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Key takeaways

Proxy Season Recap: Scrutinizing 2023 To Improve 2024

At our Comp Talks session on August 23, 2023 – **Proxy Season Recap: Scrutinizing 2023 To Improve 2024** – Cooley partners Ali Murata and Megan Arthur Schilling and Aon partner Laura Wanlass discussed recent trends in compensation-related disclosure, voting results and other lessons learned from the 2023 proxy season. Below are some key takeaways summarized by Cooley lawyer Vince Flynn:

Say-on-pay proposals received higher levels of support amid heightened investor scrutiny. Say-on-pay proposals saw a slight boost in 2023 with fewer companies receiving levels of support below 70%, likely driven by a combination of less opposition from Institutional Shareholder Services (ISS), decreased amounts of executive pay and increased stockholder engagement efforts. However, the adverse impact of low say-on-pay support on the election of compensation committee members continues to grow, so companies should be mindful of the key drivers of low say-on-pay support, identify potential issues ahead of next proxy season and address these items through off-season stockholder engagement and disclosure in next year's proxy statement.

- **Pay and performance misalignment remains a primary driver of adverse proxy advisory firm say-on-pay vote recommendations.** Quantitative alignment between pay and performance alone does not insulate a company from an adverse say-on-pay vote recommendation, so companies should be aware of the qualitative features of pay programs that may alone (or in combination with a pay and performance disconnect) lead to adverse vote recommendations.

- **Problematic pay practices continue to carry significant weight in say-on-pay evaluations.** The mere presence of problematic pay practices may result in adverse vote recommendations by ISS and Glass Lewis and should be thoughtfully considered before being undertaken. The panelists highlighted certain practices, including:

    - Repricing of underwater stock options without stockholder approval, which has increased recently due to increased stock price volatility in certain sectors – such as tech and life sciences –and high dilution and burn rates.

    - Severance payments made when the termination is not clearly disclosed as involuntary, which ISS codified and emphasized in its 2023 policy guidelines.

- **Adverse say-on-pay vote recommendations issued for "lack of responsiveness" most impactful on vote results.** Companies with 2023 say-on-pay proposals below 70% support for ISS and at or below 80% support for Glass Lewis are urged to engage with their stockholders to understand the reasons for the low support level, take appropriate actions to address stockholder concerns and provide disclosure in next year's proxy statement highlighting the company's stockholder engagement efforts (e.g., "what we heard," "what we did" and "who we talked to").

New pay-versus-performance disclosures had little, if any, impact on 2023 say-on-pay outcomes. 2023 marked the inaugural year public companies were required to provide disclosures under Item 402(v) of Regulation S-K showing the relationship between "compensation actually paid" to executives and the company's financial performance. Most companies expended substantial efforts and resources to prepare the disclosures but, consistent with prior proxy advisory firm guidance, the resulting disclosures do not seem to have had any notable impact on say-on-pay or any other proxy proposal outcomes. This could change in future years if proxy advisory firms and institutional investors begin to incorporate the pay-versus-performance disclosures into policy guidelines.

Equity plan proposals received lower levels of support, driven in part by greater opposition from ISS. The number of equity plan proposals that failed doubled year over year (five companies in 2023 compared to two companies in 2022), and the average support level declined year over year (87.0% in 2023 compared to 89.3% in 2022), as ISS issued adverse vote recommendations more often (29.1% in 2023 compared to 25.8% in 2022) due largely to perceived excessive dilution and burn rate levels. While the vast majority of equity plan proposals pass, the panelists emphasized that most proposals are designed to pass, a process requiring significant efforts and often involving concessions on key plan provisions. Companies should consider providing enhanced proxy disclosure highlighting:

1) The company's need for shares.
2) The connection to the company's broader human capital management strategy.
3) The context for dilution and burn rate data.
4) "Best practice" provisions (e.g., prohibition on repricing without prior stockholder approval), especially if proxy advisory firm opposition is anticipated.

Shareholder proposals addressing executive compensation matters increased notably, driven by a surge in proposals related to executive severance pay. Although compensation-related proposals continue to represent the smallest category of stockholder proposals, the number of compensation proposals increased markedly year over year, due largely to the submission of 51 proposals relating to executive severance pay (compared to 18 such proposals in 2022). While support for these proposals has not increased, companies should continue to monitor this trend.

Director compensation continues to evolve and remains a target of stockholder litigation. Amid the backdrop of continued scrutiny of director compensation from plaintiff firms and proxy advisory firms, many companies continued to provide enhanced proxy disclosure explaining how director compensation was determined, and several companies adjusted the equity compensation awarded to their nonemployee directors in 2023. Given the growing complexity of the director compensation landscape, it is crucial for companies to regularly reevaluate and closely monitor director compensation programs and ensure a rigorous process for setting director compensation is in place. This topic will be covered in greater detail at our Comp Talks session on February 21, 2024.

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