

# Transparency in Pay Evaluation: Adoption of Abstain as a Vote Option on Management Compensation Resolutions

April 2019

## Key Takeaways

- Ahead of the 2018 proxy season, State Street Global Advisors announced that in addition to the use of 'For' and 'Against' vote options on management compensation resolutions we will introduce an 'Abstain' vote, in situations when we cannot provide unqualified support for compensation proposals globally.
- We believe that this change will result in companies being more responsive to our vote on pay proposals and subsequent engagement efforts, thereby improving impact.
- We cannot predict all instances when we will use an 'Abstain' vote but based on past practice typical cases would include:
  - Large one-time payments that cannot be justified or explained
  - Lack of adequate disclosure or some concerns with performance metrics but recognition of strong long-term performance etc.
  - Where companies have responded to some but not all of our concerns.
- There will be no change to State Street Global Advisors' Asset Stewardship Team's evaluation of compensation votes.

## Our Approach to Compensation Proposals

- We recognize the increasing reputational risk that poorly structured executive compensation plans pose to companies.
- We utilize our proxy voting guidelines and proprietary compensation screens to identify companies where pay practices may be of concern. Consequently, screened companies are reviewed manually by the Asset Stewardship Team to reach a vote decision. The team reviews over 1,900 pay votes annually.
- Our framework for analyzing compensation proposals includes:

- Evaluation of pay for performance alignment: Assessment of C-suite pay relative to peer group and long-term performance
  - Scenario testing of executive compensation packages to threshold, target and stretch goals established by the board to understand the variability of the total compensation
  - Assessment of the balance and variability between short-term and long-term plans
  - Assessment of the link between long-term strategy and pay drivers
- Where we feel that companies are not receptive to our concerns we will vote against compensation proposals.

## Our Historic Compensation Voting Practices

Prior to 2018, State Street Global Advisors used two voting options for compensation proposals: 'For' and 'Against' and in most cases our rationale for votes 'Against' compensation proposals included:

- Pay packages were misaligned in terms of performance and pay-out
- There was a lack of adequate disclosure on short-term/long-term pay-outs
- There was inadequate disclosure on how pay metrics are aligned to long-term strategy
- Pay plans contained re-testing of performance metrics or repricing of options

As such compensation proposals that were not fully in line with our expectations based on concerns that were not significant enough to warrant an 'Against' vote, received a qualified 'For' vote. Subsequently, such votes were then tracked internally to be analyzed in the following year with some companies being targeted for engagement.

## Benefits of ‘Abstain’ as a Vote Option: Driving Impact through Transparency

Beginning with the 2018 proxy season, we will exercise ‘Abstain’ as a vote option, in situations where we cannot provide unqualified support for compensation. In addition we may also use an ‘Abstain’ vote where companies have responded to some but not all of our concerns on pay.

However, the use of an ‘Abstain’ vote should not be considered as an outright rejection of a specific pay plan, but as qualified support based on some reservations. For example, in the past where we had concerns around a specific pay structure or one-off payments we may have supported such pay proposals with unease or a “heavy heart.” Therefore, the use of an ‘Abstain’ vote allows us to demonstrate more clearly our qualified support for pay proposals where we have concerns and increase transparency to both companies and clients.

Consequently, the introduction of an ‘Abstain’ will increase transparency and positive impact by:

- Providing a clear signal to investee companies where we have reservations or unease concerning compensation
- Increasing the pro-activeness of companies to our vote and subsequent engagement on pay

- Enhanced transparency on compensation-related votes. ‘Abstain’ is a vote option on proxy cards and its use will now be reflected in the voting record that we publish annually
- Previously, ‘Abstain’ has been characterized as a vote of “no opinion” on management resolutions and therefore was not actively used, but going forward we will use it to signal support with reservations on management compensation resolutions
- Improving accuracy and/or peer comparisons of voting record

## Impact of ‘Abstain’ Vote on Our Approach to Compensation Proposals

- There will be no change to the Asset Stewardship Team’s evaluation of compensation votes and we will continue to evaluate executive compensation using our custom proxy voting guidelines and proprietary compensation screens.
- The introduction of the ‘Abstain’ vote for compensation-related proposals is expected to cause a decrease in our reported votes ‘For’ management’s recommendation.
- Figure 1 below illustrates typical examples for our votes ‘For’ and ‘Against’ on pay and circumstances where we may consider the use of an ‘Abstain’ vote.

**Figure 1: Examples of Vote Decisions on Compensation Proposals**

State Street Global Advisors’ Vote on Compensation	Potential Rationale for Vote Decision
For	<ul style="list-style-type: none"> <li>• Pay metrics are clearly disclosed and aligned to strategy and the pay structure supports long-term value creation.</li> <li>• Pay is aligned with long-term company performance.</li> </ul>
Against	<ul style="list-style-type: none"> <li>• Pay quantum is excessive despite poor performance.</li> <li>• Disclosure of the specific performance targets for long-term/short-term plans is inadequate.</li> <li>• The pay program includes a re-testing feature.</li> </ul>
Abstain	<ul style="list-style-type: none"> <li>• A one-time award grant is made for retention purposes and is not deemed to be excessive and company performance is strong.</li> <li>• Company has responded to some of our concerns on pay, but other significant concerns persist.</li> <li>• There is a lack of adequate disclosure or some concerns with performance metrics but there is evidence of strong long-term performance.</li> </ul>

Source: State Street Global Advisors’ Asset Stewardship Team.

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