The International Scope of Say on Pay

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Arguments in Favor of Say On Pay

- Make corporate management more accountable to shareholders and shift balance of power in favor of shareholders.
- Encourage boards to align pay and performance.
- Arrest the upward spiral of pay levels.
- Push boards to eliminate pay structures that encourage excessive risk taking.

Arguments Against Say On Pay

- Upset the traditional balance of power between managers and shareholders.
- Shareholders are poor judges of proper pay practices and levels.
- Increase power of ISS and voting advisors.
- Increase disclosure and voting costs, especially for smaller companies.
- Push American companies to adopt one-size-fits-all pay programs.

International Say on Pay

- We study several countries that have enacted this legislation -- the U.S., U.K., Australia, Belgium, the Netherlands and Sweden, plus two that have come close– France and Germany
- Significant variations exist amongst the countries about the type of vote and its effect – advisory or binding

The U.K. Experience

- In 2002, U.K. adopts advisory SOP vote on management's remuneration report
- Shareholders largely supported SOP proposal between 2003 and 2009, but with growing opposition after financial crisis
- Public dissatisfaction with executive remuneration levels leads to enactment of binding SOP vote beginning in 2013

U.S. -- Dodd Frank's "Say On Pay"

- As of 2011, Dodd-Frank Section 951 requires public companies to give their shareholders an advisory SOP vote on top executives' pay during the prior fiscal year
- Shareholders have generally approved SOP proposals with only 1-2% failing to obtain 50% approval and most receiving 90+% support

U.S.– Early Voting Experience

- Low stock returns and high CEO pay resulted in lower support for say on pay proposals -- Firms with CEO pay in the top quartile and TSR in the bottom quartile received the weakest average shareholder support levels (73.9%).
- In 2011, ISS issued negative say on pay recommendations at 285 firms, but 86% of them still obtained majority approval of their executives' pay packages.

Australia – Two Strikes Rule

- In 2003, Australia mandated a new executive remuneration report and gave shareholders an advisory SOP vote on it
- Shareholder opposition to SOP proposals grew, especially after the financial crisis
- In 2011, Australia adopted the two strikes rule – if in first year, 25+% of SH's vote no, then in year two, 25+% vote no, SH's are required to have a third vote on board "spill"

Belgium

- In 2010, Belgium adopted a requirement that companies provide shareholders with a detailed executive remuneration report and there is an advisory SOP vote
- Mean approval rates are around 90% for Bel 20 companies but a few dispersed ownership companies barely passed
- Many Belgium companies have control SH's though so little chance of losing SOP

Sweden

- Since 2006, the AGM casts an annual binding SOP vote on the directors' proposed remuneration policy
- In 2010, shareholder approval rates were around 90% with many controlled companies
- One exceptional defeat occurred at TeliaSonera when the Government voted its 37% block against the company

The Netherlands

- Beginning in 2005, shareholders must approve company remuneration policies and any material changes to them
- Corporate minutes show regular heavy debate of policies, although defeats are rare with average approval rates of 90%
- Several remuneration reports have been withdrawn in the face of SH opposition

France

- Shareholders vote to approve directors' fees, option/restricted stock plans, termination plans and retirement plans
- In 2013, France required companies to have a SOP vote or explain why they did not do so – SH vote on pay of officers
- This has stalled mandatory SOP but government is considering new taxes for excessive remuneration packages

Germany

- In 2009, Germany permitted SH advisory SOP vote on the remuneration system of the management board
- While not mandatory, all DAX companies had their system approved at least once since 2010 with SH approval around 90%
- Few companies had significant opposition
- In 2013, German Corp. Gov. Comm. proposed executive pay cap

Summary of Countries' SOP

- SOP varies – binding vs advisory; remuneration report vs actual pay levels; future vs past practices; voluntary vs mandatory vote
- SH approval rates hover around 90% but there are usually a few companies that do much worse and then make changes
- Presence of a control shareholder insures a favorable vote

Why is SOP Being Adopted?

- Dispersed ownership countries – SOP can be viewed as a pay monitoring mechanism
- Concentrated ownership countries are in some cases moving toward greater dispersion and use SOP to help fill the new monitoring gap
- Institutional investor (especially US and UK) stock ownership increases lead to greater monitoring of pay

Why is SOP Being Adopted?

- Social intolerance of pay inequality – Aussies and Continental Europeans appear more opposed to this gap
- Politics – Social Democrats and left wing parties have been introducing SOP
- State ownership of enterprises – pay is a politically sensitive topic and indirect regulation (SOP) is easier than direct caps

Predictions

- SOP will not have much effect on overall pay levels; rather it will impact pay outliers and not the average company
- Public pressure will continue to build to regulate pay directly, especially in countries where income inequalities are less socially acceptable and left-center governments are in power
- More EU/OECD countries will adopt SOP