

to the *point*

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Current issues for boards of directors

pwc

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Proxy access proposals, risk oversight concerns, and “fracking” are likely to surface as key shareholder issues in the coming proxy season.

What’s next for “say on pay”?

Shareholders overwhelmingly voted in favor of their companies’ executive compensation plans in 2011. As a result, many companies may be relieved that they passed their first big “say on pay” test in the 2011 proxy season, but they shouldn’t sit back and relax just yet. The Securities and Exchange Commission’s rules require that after a say on pay vote, every company must disclose in its proxy statement whether it has taken the vote into account in making decisions and setting policies affecting executive pay plans and, if so, how they did that.

Say on pay will likely continue to be an issue in the upcoming 2012 proxy season. While shareholders of less than 2% of companies voted against their companies’ executive compensation plans in 2011, approximately 600 companies received less than 80% approval. Shareholders who voted against their companies’ executive compensation plans in 2011 will likely be looking at the 2012 proxies to see if any changes were made in response to their “no” votes.

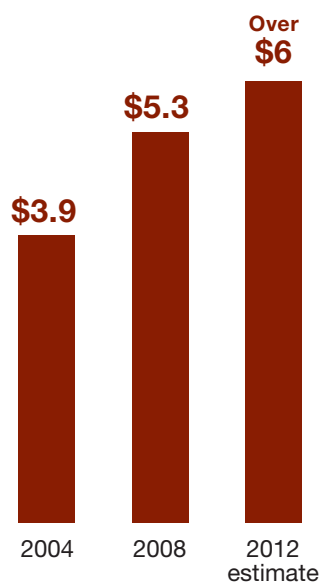
Further, shareholder advisors, such as Institutional Shareholder Services (ISS) and Glass-Lewis, will be evaluating 2011 say on pay results as part of their review of 2012 proxies. In November 2011, ISS updated its proxy voting policy on executive compensation. If a company’s previous say on pay proposal received less than 70% of shareholder support, ISS recommends a case-by-case vote for compensation committee members and the company’s 2012 executive compensation plan. ISS will consider the company’s disclosure of how it engaged with institutional investors about why there was low support, as well as specific actions taken to address the low support level.

A company that received strong support of its compensation plan in the 2011 say on pay vote may acknowledge the support in its proxy statement, along with any minor refinements management made to the plan. If a company passed its say on pay vote more narrowly, it may make more expansive disclosure about changes either enacted or under consideration.

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Political contributions and disclosure: What directors should know

Cost of US presidential elections, in billions



Source: Center for Responsive Politics

With the total price tag of the 2012 election expected to reach a record \$6 billion, political giving is an issue directors should pay close attention to.

Campaign finance law changed dramatically in 2010. In *Citizens United v. Federal Elections Commission*, the Supreme Court ruled that corporations have a First Amendment right to use their general treasuries to pay for direct communications expressly advocating for or against federal candidates. Prior to *Citizens United*, corporations could only participate in the political process through political action committees or third-party organizations, such as trade associations or lobbyists. As campaign finance law is a complex area governed by different federal and state statutes, the rules related to political spending may not always be clear.

Much of the debate about corporate political activity is over the issue of disclosure as there is no mandatory disclosure requirement. Over the last five years, a small group of large publicly traded companies have chosen to voluntarily disclose certain aspects of their political giving. But at present, only about 80 of the thousands of publicly traded companies disclose any of their political giving.

The *Citizens United* ruling has brought more attention to the issue of corporate political contributions and related disclosures and has prompted increased shareholder interest. In fact, there were more shareholder proposals on this issue in 2011 than any other, and they had higher levels of support. One-quarter of the 360 proposals filed in 2011 focused on greater oversight and disclosure of political contributions, according to shareholder activist site Moxxy Vote. On average, 33% of shareholders supported those proposals.

Other groups have also responded to the ruling. Proxy advisory firm ISS changed its proxy voting policy regarding corporate political contributions to a “generally vote for” recommendation from a “case-by-case” approach. The two biggest public US pensions, the California Public Employees’ Retirement System and the California State Teachers’ Retirement System, also approved new policies on political giving that call for companies in which the pension plans invest to annually disclose political spending information. Additionally, a group of law professors and academics filed a formal petition asking the Securities and Exchange Commission to require public companies to list political contributions in their annual proxy statements. A number of institutional investors are also starting to look more closely at their policies on shareholder proposals and are calling for disclosure.

Issues and questions directors should be thinking about

- Consider the company’s political giving program as part of the board’s risk oversight responsibilities.
- Does the company’s political engagement program align with its business interests and corporate culture, and is it in the best interests of shareholders?
- What governance processes are in place to ensure appropriate political activity at the company?
- To what extent is the board involved in the oversight of political contributions?
- Are board members staying abreast of the company’s policies regarding disclosure?
- Who in management is making the decisions regarding the political giving program?

What else to expect for the upcoming proxy season

ISS recommends votes “for” proposals that request greater disclosure of a company’s fracking operations.

Say on pay and political giving are not the only two issues directors should be thinking about ahead of the 2012 proxy season. ISS’s November annual policy update also included changes on other issues that are important to shareholders. Directors will want to understand these issues, which are described below.

Proxy access proposals—The SEC adopted an amendment to Rule 14a-8 in September allowing shareholders the possibility of amending company bylaws to include their own director nominees in the company’s proxy materials. (See “Proxy Access: Not gone yet” in the Fall 2011 issue of *To the Point* for more on this subject.)

ISS will continue to evaluate proxy access proposals on a case-by-case basis. It will take into account company-specific circumstances, including the percentage and duration of the shareholders’ ownership, the maximum proportion of directors that shareholders can nominate each year, and the method of determining which nominations should appear on the ballot if multiple shareholders submit nominations. ISS will also consider any other factors it deems relevant, including the proponent’s rationale. ISS is expected to update its guidance on this issue in January 2012.

Risk oversight and director elections—ISS’s policy is to recommend shareholders vote “against” or “withhold” for individual directors, committee members, or the entire board when there are material failures of governance, risk oversight, or fiduciary responsibilities, failures to replace management as appropriate, or egregious actions related to a director’s service on other boards that raise substantial doubt about his/her ability to oversee management.

The explicit reference to a material failure of “risk oversight” is new and makes clear that ISS views risk

oversight to be a significant part of directors’ fiduciary responsibilities. ISS states that the policy change in this area is not designed to “penalize” boards that take prudent business risks or exhibit a reasonable risk appetite but is a means to emphasize the board’s risk oversight role.

Exclusive venue proposals—There was an increase in management proposals seeking approval of charter and bylaw amendments to limit shareholder lawsuits to one jurisdiction (most often Delaware). ISS’s policy was to vote “against” such proposals unless the company adopted certain governance practices, including allowing owners of 10% of outstanding shares to call a special meeting.

ISS will now review these proposals on a case-by-case basis and will consider the company’s litigation history and governance practices. ISS will no longer consider the company’s special meeting provision.

Hydraulic “fracking” and other environmental issues—Hydraulic fracturing, or fracking, uses the high-pressure injection of water, sand, and chemicals into a gas-bearing shale rock formation to extract natural gas. Other “green” issues will likely continue to be hot topics.

ISS recommends votes “for” proposals that request greater disclosure of a company’s fracking operations and measures taken to mitigate community and environmental risks. ISS’s recommendation will consider the company’s disclosure relative to its peers, as well as controversies, fines, or litigation related to its fracking operations. ISS takes a case-by-case approach to recycling proposals. It has adopted a case-by-case policy on water issues, i.e., for proposals requesting that a company report on, or adopt, a new policy on water-related risks and concerns.

What's next for "say on pay?"

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Companies may then find themselves in one of several positions:

- Making no strategic or tactical changes because they believe the vote fully supported their compensation approaches
- Making no change to their overall compensation strategies—because they believe the say on pay vote supported the strategies—but making some tactical changes to how the strategies are carried out that were influenced by the vote
- Making changes to their compensation strategies and outlining why and what aspects of the vote prompted the changes

Boards and compensation committees can play an active role by setting forth a clearly articulated compensation strategy that they can reference each year as management makes its recommendations to pay programs. Changes can be viewed either as affecting the overall strategy or as changes in the implementation and administration of the existing strategy. Many companies make some kind of change each year—for example, in the form of minor changes to total compensation “mix” or changes in metrics used to evaluate annual incentives—that don’t constitute changes in the overall strategy.

Some companies may also consider engaging more with shareholders beyond the annual proxy statement. Advocates of this approach believe they can get a real-time sense of shareholders’ views on their compensation programs and say on pay votes. Among the approaches used are interactive corporate governance sections on company websites, solicitation of shareholder views through targeted mailings, and in-person meetings to talk directly with shareholders.

How PwC can help

To have a deeper discussion of how these subjects might affect your company or board, please contact:

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