Canadian Investor Relations Institute
Institut canadien des relations avec les investisseurs

IR Issues Backgrounder

March 2010
Revised: October 2013

Issue: Say on Pay

'Say on pay' refers to the non binding, advisory vote by shareholders 'for' or 'against' the compensation paid to executives as described in the proxy circular. Voting allows shareholders to express their approval or disapproval of a company's compensation policies. Excessive executive compensation unrelated to performance has become a lightning rod for shareholder discontent, particularly during the recession and with companies that were bailed out with taxpayer dollars. Mandatory say on pay voting has been implemented in various forms in numerous countries.

While not mandatory in Canada, by mid-2013, 129 companies had voluntarily added annual say on pay resolutions to their AGM proxies, either as a matter of good governance or in response to shareholder proposals.

Background

Say on pay first gained momentum in the UK in the late 1990s, where an annual non binding advisory vote became mandatory in 2003. Say on pay votes are now mandatory in many of Canada's peer countries including the United States, Australia, the Netherlands, Norway, South Africa, Spain and Sweden.

In Canada, the voluntary adoption of shareholder say on pay votes on the compensation practices of public companies started in 2009, when the major Canadian banks announced that they would give shareholders an advisory say on pay vote in 2010.

By the end of the 2013 proxy season, 129 companies had adopted say on pay votes according to the Shareholder Association for Research & Education (SHARE). Overall, the say on pay resolutions received high approval rates, but three companies (Barrick Gold, Equal Energy and Golden Star Resources) failed to receive majority support. The issue grabbed headlines across the country and sent a message to all Canadian companies to take shareholder communications more seriously, and consider industry standards and governance best practices when developing their compensation policies.

Currently, there aren't any Canadian securities commission proposals regarding mandatory say on pay voting. However, in 2011, the Ontario Securities Commission (OSC) sought comments on a variety of shareholder rights issues, including say on pay. Feedback indicates that investors and issuers are divided on the issue. The OSC's Statement of Priorities for 2013/2014 references say on pay in the context of improving proxy-voting mechanisms. The Canadian Coalition for Good Governance (CCGG) supports say on pay. In 2009, it adopted a Shareholder Engagement and "Say on Pay" Policy, whereby it meets with the chair of the board and the compensation committee of select Canadian public companies and provides CCGG members with information to assist them in voting at AGMs for the election of directors and on any advisory vote on executive compensation. In 2010, the CCGG went further, recommending that all issuers place an advisory vote on executive compensation on the proxy every year. Subsequently, it produced a model 'Say on Pay' Policy for Issuers. According to the CCGG, this model has been adopted by all issuers who have agreed to hold say on pay votes with the exception of one company.

Proxy advisory firm Institutional Shareholder Services (ISS) has identified say on pay as the primary communication tool for shareholders expressing dissatisfaction with compensation practices. Applying its policy guidelines for evaluating say on pay resolutions, ISS recommended voting “against” eight Canadian companies in 2013, resulting in significantly lower shareholder approval levels for those companies.

Ontario Teachers’ Pension Plan, a founding member of CCGG, does not support shareholder proposals seeking to implement an advisory vote on compensation; however, where required to vote on management compensation proposals in an advisory or legally binding capacity, as is the case in certain jurisdictions, it reviews compensation to ensure that it meets the criteria set out in its proxy voting guidelines.

The Institute of Corporate Directors (ICD) does not favour prescribed rules for say on pay and does not generally “support practices which effectively undermine or diminish the board of directors’ responsibility on compensation matters”.

In a comment to OSC Staff Notice 54-701 in March 2011, CIRI expressed concern that the yes-or-no nature of a say on pay vote significantly reduces an issuer’s ability to understand the nature and full scope of shareholder concerns, many of which, while compensation related, may also encompass other issues such as financial performance and management expertise. At that time, advisory say on pay votes were a relatively new issue for Canadian investors, evidenced by the relatively small number of issuers in the TSX composite index that had adopted it. Given these factors, CIRI said it was premature to recommend a mandatory vote.

Impact on IR

One of the outcomes of say on pay voting has been increased board-shareholder dialogue, initiated by boards to consult during the compensation design stage and/or by investors to voice concerns. There have also been say on pay lawsuits launched in the U.S. related to negative votes and procedures related to votes; none have been successful.

Say on pay presents an important opportunity for IR to bring value at the board level by providing directors with the shareholders’ perspective, particularly if there is dissatisfaction among shareholders and the vote could be less than a sound endorsement of the company’s performance or compensation policy. If a company is in tune with its shareholders, the probable outcome of a say on pay vote should not come as a surprise.

While a say on pay vote is not binding, a failed say on pay vote can harm a company’s reputation, and a company cannot afford to ignore the message. If shareholder concerns are not addressed in the next year’s materials and compensation practices continue to be a source of concern, the company could face a proxy battle for the election of a dissident slate of directors, or even a lawsuit for breach of duty.

IR can be proactive and contribute to the discussion by:

- engaging with investors about executive compensation and monitoring any concerns they may have;
- reviewing competitors’ compensation practices as disclosed in their proxy circulars and

CCGG compensation disclosure guidelines to understand industry standards and best practices;

- contributing to proxy circular disclosure to ensure that the compensation discussion and analysis is written in plain language and that it clearly articulates the company's compensation philosophy, explains the reasons behind compensation decisions, and ties compensation to specific performance criteria;

- understanding the compensation voting policies of proxy advisory firms to gauge the likely outcome of a say on pay vote.

Highlights:

- Say on pay votes are mandatory in many peer jurisdictions, which means they could become mandatory in Canada eventually.

- Aligning executive pay with performance is becoming an increasingly important investment criterion.

- IROs should pro-actively communicate investor perceptions on executive compensation to management and directors. If investors request information on executive compensation or meetings with directors to discuss compensation policies, IR should be involved in preparing the response.

Additional Resources:

- *2013 Canadian Say on Pay Results*, Meridan Compensation Partners (July 2013)

- *Testing the waters: The litigation risk implications of failed say on pay votes for Canadian companies*, McMillan LLP (July 2013)

- *Canadian companies that have adopted a Say on Pay*, SHARE

- *Say-on-Pay – What's Next?*, Blake, Cassels & Graydon LLP (September 2011)

- *Shareholder Engagement: Questions for Directors to Ask*, CICA (2011)

- *IR Issues Backgrounder: "Say on Pay"* CIRI (2010)

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