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INNOVATIONS IN PROXY STATEMENTS

In her regular column on corporate governance issues, Holly Gregory explores the innovations and improvements in proxy statements that companies are implementing to communicate more effectively with their shareholders.

As a key disclosure document that must strictly comply with an ever-expanding array of Securities and Exchange Commission (SEC) rules, the typical annual proxy statement can be a dense tome. Despite the SEC's efforts to encourage the use of plain English, proxy statements are not known to be an easy read. In the last several years, however, this has begun to change as a handful of leading companies are exploring ways to improve shareholder communications through their proxy statements.

Providing shareholders with the requisite information to make knowledgeable voting decisions is an essential function of the proxy statement. Shareholders need information to determine:

- Whether directors are qualified and independent.
- Whether the board is compensating executives in a rational manner.
- How to vote on various management and shareholder resolutions.

However, the continual stream of SEC rules and guidance has caused the proxy statement to function more as a compliance document than as a tool for communicating with shareholders. It has also led the proxy statement to grow significantly in

length and breadth. In just five years (from 2006 to 2011), the average length of proxy statements filed by Dow 30 companies increased 54% from 46 pages to 71 pages. The fact that even the most sophisticated institutional investors are requiring assistance from proxy advisors to digest proxy statements and advise them on how to vote raises concern that the increased quantity of proxy statement disclosures may serve to obscure meaningful information, with the risk of impairing investor understanding.

In response, leading companies are now making concerted efforts to increase proxy statement readability. One of the most important developments in the 2011 and 2012 proxy seasons has been the use of innovations and improvements in proxy statements to enhance shareholder communications. These new features include:

- Letters from the board or chief executive officer (CEO).
- Summaries of key information, such as:
 - proxy summaries; and
 - compensation discussion and analysis (CD&A) executive summaries.
- Shareholder-friendly graphics.
- Director skills matrices.

- Electronic navigation tools embedded within the proxy statement.
- Enhanced disclosure about corporate responsibility issues.
- Focused discussion of company response to say on pay voting results.

>> For detailed information about the main sections of a proxy statement, and how to prepare and file proxy materials, search [Proxy Statements](#) on our website.

LETTERS FROM THE BOARD OR CEO

Prudential Financial has been acknowledged as leading the way in proxy statement innovations, and was recognized by Corporate Secretary Magazine as having the best proxy statement of 2011. Among its innovations, Prudential Financial has included letters to shareholders from the board since 2010. In its 2012 proxy statement, the company included letters both from the board (with pictures of each director) and from the CEO. The letter from the board addressed the board's reaction to the 2011 say on pay vote and highlighted its shareholder engagement efforts (both of which are expanded on in the body of the proxy statement).

SUMMARIES OF KEY INFORMATION

Growing concern among corporate secretaries and other observers that proxy statement length and complexity may lead some investors to rely on summaries prepared by proxy advisory firms rather than on the proxy statement itself has led to efforts to summarize key information. By providing their own high-level summaries, companies hope to communicate directly with key institutional investors and influence the accuracy of the proxy advisors' own summaries.

Proxy summaries and CD&A executive summaries can be particularly useful, but special care must be taken to ensure that the information presented in these summaries is balanced. They should contain the information that institutional investors and their proxy advisors are interested in, including information that may be viewed negatively. The use of clear, concise and direct summaries can help transform the proxy statement from a compliance document into a communications document.

PROXY SUMMARIES

In recent years, a number of companies have organized and presented detailed information in the form of a proxy summary. For example, EMC included a four-page section titled "Summary Information" highlighting the key information in its proxy statement, including:

- The company's 2011 business results.
- The date, time and location of the annual meeting of shareholders.

- The annual meeting agenda, along with the board's voting recommendations and cross-references to where each item is discussed in the proxy statement.
- The director nominees, including information on their ages, board tenure, principal occupations and committee memberships.
- Sub-sections titled "Corporate Governance Highlights" and "Compensation Highlights" that flag both the company's adoption of certain ISS-approved features and the lack of certain ISS "hot buttons."
- A table summarizing the fees billed to the company by their independent auditors for 2011 and 2010.
- The say on pay proposal, providing an overview of the company's executive compensation program and its pay-for-performance philosophy (which are also addressed in the CD&A executive summary).
- Relevant deadlines for the company's 2013 annual meeting of shareholders.

CD&A EXECUTIVE SUMMARIES

Another innovative feature that has grown in use over the past few years is the CD&A executive summary. Some companies now include an introductory section providing a succinct overview of the significant aspects of compensation discussed in the CD&A. For example, Raytheon included a three-page CD&A executive summary in its proxy statement with the following features:

- A statement that the company's compensation program reflects a commitment to its four compensation objectives.
- Bulleted highlights of the company's current compensation program and cross-references to where each program highlight is discussed in the CD&A.
- A table describing each element of the compensation program and its link to the company's four compensation objectives.
- Pie charts illustrating the percentage of total target compensation corresponding to the target levels for each compensation element for both the CEO and all other named executive officers (NEOs) as a group.
- Tables reflecting the total direct compensation opportunities for fiscal year 2011 for both the CEO and all other NEOs as a group.

>> For more information on what to include in the CD&A executive summary, search [Preparation of Compensation Discussion and Analysis](#) on our website.

ELECTRONIC NAVIGATION TOOLS

A number of companies filed proxy statements in 2012 that made use of design features to improve organization and

2012 PROXY STATEMENTS: BEST IN CLASS

Companies can gain valuable insight from leading 2012 proxy statements, as they begin to review and respond to the results of this year's annual meetings and consider ways to better summarize and highlight information. In addition to consulting with counsel, some companies may find it helpful to obtain advice from design firms to assist with simplifying and modernizing their proxy statements.

COMPANY	NOTABLE FEATURES
EMC	In addition to a comprehensive summary, the proxy statement includes bands at the top of every page identifying what section the reader is in. The CD&A includes CEO and other NEO pay mix pie charts and a table setting out the five-step process EMC used to select its compensation peer group companies.
GE	The proxy summary includes a table with information about each director nominee, including a bulleted list of each nominee's specific skills that led the board to conclude that he or she is qualified to serve on the board.
Intel	The CD&A executive summary includes a graph showing the relationship between the listed officer average incentive cash payment and adjusted net income since 2002.
Johnson & Johnson	Portions of the proxy summary and the CD&A executive summary look similar to an ISS proxy voting recommendations report, with bullet point data separated into shaded boxes.
Kraft Foods	The section on director elections highlights the diverse experience, backgrounds and personal characteristics of director nominees in a bullet point list indicating that the board has three female directors, including the chair, and one African-American director. The CD&A executive summary includes a shaded table of "Compensation Governance Highlights."
PepsiCo	The CD&A executive summary includes a chart illustrating the 2012 long-term incentive program design under a subsection titled "Changes to 2012 Program to Reinforce Our Pay-for-Performance Philosophy."
Prudential Financial	The proxy statement includes both board and CEO letters. Shaded boxes throughout the proxy statement highlight high-profile governance topics, including board diversity, responsibilities of the lead independent director, rotation of the lead audit partner and recent efforts to dismantle takeover defenses.
Raytheon	The CD&A executive summary includes two compensation mix pie charts and a table describing each compensation element and its link to Raytheon's compensation objectives.
UnitedHealth	The proxy summary includes a high-level overview of proposals to be voted on and key topics, including corporate governance, enterprise-wide risk oversight and executive compensation.

layout and enhance the functionality of electronic versions of the proxy statement. For example:

- Johnson & Johnson used QR codes so that readers can access information on mobile devices.
- General Electric (GE) used hyperlinks throughout its entire proxy statement (including the proxy summary, proposals and even information included within compensation tables), allowing readers to navigate to specific sections, tables, descriptions of compensation elements, and director biographies and qualifications.

SHAREHOLDER-FRIENDLY GRAPHICS

Graphs, charts and tables can be used to draw attention to and explain difficult topics, deliver straightforward and impactful takeaways and facilitate communications about trends. Companies are using a variety of graphics to present important information, such as:

- **Financial performance.** Graphics can help illustrate the link between executive compensation and the company's financial performance. For example:
 - Intel included a chart showing how the amount of average annual and semiannual incentive cash payments to its NEOs over ten years has varied compared to its adjusted net income over the same period; and
 - EMC included a bar graph demonstrating how its revenue and non-GAAP earnings per share grew at a double-digit compound annual rate from 2007 to 2011.
- **Elements of compensation.** Tables can succinctly summarize the principal components of a company's compensation program. For example:
 - GE included a table briefly describing the forms and terms of its compensation elements; and
 - Kraft Foods included a table summarizing the elements and program objectives of its 2011 executive compensation program.

- **Compensation mix.** Graphics can be used to create a high-impact overview of the relative weights given to components of executive compensation. For example:
 - EMC included pie charts showing the total pay mix for the CEO, all other NEOs and directors; and
 - Kraft Foods included graphics describing why the company pays each of its long-term incentive compensation components and illustrating the relative weight of each component.
- **Compensation benchmarking.** Graphics can be used to illustrate peer group comparisons. For example:
 - Johnson & Johnson included a line graph comparing the company's total shareholder returns percentile to the CEO's realizable pay percentile for 2008 to 2010, both compared to the company's executive peer group; and
 - Kraft Foods included a chart showing the total compensation mix, on average, for the CEO and other NEOs, based on target awards in 2011, compared to the average of the company's compensation survey group.
- **CEO compensation.** Charts can offer a concise way to show how CEO compensation is directly impacted by a company's financial performance. For example, Johnson & Johnson included a line graph and a table comparing the CEO's total actual compensation to the company's total shareholder returns for 2007 to 2011.

DIRECTOR SKILLS MATRICES

A 2010 SEC rule requires companies to disclose, for each director and nominee, the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company (*Item 401(e), Regulation S-K*). Companies have taken different approaches to this requirement. Several leading companies, including Prudential Financial and GE, have included in their proxy statements a director skills matrix that provides a composite view of both the skills the company seeks and the representation of those skills by each board nominee.

CORPORATE RESPONSIBILITY DISCLOSURES

A number of companies provided enhanced disclosure on company initiatives regarding social, environmental and political responsibility in their 2012 proxy statements. For example:

- Raytheon highlighted its adoption of recent governance and compensation practices (such as the shareholder right to call special meetings, a clawback policy and independence requirements for compensation consultants) upfront in the CEO's letter to shareholders.
 - Prudential Financial included information about its corporate political contributions, lobbying expenditures
- and corporate social responsibility work, including the efforts of The Prudential Foundation and employee volunteer activities, in its corporate governance section.
- PepsiCo disclosed its political contributions policy (which is also available on its website) in its discussion of corporate governance.

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RESPONSES TO SAY ON PAY RESULTS

Companies were required to respond to say on pay voting results in their proxy statements for the first time in 2012. Several companies, including some that did not receive a significant vote against their executive compensation, used the new disclosure requirements as an opportunity to point out changes to their compensation policies, practices, decisions and disclosure, and to highlight their shareholder engagement efforts. For example:

- Prudential Financial disclosed that, based on the results of its say on pay vote as well as shareholder feedback received through its engagement efforts, it concluded that "though our overall executive compensation policies and practices enjoy favorable shareholder support, it was appropriate to rebalance the compensation mix of our senior executive officers to better align their compensation mix to market and competitive practices and to tie more of their compensation to longer-term performance and risk outcomes."
- In response to passing but relatively low say on pay support (61%), Johnson & Johnson acknowledged that it was "disappointed in our vote result, recognized the need to better understand our investors' opinions, and initiated a review to gain further feedback from key stakeholders on their perspectives of our executive compensation programs." Johnson & Johnson's CD&A (which included its own separate table of contents allowing readers to navigate with greater specificity) outlines the "most significant executive compensation program design change in over 60 years." It includes an executive summary, graphics illustrating the relative weight of performance metrics used to determine performance

IMPROVING PROXY STATEMENTS: ISSUES TO CONSIDER

Boards and governance committees should consider the following questions when assessing whether the company can improve shareholder communications through the proxy statement:

- **Readability.** Is the proxy statement readable? Does it use plain English or is it written in an overly complex, legalistic style? Does it convey key information in a manner that shareholders and their proxy advisors can readily understand and use?
- **Organization.** Is the proxy statement well-organized and easy to navigate? Do the table of contents and headings highlight significant issues? Are sections boldly labeled and hyperlinked? Are there bands at the top of each page or other indications that help the reader easily identify particular sections?
- **Design.** Does the design of the proxy statement, including its layout, typeface, graphics, charts and summaries, present information in a way that draws the reader in and is easy on the eyes?
- **Tone.** Does the proxy statement adopt a tone that conveys the board's commitment to good governance and shareholder accountability?
- **Important board decisions.** Does the proxy statement highlight and explain important or unusual activities or decisions of the board?
- **Proposals and key issues.** Does the proxy statement effectively use summaries and charts to provide a high-level overview of shareholder and management proposals and issues of significant interest to shareholders and their proxy advisors, such as board composition, board leadership, corporate governance processes, risk oversight and executive compensation?
- **Shareholder engagement efforts.** Does the proxy statement discuss with some specificity and with a positive tone the company's shareholder engagement efforts and any compensation changes made as a result of say on pay votes?
- **CD&A.** Does the CD&A effectively use summaries and charts to provide information about how executives were compensated last year relative to company performance, highlighting any changes in the compensation program?
- **Company initiatives.** Does the proxy statement highlight the company's good deeds, such as company initiatives related to corporate social, environmental and political responsibility?
- **Director skills matrix.** Does the proxy statement present information about directors in an easy-to-read format, such as a director skills matrix, that adequately communicates each individual director's qualifications and provides the appropriate composite view of the board?

share payout, multiple pie charts illustrating NEO pay mix and several line graphs comparing company pay against total shareholder return.

This year, counsel should ensure that sufficient time is reserved on board and compensation committee agendas to discuss the company's efforts to reach out to shareholders in the aftermath of the say on pay vote and other compensation matters. The compensation committee should consider whether the say on pay voting outcome suggests that the CD&A effectively presents the company's compensation story. Corporate secretaries and other members of a company's proxy statement preparation team may wish to consider whether any of the suggestions made by the CFA Institute's *Compensation Discussion and Analysis Template* (CD&A Template), available at cfainstitute.org, could enhance shareholder communications.

The CD&A Template is intended to help companies explain their compensation policies, practices and decisions in a clear and concise way that can be read and understood by average retail investors, and to provide guidance and structure on typical CD&A contents. It provides specific guidance on points to emphasize in each section of the CD&A. These sections include:

- Overview of Previous Year Performance and Compensation.
- Elements of Compensation for the Past Fiscal Year.
- Performance Targets for the Past Year/Performance Period.
- Compensation Decisions Made in the Past Fiscal Year/Performance Period.
- Compensation Framework: Policies, Process and Risk Considerations.
- Employment and Termination Agreements.

- >> For more information on the CFA Institute's CD&A Template, highlighting the most important communication points in each section of the CD&A, search [Innovations in Proxy Statements](#) on our website.
- >> For key issues to consider before and during drafting of the CD&A, search [CD&A Checklist: What Every Lawyer Needs to Ask](#) on our website.

The views stated above are solely attributable to Ms. Gregory and do not reflect the views of Weil, Gotshal & Manges LLP or its clients. The author would like to thank Audrey Susanin, an associate at Weil, Gotshal & Manges LLP, who assisted with research for this article.