MERCER

uncertain times

proxy advisers weigh in on COVID-19's impact on pay and governance

Against the backdrop of the COVID-19 pandemic, proxy advisers Institutional Shareholder Services (ISS) and Glass Lewis are weighing in on how they will apply their proxy voting policies during the 2020 proxy season.

Both believe their current policies position them to respond to governance-related questions arising from the pandemic, while acknowledging the need for pragmatism and flexibility, and a case-by-case approach.

On executive pay, the advisers caution companies not to make changes without sufficient rationale and real-time disclosure.

Institutional Shareholder Services

ISS's guidance advises companies to provide real-time disclosure on pay program changes and warns against quick decisions to adjust incentive plan goals or reprice options. It also confirms the proxy adviser is open to virtual-only shareholder and board meetings during the pandemic.

Compensation

- **Changes to performance metrics, goals, and targets.**
  - Changes to short-term incentive plan metrics, goals or targets likely won't come up for a shareholder vote until the 2021 annual meeting but ISS urges real-time disclosure (e.g., on Form 8-K) of the changes and supporting rationale.
  - ISS generally doesn't support midstream changes to long-term incentive awards but will review changes to address the pandemic case by case to determine if directors exercised appropriate discretion and provided an adequate explanation.
  - ISS will assess structural changes (which may include pay mix changes) to long-term incentive plans under its existing benchmark policy frameworks.
- **Option repricing/exchange**. If boards reprice or exchange options without shareholder approval, ISS may recommend voting against directors. If boards seek shareholder approval of a repricing / exchange, ISS

will apply its case-by-case approach of generally recommending against a repricing within one year of a precipitous drop in the company's stock price. Other features ISS will flag include:

- Exchanges that aren't shareholder value neutral (value-for-value exchange)
- Adding back surrendered options to the plan reserve
- Immediate vesting of replacement awards
- Inclusion of executive officers and directors

Shareholder meetings

In recognition that shareholder meetings may be postponed or held virtually:

- ISS encourages the use of webcasts, conference calls and other mediums of electronic communications to engage with shareholders and investors.
- ISS won't oppose virtual-only meetings during the pandemic but companies holding virtual-only meetings should disclose the reason and give shareholders an opportunity (subject to local laws) to participate as fully as possible, including asking questions of directors and management. Boards should return to in-person or "hybrid" meetings (or ask shareholders to decide) as soon as practicable.

Board meeting attendance

ISS is open to alternatives to in-person attendance at board and committee meetings with adequate explanation. Disclosures should be sensitive to privacy concerns with respect to directors' health, while giving shareholders adequate information to make informed voting decisions.

Director and senior management changes

ISS will take a flexible approach if companies need to fill board or senior management vacancies due to an individual's incapacity or to add critical expertise due to the pandemic. The proxy adviser will adjust its policies (e.g., on overboarding and board independence and diversity) as appropriate.

Glass Lewis

COVID-19 impact

Like ISS, Glass Lewis published general guidance on the impact of the pandemic on its standard proxy research approach. But Glass Lewis's guidance is more in the nature of a warning against executive pay changes and poor governance planning as follows:

Compensation. Glass Lewis will take a dim view of executive pay changes that are inconsistent with the challenges workers are experiencing. The proxy adviser is most likely to support changes that "take a proportional approach to the impacts on shareholders and employees". Glass Lewis warns against "maintaining or even increasing executive compensation levels" and cautions that trying to make executives whole is a "certainty for proposals to be rejected and boards to get thrown out—and an open invitation for activists and lawsuits onto a company's back for years to come."

Shareholder meetings. Glass Lewis's updated virtual meeting policy indicates support for virtual meetings through June 30, 2020, provided the company discloses its rationale (e.g., COVID-19). Companies holding virtual-only meetings after June 30, 2020, should include "robust" proxy disclosure on shareholder participation consistent with the proxy adviser's standard policy.

Board composition and effectiveness. Glass Lewis acknowledges that the crisis will test succession planning and present significant risks for boards and management teams that lack age and gender diversity. The proxy adviser also notes there may be reduced director attendance rates and reduced effectiveness of board meetings and decision making with remote meetings.

New feedback service

Unrelated to the pandemic, Glass Lewis will allow companies to include "unedited company feedback on its research" in its proxy research reports if certain conditions are met.

Glass Lewis announced it will allow companies, at no cost, to include "unedited company feedback on its research" in the proxy adviser's research reports. Glass Lewis will deliver the feedback directly to its investor clients by including it on, or making it accessible from, the front page of the research report. However, the service is available only if, among other things, a company:

- Purchases the research report from Glass Lewis
- Submits a Report Feedback Statement (RFS) within seven days immediately after the publication of the

research report, and no later than 14 days before the annual or special meeting

Once a company submits a RFS, Glass Lewis will update the research report to include it, remove prior versions of the report from distribution, and email an updated report to investors that already downloaded it.

The impetus for the feedback initiative is amendments to the proxy solicitation rules proposed by the SEC in Nov. 2019. If adopted, the amendments would require proxy advisers to allow companies time to review and provide feedback on voting recommendations, with an option to have a hyperlink to the feedback included in the proxy adviser's report before it is distributed to clients.

What should companies do now?

Much of the proxy advisers' guidance on executive compensation and governance is consistent with the approach Mercer recommends companies take in making pay and governance decisions during the pandemic and economic downturn:

Demonstrate good governance

- **Balanced judgment is key.** Companies should consider broader workforce employment and pay decisions, financial realities, and perspectives of shareholders, proxy advisers, and other key stakeholders.
- **Good governance is noticed.** Shareholders will notice strong leadership and thoughtful decision making during a crisis. Companies have an opportunity to be seen as employers (and investments) of choice based on how they respond.

Practice patience

- **We don't know what we don't know.** No one knows how long COVID-19 will disrupt the economy and impact company operations. Immediate action is required for companies in some industries but many companies should delay decisions that will have a lasting impact on their pay programs.
- **Some decisions can wait.** Given the degree of uncertainty, recalibrating performance metrics or targets for outstanding incentives and 2020 plans should "take a back seat" to more pressing, timesensitive issues such as broader operational and employee concerns.

Communicate and consider disclosure

- **Employees are anxious.** Companies should regularly communicate decisions, including the rationale and timeline, so that those impacted are "in the know" and can focus on their job. Timely and effective communication can also mitigate post-crisis retention issues.
- **Disclosure is critical.** Companies should consider how decisions they make today will look when disclosed in 2021 proxy statements.

For a detailed discussion of addressing the impact of COVID-19 and the economic downturn on incentive compensation, see Managing incentives in uncertain times.

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