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4 Things You Need to Be Prepared for on Your Earnings Calls

1 EXECUTIVE COMPENSATION DISCLOSURES

Executive compensation has come under intense scrutiny by Washington regulators and investors alike, giving IROs ample reason to have answers at the ready on this hot-button issue. Regulatory uncertainty surrounds at least three current compensation-related issues:

- **CEO pay ratio:** In 2015, the SEC adopted a rule implementing the Dodd-Frank Act's requirement that public companies disclose three compensation-related data points: (i) the annual compensation of their CEO, (ii) the median compensation for all employees (excluding the CEO), and (iii) the ratio between the two. Assuming this Dodd-Frank provision stays in place, these disclosures would be made beginning January 1, 2018. Of course, that's a significant assumption. The Financial Choice Act of 2017, which is through the House (but not, as of this writing, the Senate) would fully repeal Dodd Frank's CEO pay-ratio provision. The SEC could also repeal its own rule on the subject, but cannot do so with just two of its five commissioner seats currently filled.

- **Pay versus performance:** The Dodd-Frank Act contains a provision requiring companies to disclose the relationship between the compensation actually paid to the CEO and other "named executive officers" and the financial performance of the company, as reflected in its "total shareholder return." Pay-versus-performance disclosure requirements were proposed in 2015, and the provision is not affected by the Financial Choice Act.
- **Say on pay:** Under current rules, public companies must give their shareholders an advisory vote on the compensation of top executives at least once every three years. Although the vote is non-binding, a "no" vote from shareholders on a CEO's compensation can be a stinging rebuke. Only a handful of companies have suffered losing votes on executive pay, but in 2017 the shareholders of both FleetCor Technologies and EpiPen maker Mylan voiced their displeasure with large pay packages for their company's executive leaders. The Financial CHOICE Act would require companies to hold votes on compensation only in years in which "there has been a material change to the compensation of executives of an issuer from the previous year." The practical impact of any legislative change is uncertain, given that most companies now give shareholders a "say on pay" every year.

Regardless of what public companies are legal required to disclose on these issues, they are on the minds of information-hungry institutional investors. When the Securities and Exchange Commission indicated that it may delay implementation of the CEO pay ratio rule, for instance, more than 100 institutional investors—including CalPERS and the AFL-CIO—joined together to push back against the proposed delay. These are issues, then, that IROs must be fully informed on and prepared to address.

2 M&A AND TRANSACTIONAL EVENTS

The volume of global mergers and acquisitions dipped slightly in 2016, but that was coming off record levels in 2015. And while the number of transactions fell, the revenue associated with those deals decreased only two percent—meaning that the deals got larger in size. The trend towards megadeals has continued in 2017, with the value of deals targeting the U.S. rising 21 percent in the first quarter.

M&A transactions are transformative events for the corporations undertaking them—all the more so in the case of the colossal deals happening with more frequency. Investor relations teams, which contribute to the messaging around these transactions, have a significant role to play given that institutional investors, buy-side analysts, and portfolio managers are frequently skeptical of M&A as a vehicle for corporate growth. IROs will be asked to champion any M&A transactions that a company makes; specifically, they will be called on to explain the strategy behind the transaction, and to outline plans to integrate the purchased entity into its new owner. Even for companies that are not going through M&A events, their IROs should be prepared to assure audiences that management is seeking out opportunities.

3 MANAGING EXTRAORDINARY EVENTS

As the responsibilities of IROs increase, their jobs touch more and more events that impact their companies. Cybersecurity and data breaches offer a prime example of this phenomenon. While IROs of decades past would not have been concerned with cybersecurity, the role of the IRO has advanced to the point where IROs must be prepared to address any event that can damage the company's brand or market value, which definitely includes cybersecurity incidents. Shareholders may want to know, for instance, if the company has:

- Inventoried its critical digital assets and put plans in place to protect them;
- Created data breach response plans to mitigate the damage of a successful attack, and apply with all relevant law; or
- Established policies and procedures to mitigate the cyber-risk posed y third-party vendors and other external relationships.

On the cybersecurity front, the IRO has more to do than answer these questions. The investor relations team may well be an integral part of a cybersecurity response plan, fulfilling any duties a company has to inform its investors of a security breach. The IRO should also be actively involved in protecting sensitive financial information from unauthorized release. If IROs were not already attuned to the potential for misuse of the information they trade in, they should have been after hackers recently gained access to thousands of financial press releases and executed trades on the news contained within them.

Beyond cybersecurity, IROs should be prepared to address any global news events with the potential to have a material impact on the business. From Brexit to Congressional action on healthcare, IROs should be ready to disclose how important news events could affect the business, and to discuss how the company has prepared to address the global events with the greatest impact on its operations.

4 BRINGING THE BOARD INTO FOCUS

One focus of increasing investor activism is board representation, making it another area that IROs should be ready to proactively address. Boards and their audit committees are now asked to be fluent not only in cybersecurity, but also the Foreign Corrupt Practices Act, whistleblower claims, and other matters that require a sophisticated understanding of technological and legal matters. Shareholders may demand to know whether board members—and in particular, members of the audit committee most likely to be dealing with some of the more challenging matters—have the appropriate experience to handle them.

One area of particular attention recently is the diversity of corporate boards. To give just one example, the largest asset manager in Britain recently vowed to start voting against directors at U.S. companies with no women on their boards. And although shareholders rejected the proposal, it's worth noting that two large investors in Apple recently pushed the tech giant to increase the diversity of its board.

The British investor, Legal & General Investment Management, initiated a campaign against all-male boards at British companies two years ago, and it is credited with achieving the appointment of female board members at Jimmy Choo and other companies. Beyond that specific issue, there are signs that "ESG" (environmental, social, and governance) issues are becoming ever more important to investors. Shareholder resolutions on ESG matters increased from 370 in 2016 to 430 thus far in 2017, according to ProxyPreview. And according to Harvard University research, ESG issues account for 40 percent of all shareholder proposals for companies in the Russell 3000. ESG factors are clearly on the minds of investors and, accordingly, should be top of mind for IROs as well.

There is no doubt that the modern IRO has many subjects to master in preparation for the quarterly earnings call. It could be said that having such broad responsibility is the price for being counted among a public companies most important executives. Regardless, there is no reason to believe that a corporation's interactions with its investors will ever diminish in importance; to the contrary, if history is guide, the IRO will only continue to gain recognition for playing such a vital corporate role.