Cogent Alert

COGENT COMPENSATION PARTNERS

Preparing for Say on Pay - Practical Considerations

American companies have been anticipating legislation requiring shareholder votes on executive pay for some time. Now, with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July of 2010, most public companies will be required to provide shareholders with a non-binding vote on their executive compensation programs, popularly known as say on pay. The SEC proposed rules related to say on pay in October of 2010, and is expected to adopt the final rules in early 2011. Implementation will begin at companies with shareholder meeting dates on or after January 22, 2011.

While the legislation may have been motivated to address perceived abuses in executive pay, the vast majority of publicly traded companies in the U.S. already administer executive pay in a reasonable and responsible manner. Nevertheless, this legislation is causing public companies to assess their executive pay programs in light of the new requirements.

In preparation for executive compensation disclosure under the new rules, this Cogent Alert offers suggestions to help frame the process. It is not intended to deal with the myriad of compliance issues reserved for legal counsel, but rather to offer practical considerations for those involved in executive compensation administration.

1. Take a deep breath. You are probably doing fine as the majority of filers' pay practices are reasonably constructed. Popular media attention tends to focus on the outliers.

2. Critically assess current compensation arrangements and governance practices from an objective standpoint and anticipate shareholder reaction.
   - Look for investor red flags and test the business case for such practices (e.g., perquisites, gross-ups)
   - Test your current executive compensation arrangements for linkage to short-term and long-term business objectives and strategy
   - Assess whether there is a real linkage between pay and performance
   - Look objectively at the reality of the shareholder experience as it relates to equity compensation and company stock performance
   - Determine if pay plans are current as meaningful change in the market challenges the validity of existing programs

- Ensure that gaps in governance practices do not leave room for shareholder criticism, including areas such as:
    - Committee independence
    - Consultant independence
    - Executive involvement in the decision process
    - Charter relevance
    - Outdated peer groups

3. Challenge existing shareholder communications for cogency and persuasiveness. Many Compensation Discussion and Analysis sections (CD&As) started out to describe pay programs but have been obscured by compliance considerations.
    - Start with a clean piece of paper.
        - Examine, identify, and confirm core message to shareholders concerning executive pay programs and ask if the existing CD&A really conveys that message
        - Involve new participants in the process; fresh eyes on existing communications may stimulate new perspectives
    - Develop an outline that guides the train of thought
        - Because the disclosure rules require so much detail in compliance, an outline can help keep messaging on track
    - Tell your story
        - Describe to shareholders the company's successes, and how company performance drives executive pay
        - Explain the linkage of pay programs to the shareholder experience, and the creation of long-term value by the executive team
        - Disclose any shareholder-friendly changes to compensation programs
    - Consider communication methods that contribute to concise and accurate reporting, including bullet points, tables, charts and graphics
    - Resist boilerplate language and redundancy
        - Start with an ideal length for the CD&A (and tables) and hold yourself to some boundaries
        - Approach the communication from the standpoint of the shareholder question, "What's in it for me?" This external view of communication will help balance the message
        - Develop CD&A disclosure so that it facilitates more direct communication with influential shareholders

- Do not discount legal and compliance issues. The rules governing disclosure require up to date advice from qualified legal counsel and involving them from the outset is essential. Share with them your intention to enhance the message of this year's CD&A. The SEC is stepping up the review of disclosures on executive compensation, and its scrutiny means more potential compliance issues to deal with on an on-going basis.

4. Review any previous shareholder feedback from various sources:
   - Update Communications
     - Written letters
     - Shareholder conferences
     - Investor relations professionals
     - Proxy solicitors
   - Proactively solicit specific feedback from key investors
   - Work with your proxy solicitor to anticipate shareholder reaction
   - Examine the potential reaction from proxy advisory firms in light of their policies
   - Develop an action plan in the event of unfavorable shareholder reaction; until the process has a track record of experience it is difficult to predict what constitutes a favorable or unfavorable shareholder reaction to the say on pay proposal

Finally, work with your independent compensation consultant for their insights. Involve the compensation committee to encourage their input and confidence in the process. Doing so recognizes that the shareholder vote will affect them (even though the CD&A is a management report), and it will help avoid surprises further on in the process.

Allowing shareholders to have a say on pay increases the need for concise and persuasive disclosure in the CD&A regarding executive compensation programs. The pressure will be placed on companies to express to shareholders how these programs relate to the shareholder experience and long-term value creation. The suggestions provided here are not intended to be prescriptive, but instead used as tools by companies to help solidify the foundational principles of the executive compensation program and effectively communicate with shareholders. A thoughtful, organized, and principled approach will help companies be better prepared for say on pay.

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About Cogent Compensation Partners

Cogent Compensation Partners is a leading provider of objective and expert advice on the subject of executive compensation, corporate governance, and the linkage between company performance and executive pay.

Our executive compensation consultants assist in driving together the various interests involved in the executive pay debate: employees, shareholders, institutions, and other stakeholders. Our services include compensation committee advisory, incentive plan design, compensation strategy development, board of director compensation analysis, executive compensation related shareholder proposal assistance and stock ownership guidelines development.

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