

Proxy Advisor Guidance on COVID-19 Pandemic: Minimal Relief Provided

As anticipated, both ISS and Glass Lewis have released limited guidance on how they intend to apply some of their policies in light of the COVID-19 pandemic. Below is a summary of what we know so far, with updates anticipated as we learn more about the economic impact of the coronavirus.

Institutional Shareholder Services

The guidance issued fell short of providing meaningful policy changes and relief, instead emphasizing that most of the policies already have sufficient flexibility and discretion baked in to enable ISS to take the massive impact of the pandemic into account in its voting recommendations. It addressed the following specific topics:

Annual Incentive Plans: ISS recognized that boards are likely to consider material changes to the performance metrics, goals, or targets used in their AIP. ISS encourages companies to make contemporaneous disclosure to shareholders as changes occur rather than waiting for the 2021 proxy. (Note that material changes at any point in time would likely trigger a Form 8-K in most cases.)

Long-Term Incentive Plans: ISS emphasized that it is generally not supportive of changes to mid-cycle awards as they cover multi-year periods. ISS will review in-flight changes made to long-term awards on a case-by-case basis to determine if directors exercised appropriate discretion and provided adequate explanation to shareholders of the rationale for changes. ISS recognizes that some boards may consider altering the structures of LTI plans to take the new economic environment into consideration. ISS will assess such structural changes under its existing benchmark policy frameworks.

Repricing: ISS is not giving any relief to their regular policy procedure on repricing and continues to believe that its case-by-case policy approach is appropriate for the 2020 proxy season. If a board undertakes a repricing action (e.g., by repricing, exchanging, or canceling and re-granting “out-of-the-money” options) without shareholder approval or ratification, the directors’ actions will be subject to scrutiny under ISS’ board accountability policies and could therefore result in vote recommendations against compensation committee members and potentially the entire board. If boards seek shareholder approval or ratification of repricing actions at their 2020 annual meetings, ISS will apply its existing

case-by-case policy and will generally recommend opposing any repricing that occurs within one year of a precipitous drop in the company's stock price. In its evaluation, ISS will consider whether (1) the design is shareholder value neutral (a value-for-value exchange), (2) surrendered options are not added back to the plan reserve, (3) replacement awards do not vest immediately, and (4) executive officers and directors are excluded.

Director Attendance: ISS noted that many directors may not physically attend shareholder meetings or scheduled board meetings for their safety and the safety of others. Certain markets, such as the US, have specific disclosure rules that count telephonic or electronic participation as full participation in board and committee meetings. For those markets that do not, companies should provide disclosure explaining the alternative forms of attendance with enough information about directors' attendance at board and committee meetings to allow shareholders to make informed judgments and voting decisions, while being sensitive to directors' privacy as well.

Changes to the Board of Directors or Senior Management: ISS understands that some companies may need to fill critical vacancies due to death, disability, or incapacity and will have discretion to consider this in assessing director independence, potential overboarding, board diversity, and other board attributes usually scrutinized by ISS.

Postponement of Annual Meetings: ISS understands the need for postponements but states that it will be positively noted when companies and boards use webcasts, conference calls, and other mediums of electronic communications to engage with their shareholders and investors, even if meetings have necessarily been postponed.

Virtual-Only Meetings: Under most ISS benchmark policies globally (including those applied to US companies) ISS does not have a policy to recommend votes against companies who hold "virtual-only" meetings and there is no change to that approach. In limited markets where ISS discourages virtual-only meetings, it will not be making adverse votes until such time as it is safe to hold in-person meetings again. If boards opt to hold virtual-only meetings, they should disclose clearly the reason for their decision (i.e., that it is related to the COVID-19 pandemic) and strive to provide shareholders with a meaningful opportunity to participate. These companies are encouraged to commit to return to in-person or "hybrid" meetings as soon as practicable.

Dividends: This year ISS will support broad discretion for boards that seek to set payout ratios that may fall below historic levels or customary market practice.

Share Repurchases: ISS warned of the intense scrutiny and reputational harm a company may face if it were to repurchase shares in the midst of the current pandemic, particularly if the company recently made workforce reductions, and even if the repurchase is made under authority previously approved by shareholders. In the absence of "barring regulation" or serious concerns related to the company, ISS will generally continue to recommend in favor of repurchase authorizations (which typically extend for 12 months or more) within customary limits. However, it will review any repurchases undertaken through the next annual meeting in 2021 to consider whether directors managed risks responsibly. While the

new guidance does not specifically address repurchases under board-approved authority, boards should be aware that ISS could similarly scrutinize such repurchases from a risk oversight perspective under its “governance failures” policy. Under that policy, ISS recommends against directors, committee members, and potentially the entire board due to material failures of governance, stewardship, or risk oversight.

Poison Pills and other Defensive Measures: ISS noted that while it will continue to evaluate shareholder rights plans (poison pills) on a case-by-case basis, ISS will consider a significant drop in the company’s stock price as a result of the COVID-19 pandemic to be a valid justification “in most cases” for adopting a pill of less than one year in duration without a shareholder vote. In its determination, ISS will consider the board’s explanation for adopting the pill, including the specific pill provisions (e.g., trigger threshold, duration, and exemptions).

Glass Lewis

Glass Lewis’ messaging was a little more direct albeit dogmatic, admitting that all governance issues will be impacted by the pandemic, and committing to exercising existing discretion and pragmatism to prioritize timing, certainty, disclosure, and voting on any affected proposals, likely through 2021. Their guidance, particularly with respect to compensation, seemed to contain more cautionary warnings than specific guidance, as follows.

Compensation: GL expects a marked increase in shareholder concerns on repricing, dilution, burn rates, hurdle adjustments, changes to vesting periods, caps and cuts on incentives, and the quality of disclosure concerning the limits and exercise of board discretion. GL anticipates that “companies with strong pay structures will be challenged to abide by them, and firms with less robust programs will be forced to choose between lying in the bed they’ve made or changing arrangements and all but guaranteeing shareholder ire.”

GL throws jabs at any companies thinking about conserving capital by reducing shareholder returns even further than the crisis already has, while simultaneously paying large bonuses, repricing grants, adjusting hurdles, or increasing the cost and dilution of future compensation. On the contrary, GL believes that responsible companies hit hard by the crisis should take early and decisive action to roll back planned salary increases or above-target bonus outcomes. GL believes that executives should share the pain felt by employees and shareholders. GL notes that executives and employees alike should not expect to be worth as much as they were before the crisis, because their free market value as human capital has now changed.

Finally, Glass Lewis notes that boards and executives need to be prepared to justify their compensation levels in a drastically different market for talent. GL warns that trying to make executives whole at even further expense to shareholders and other employees is a certainty for proposals to be rejected and board members to get thrown out—and an open invitation for activists and lawsuits to pile onto a company’s back for years to come. Even

those companies who project a “business as usual” approach to executive pay will face opposition if employees and shareholders see their own paychecks cut. Glass Lewis ominously notes that “Companies would be wise to avoid this.”

Disclosure: Glass Lewis emphasizes that effective disclosure and rationales provided by companies will be particularly critical to assess whether their actions are justified and address material shareholder concerns. Particularly with regard to executive pay, it expects boards to proactively seek changes that align with employee and shareholder experiences, recognizing that executives might need to take a pay cut. Further, Glass Lewis notes that companies that have a good track record on governance, performance, and the use of board discretion prior to the pandemic will be afforded more discretion in their analysis than those that do not.

Virtual-Only Meetings: The standard policy provides that Glass Lewis will generally recommend against the chair of the nominating and governance committee if companies do not provide adequate disclosure concerning the protections afforded to shareholders when conducting a virtual-only meeting (including allowing shareholders to ask questions during the meeting, procedures to access and address technical support, etc.). The revised policy provides that for companies opting to hold a virtual-only shareholder meeting due to COVID-19 between March 1, 2020 and June 30, 2020, Glass Lewis will generally refrain from recommending a vote against members of the governance committee on this basis, provided that the company discloses, at a minimum, its rationale for doing so, including citing COVID-19.

Conclusions

While there was no specific relief provided, particularly on compensation policies, it was encouraging to see both advisors recognize the need for flexibility in light of the unprecedented global crisis. Glass Lewis was slightly more peremptory in warning companies that executive compensation should not be protected at the expense of employees and shareholders. The universal theme signaled is that robust, well-reasoned, and frequent communication with shareholders will be paramount in any and all compensation-related decisions that are driven by these extraordinary times.

Important Notice: Pearl Meyer has provided this analysis based solely on its knowledge and experience as compensation consultants. In providing this guidance, Pearl Meyer is not acting as your lawyer and makes no representations or warranties respecting the legal, tax, or accounting implications or effectiveness of this advice. You should consult with your legal counsel and tax advisor to determine the effectiveness and/or potential legal impact of this advice. In addition, this Client Alert is not intended or written to be used, and cannot be used by you or any other person, for the purpose of (1) avoiding any penalties that may be imposed by the Internal Revenue Code, or (2) promoting, marketing, or recommending to another party any transaction or other matter addressed herein, and the taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Raleigh, and San Jose.



Pearl Meyer

NEW YORK
(212) 644-2300
newyork@pearlmeyer.com

ATLANTA
(770) 261-4080
atlanta@pearlmeyer.com

BOSTON
(508) 460-9600
boston@pearlmeyer.com

CHARLOTTE
(704) 844-6626
charlotte@pearlmeyer.com

CHICAGO
(312) 242-3050
chicago@pearlmeyer.com

HOUSTON
(713) 568-2200
houston@pearlmeyer.com

LONDON
+44 (0)20 3384 6711
london@pearlmeyer.com

LOS ANGELES
(213) 438-6500
losangeles@pearlmeyer.com

RALEIGH
(919) 644-6962
raleigh@pearlmeyer.com

SAN JOSE
(669) 800-5074
sanjose@pearlmeyer.com

**For more information on
Pearl Meyer, visit us at
www.pearlmeyer.com or
contact us at (212) 644-2300.**