Key developments of the 2013 proxy season
Management and boards are increasingly participating in ongoing dialogues with shareholders and using the proxy statement to communicate their outreach efforts and the board’s targeted message on governance topics.

Investors are demanding more accountability, transparency and access. Discussion is growing around investor stewardship, including responsibilities for governance engagement and proxy voting.
Overview

In the 2013 proxy season, many companies made significant efforts to engage with investors and demonstrate a meaningful level of responsiveness. Company disclosures highlight an increase in shareholder outreach programs and governance changes made in response to shareholder feedback. These efforts have paid off in the form of higher support for director elections and compensation programs through say-on-pay (SOP) shareholder votes. It is clear that shareholder influence in the boardroom is growing. Investors continue to challenge companies across a wide spectrum of governance practices using a variety of methods to press for change, including letter writing, proxy voting, shareholder proposals and campaigns. In addition, as the influence of the proxy advisory firms comes under increased scrutiny, some larger institutional investors are making it clear their proxy voting decisions are the result of independent evaluation in the context of their own voting guidelines. Companies may find that in this evolving governance landscape, maintaining constructive ongoing relationships with shareholders has more payoff potential than ever.

This publication reviews emerging trends coming out of the 2013 proxy season, alerting directors and management teams to governance developments that may impact board decisions and communications. These insights are based on the Ernst & Young Corporate Governance Center’s proprietary database and ongoing conversations with issuers and investors.

Top 10 governance trends of the 2013 proxy season

1. Shareholder proposal submissions increase
2. Board leadership structure debate continues
3. Board diversity remains a priority – board turnover comes under scrutiny
4. Directors receive increasing support
5. Environmental and social topics continue to dominate shareholder proposal landscape
6. Shareholders press for transparency of political and lobbying spending
7. SOP support increases; targeted compensation shareholder proposals return
8. Companies with staggered boards targeted for change
9. Proxy access fizzes
10. Proxy disclosures enhanced to tell governance story
1. Shareholder proposal submissions increase

Shareholder proposal submissions appear on track to eclipse the total submissions for all of 2012 and for all annual meetings through 30 June have increased by 6% over the same period last year. While the aggregate number of proposals is rising, successful engagement between companies and investors may play a role in reducing instances of proposals being filed or coming to a vote at specific companies.1

One reason for the increase is that many companies’ shareholder outreach efforts do not extend past their largest 10 to 15 shareholders, so smaller investors may rely on shareholder proposals to trigger dialogue and help ensure a topic is raised at the board level. Individual investors submit the most proposals (about 30%), followed by public pension funds (about 20%)—though proponents are increasingly co-filing proposals, with a variety of proponent types working together and collaborating.

Shareholder proposal submissions, 2012-13

The number of shareholder proposals withdrawn prior to coming to a vote is also increasing: 30% of proposals submitted for meetings through 30 June were withdrawn compared with 26% for the same period last year and 27% for all of 2012. Almost 80% of the proposals withdrawn were a result of action taken by the company and/or constructive dialogue. This indicates that more companies are engaging with shareholder proponents, finding common ground and reaching agreement.

Proposals are submitted on a wide range of issues, and those focused on environmental and social topics continue to represent the largest category of proposals. The top five topics of all submissions so far in 2013:

- Targeted executive compensation practices
- Political spending/lobbying activity
- Environmental sustainability
- Annual director elections
- Independent board chair

2. Board leadership structure debate continues

Investors continue to push for independent board chairs—submitting a record number of shareholder proposals on the topic this year (nearly 80 so far)—and a handful of high-profile shareholder campaigns have attracted attention to the debate. Even so, support for independent board chair shareholder proposals declined from last year, averaging 31% as compared to 36% last year. This may reflect votes taking place for the first time at a larger number of companies, as first-time resolutions tend to garner less support. There are only three known withdrawals due to companies and proponents reaching agreement.

These results suggest that while for some investors there is no substitute for an independent board chair, others find independent chair alternatives sufficient, provided the lead and presiding directors have clearly defined and robust responsibilities.

Independent board chair shareholder proposals, 2000-13

Independent leadership structures at S&P 1500 companies

86% have some form of independent leadership

<table>
<thead>
<tr>
<th>%</th>
<th>Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>Independent board chair</td>
</tr>
<tr>
<td>45%</td>
<td>Lead director</td>
</tr>
<tr>
<td>11%</td>
<td>Presiding director</td>
</tr>
</tbody>
</table>
3. Board diversity remains a priority – board turnover comes under scrutiny

Proxy disclosures show that when describing the backgrounds and qualifications of director nominees, boards are increasingly focused on diversity – usually broadly defined as varying expertise, experience, skills sets and viewpoints. This information can help investors appreciate how overall board composition is tailored to market challenges, business characteristics and strategic goals.

However, growth in gender diversity – a critical component of a diverse board – is slow. Women represent 15% of directors on S&P 1500 boards, up from 14% in 2012 and 11% in 2006. This is despite long-standing investor efforts to promote change, which this year included a letter-writing campaign targeting companies in the Russell 1000 with no women on their boards and shareholder proposals seeking greater gender and/or ethnic diversity on boards (most of which were withdrawn as companies agreed to incorporate diversity into director search criteria).

Fortune 100 company diversity disclosures

The SEC rule requiring proxy statement disclosure of whether and, if so, how nominating committees consider diversity has shed more light on how companies approach board diversity.

The slow pace of change in gender diversity is generating renewed discussion of board turnover, since the lack of turnover is thought by many to be one of the greatest obstacles to increased diversity. Some US investors, generally averse to quotas and mandatory term limits, appear to be taking a closer look at solutions that would encourage board refreshment where lack of turnover is raising concern that board independence may be compromised, group-think may be stifling boardroom debate, or fresh perspectives and insights may be lacking from strategic discussions.

2 in 10 new directors are women

In the last two years, 2 in 10 new directors among the S&P 1500 were women. The rate at which women are joining US boards will not significantly strengthen board diversity in the short term.
4. Directors receive increasing support

Opposition to director elections continues to trend downward following a spike in 2009, dropping to its lowest point in more than five years. The ability of investors to vote on say-on-pay (SOP) proposals appears to be the main reason for the drop. Increased company-shareholder engagement and enhanced disclosures on board composition also seem to be playing a role.

Higher opposition votes appear largely tied to poor attendance at board and committee meetings, a board’s adoption of a poison pill in the prior year without a contingency provision for shareholder approval, related-party transactions (particularly for directors on key board committees) and failure to act on a shareholder proposal that received majority support.

Trends in opposition to board nominees (% of all nominees)

<table>
<thead>
<tr>
<th>Opposition level</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 20%</td>
<td>4.8%</td>
<td>5.5%</td>
<td>9.8%</td>
<td>8.0%</td>
<td>5.1%</td>
<td>5.3%</td>
<td>4.0%</td>
</tr>
<tr>
<td>More than 40%</td>
<td>0.8%</td>
<td>1.0%</td>
<td>2.1%</td>
<td>1.8%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>0.7%</td>
</tr>
<tr>
<td>More than 50%</td>
<td>0.2%</td>
<td>0.2%</td>
<td>0.6%</td>
<td>0.6%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>
5. Environmental and social topics continue to dominate shareholder proposal landscape

Shareholder proposals focused on environmental and social topics represent the largest category of shareholder proposals submitted, at nearly 40% of all proposals. In particular, shareholders continue to push for increased transparency regarding the management of sustainability-related risks and opportunities, including across the supply chain. They also want to be certain of board oversight of these topics. Forward-looking companies are preparing for the low-carbon economy, assessing strategic risks and compliance considerations, increasing operational efficiency, identifying competitive advantages that can be gained through more sustainable business practices, and communicating these efforts to investors.6

Average support for shareholder proposals on environmental and social topics stands at 21%, with certain well-targeted proposals commanding higher support. About 30% of shareholder proposals in this category have been withdrawn so far in 2013 as a result of constructive dialogue and company action.

### Three most highly submitted and supported environmental and social topics in 2013*

<table>
<thead>
<tr>
<th>Topics</th>
<th>Proposals submitted</th>
<th>Proposals withdrawn</th>
<th>Proposals voted</th>
<th>Average support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political spending/lobbying</td>
<td>127</td>
<td>37</td>
<td>80</td>
<td>23%</td>
</tr>
<tr>
<td>General corporate sustainability and climate-change-related reporting</td>
<td>55</td>
<td>27</td>
<td>26</td>
<td>26%</td>
</tr>
<tr>
<td>(including supplier-issued sustainability reports)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equal opportunity employment policies</td>
<td>27</td>
<td>11</td>
<td>11</td>
<td>29%</td>
</tr>
</tbody>
</table>

*Includes topics where five or more proposals were voted.
6. Shareholders press for transparency of political and lobbying spending

Given the ample mandatory rulemaking still on the Securities and Exchange Commission (SEC) agenda, it appears unlikely it will propose rules requiring disclosure of corporate political spending in the near term – notwithstanding the support from some academics, investor groups and certain members of Congress for it to do so. Absent SEC action, shareholders are likely to continue to campaign for corporate political/lobbying transparency and accountability company-by-company, as reflected by the record number of shareholder proposals submitted this year.

While political and lobbying proposal submissions are high, support remains fairly level, averaging 28% in 2011, 22% in 2012 and 23% so far in 2013. New variations in the area, such as complete bans on political spending or increased congruency between corporate values and political contributions, attract less support. Traditional political and lobbying proposals seeking disclosure and board oversight of such expenditures average 27%.

Although average support for these proposals has not increased, proponents have succeeded in getting many large companies to voluntarily disclose US corporate political expenditures in a central location and ensure board oversight of this spending. As of 2012, almost 50% of companies in the S&P 200 provided some disclosure of their direct US political spending and 56% indicated their boards regularly oversee company political spending. Further, 21% of companies that received shareholder proposals on this topic in 2013 have so far agreed to enhanced disclosure and oversight in exchange for withdrawal of the proposal.

Political and lobbying proposals are on the rise, but support for them is not.
7. **SOP support increases; targeted compensation shareholder proposals return**

Most companies appear to have mastered the SOP vote: overall support for SOP proposals has climbed to 92% this year, from 91% in 2012, and 33 SOP proposals have failed to receive majority support of votes cast through 3 June, down from 40 proposals at the same time last year. Proactive outreach to investors, enhanced proxy disclosures and changes to pay practices in response to shareholder feedback have all helped to secure this support.

Company proxy disclosures highlight increasing engagement with investors in connection with SOP votes. Although investors are showing increasing support for overall pay programs, proponents are targeting specific company pay practices. The number of compensation-related shareholder proposals submitted in 2013 jumped following a sharp decline in 2011 after implementation of mandatory SOP votes. In fact, shareholder proposal submissions in 2013 doubled pay-related submissions in 2011. These proposals and related engagement focus primarily on implementing equity retention policies and stronger pay clawback provisions, as well as eliminating provisions for accelerated vesting upon change of control and tax gross-up payments.

![Compensation-related shareholder proposals voted on](image)

**Investors and companies collaborate to set industry standard on pay recoupment**

This year, six pharmaceutical companies joined 13 institutional investors to endorse a set of executive pay recoupment principles. The development of the principles was a collaborative effort which could be a standard-setter for companies and investors around key engagement topics.

The key agreed-upon principles include:

- Compensation committee discretion on whether to claw back incentive compensation already paid or otherwise recoup or reduce compensation that has not yet vested or has not yet been paid
- The potential inclusion of supervisors in application of the recoupment principles
- Public disclosure concerning decisions to recoup compensation
8. Companies with staggered boards targeted for change

Companies are moving away from staggered boards to annual elections of all directors. For many – larger companies in particular – these changes have been driven by investors through the submission of shareholder proposals. Nearly 90 companies with staggered boards were targeted with shareholder proposals on this topic in 2013, most as part of a coordinated shareholder campaign. Nearly 60% agreed to implement annual elections in exchange for withdrawal of the shareholder proposal, likely because these proposals consistently receive high levels of voting support, averaging 80% of votes cast so far in 2013. Failure to implement a majority-supported shareholder proposal can lead to votes against incumbent nominees the following year.

As staggered boards are now less common among larger companies, investors have begun to submit proposals to small- and mid-cap companies.

9. Proxy access fizzles

So far, investors have sought proxy access only at select companies with a series of long-standing governance concerns, and are not pushing the reform market-wide through broad-based proposal targeting. A handful of companies facing the proposal have adopted proxy access procedures based on the now vacated SEC Rule 14a-11 (i.e., 3% ownership for three years), which is setting the bar for successful shareholder proposals on this topic. While some investors continue to test alternate ownership terms, the momentum for proposals around proxy access seems to be fading for now.

<table>
<thead>
<tr>
<th>Proposed ownership requirements</th>
<th>Proposals voted</th>
<th>Proponent type</th>
<th>Binding if approved</th>
<th>Average support</th>
</tr>
</thead>
<tbody>
<tr>
<td>3% for three years</td>
<td>5</td>
<td>Public funds, SRIs, individuals</td>
<td>No</td>
<td>55%</td>
</tr>
<tr>
<td>1% for one year</td>
<td>3</td>
<td>Sovereign wealth</td>
<td>No</td>
<td>32%</td>
</tr>
<tr>
<td>1% for two years, or group of 50 shareholders holding US$2,000 of company stock, representing 0.5% of outstanding company stock in aggregate, for one year</td>
<td>4</td>
<td>Individuals</td>
<td>No</td>
<td>11%</td>
</tr>
</tbody>
</table>

*Proposals coming to a vote; does not include three proposals that were submitted but later withdrawn.

S&P 500 companies moving to annual elections

2000 37% 2005 47% 2010 63% 2012 80% 2013 81%
10. Proxy disclosures enhanced to tell governance story

An analysis of available Fortune 100 2013 proxy statements finds that more companies have begun to use their proxy statements as an engagement tool to communicate the board’s targeted message on governance topics to a broad audience and secure investor confidence and support. These disclosures may, over time, lessen the need for direct dialogue between companies and investors or lay the foundation to make direct dialogue more productive and efficient, or both.

Notable disclosure enhancements focus on:

- **Engagement:** More companies are highlighting shareholder outreach efforts and communicating changes made in response to shareholder feedback. Among the findings is an increase in companies disclosing engagement with investors, up from 38% in 2012 to 55% in 2013.

- **Board composition:** The ability for investors to assess board quality is limited. A skills matrix that clearly defines the areas of expertise and qualifications the company seeks to have on the board, and that connects individual directors to those attributes he or she brings, can help investors understand how board composition is tied to the company’s specific circumstances, strategy and business characteristics.

- **Audit committee reporting:** Audit committee disclosures are going beyond minimum requirements, including providing additional information about the audit committee’s oversight of the independent auditor.\(^7\)

**Fortune 100 company proxy statement disclosures**

| Implemented governance/pay changes related to engagement/shareholder feedback | 33% |
| Discusses engagement with investors | 55% |
| Includes executive summary highlighting corporate governance practices/developments | 36% |
| Includes letter to shareholders from board/board leadership discussing governance topics | 11% |
| Uses skills matrix to connect board composition to business needs | 13% |

Nearly 6 in 10 Fortune 100 companies disclose engaging with shareholders

\(^1\)The number of proposal submissions, withdrawals and votes throughout this report are based on meetings through 30 June 2013. Vote results are based on data available through 3 June 2013 and are calculated based on votes cast for and against the proposal. Prior year data is for the full year unless otherwise noted.

\(^2\)Getting on board: Women join boards at higher rates, though progress comes slowly, Ernst & Young LLP, 2012


\(^4\)Six growing trends in corporate sustainability, Ernst & Young LLP and Green Biz Group, 2013.

\(^5\)Following a strongly supported 2011 petition calling on the SEC to require public disclosure of corporate political spending, the SEC amended the Office of Management and Budget Unified Agenda, indicating that it is considering whether to recommend that the Commission issue a proposed rule on the topic. OMB website, accessed June 2013, http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=2012108&RN=3235-AL36&bcsI_scan_4f965425cd6c178=NvIyY5OFHkJ0QYlRwTbU1T7h72oHAAAAAFv6Bw.

\(^6\)In addition, 11% disclosed that they do not engage in direct political spending, 36% made some disclosure of their payments to trade associations, and 5% asked trade associations not to use their payments for political purposes. The 2012 CPA-Zicklin Index of Corporate Political Accountability and Disclosure, Center for Political Accountability, 2012, http://politicalaccountability.net/index.php?ht=a/GetDocumentAction/4693

\(^7\)Audit committee report to shareholders: going beyond the minimum, Ernst & Young LLP, February 2013.
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