partner James D. C. Barrall told BNA.

Another corporate governance lawyer said that, while the proxy advisory firms may materially influence the outcome of a say-on-pay vote, a ''no'' recommendation from ISS or Glass Lewis ''is not an absolute kiss of death.''

Outsourcing of Work? Several practitioners said companies, with the advent of the say-on-pay vote, may be looking to the proxy advisory firms to assist with analyzing proxy materials.

Some companies essentially outsource their proxy statement review and voting completely, wholly relying on the advisory firms and voting their shares in accordance with proxy advisory firm recommendations, Brauer, of Georgeson Inc., said.

These investors believe they are satisfying their fiduciary duties in this way, said Brauer, whose firm helps its public-company clients facilitate engagement with their investors to achieve their desired proxy voting results, and also provides other corporate governance consulting services.

Many institutional investors are both ISS and Glass Lewis clients because the combination provides two distinct points of view on a company, which may help investors make more informed voting decisions, she said.

Some proxy advisory firms also offer clients the option of facilitating shareholder votes. Glass Lewis, for instance, offers its clients the ability to implement their own custom proxy voting policy, or to select from a number of pre-set policies

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