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Proxy Advisors Issue Guidance on Executive Pay and Governance Changes Due to COVID-19

ISS and Glass Lewis announce updated guidelines on how they will evaluate governance policies — from compensation changes to dividend payouts — in this changing environment.

Institutional Shareholder Services (ISS) and Glass Lewis are altering their views on some compensation and governance issues in light of the changing landscape created by the COVID-19 pandemic. For example, ISS says it will look at the facts and circumstances faced by individual companies when determining the appropriateness of boards exercising discretion in incentive payouts for executives or making adjustments to plans.

In this article we highlight key takeaways from the latest ISS and Glass Lewis guidance as it relates to capital payouts, board of director composition and risks, compensation changes and disclosures, and virtual meetings.

ISS Guidelines

Board of Directors

ISS is understanding of alternative forms of attendance (e.g., telephone, computer, etc.) for board and committee meetings as long as adequate disclosure is provided. ISS also expects pertinent disclosure on any absences to allow shareholders to make informed voting decisions. ISS will continue to use discretion when assessing the need to fill any vacancy of executive or board seats caused by incapacity of individuals or adding expertise to address concerns in light of the pandemic.

Capital Structure and Payouts

Key issues and considerations include:

- Dividends: ISS will support broad discretion for boards that set payout ratios that fall below historic levels or customary market practice.
- Share Repurchases: ISS will generally continue to recommend in favor of repurchase authorizations (buybacks) within customary limits (in the absence of regulation that would prevent the buyback or serious concerns about the company's actions). However, ISS cautions boards to carefully consider this action in today's climate as they may face intense criticism if the company's workforce has been negatively affected by the economic uncertainty.

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- Share Issuance: ISS will continue to evaluate proposals to increase the number of common or preferred shares for issuance on a case-by-case basis. Importantly, ISS says it may support proposals that exceed normal market-specific limits if the company provides clear and compelling justification. Policies will also be adapted to consider any relevant local market regulatory relaxations or new guidance as a result of the crisis

- Private Placements: ISS policies related to private placement issuances are unchanged. ISS will consider private placements issuance on a case-by-case basis considering the rationale, potential dilution and other factors. Exceptional circumstance will also be considered, such as a company expecting to liquidate or file for bankruptcy protection if the transaction is not approved.

Compensation Issues

Key issues and considerations include:

- Long-Term Plans: ISS has previously stated they do not support companies making changes to outstanding awards that cover multi-year periods. Any changes will continue to be assessed on a case-by-case basis to determine if directors exercised appropriate discretion and provided adequate explanation to shareholders.

- Short-Term Plans: ISS encourages boards to provide contemporaneous disclosure to shareholders of the rationale for any changes to their current short-term plans (metrics, goals or targets) to provide robust disclosure of the rationale for the changes now, even though the 2020 decisions will be not be covered until next year's annual shareholder meeting. It is still very early for companies to adjust or disclose adjusting their annual incentive programs, except in perhaps the most impacted industries. As such, a lot of companies are taking a way and see approach to making adjustments and will disclose any actions taken this fiscal year in their 2021 proxy.

- Stock Option Repricing: ISS has not made any changes to its stock option repricing policies, which includes opposition to any repricing following a steep drop in a company's stock price. However, most companies seeking shareholder approval of an underwater stock option exchange or repricing do not seek an ISS-compliant exchange, therefore no change in policy here is unlikely to have an impact on a company's decision to pursue a repricing.

Virtual Meetings

This year, ISS will not issue any adverse recommendations for companies who hold virtual-only meetings. The firm encourages companies to disclose why they are holding virtual meetings and to provide shareholders with meaningful opportunities to engage with the firm — for example, through webcasts and conference calls. See our article *Understanding New SEC Guidance for Virtual Meetings and Filing Delays Due to COVID-19* for more information about SEC guidance on virtual-only meetings.

Glass Lewis Guidelines

Activism and M&A

As seen during the 2008-09 recession, poor governance and shareholder returns can inspire a wave of shareholder activism, M&A, lawsuits and consolidations once conditions begin to stabilize. Glass Lewis' new guidance raises this issue as a potential risk for companies.

Board Composition, Effectiveness and Risk

Reduced attendance rates and changes in committee and board independence is likely, especially for boards who have over-extended directors that may need to reduce their commitments. This might also expose companies who lack effective succession planning and board renewal programs. Furthermore, certain demographics may more vulnerable to COVID-19, and a lack of diversity on boards in terms of gender and age may pose a unique risk in light of the pandemic, Glass Lewis notes.

Compensation

Glass Lewis says that companies taking early and decisive changes to their compensation programs, such as rolling back merit increases or above-target bonus outcomes, that have a proportional approach to impacts on shareholders and employees are more likely to be supported. Companies who try to make executives whole by adjusting hurdles, paying large bonuses or even acting like “business as usual” will likely face adverse recommendations of their say-on-pay proposal.

Shareholder Concerns

Companies will need to address shareholder concerns as a result of poor pay and performance grades. Also, any actions a company takes to mitigate the impact of COVID-19 — such as repricing, dilution, hurdle adjustments, and changes to vesting periods — will also cause further shareholder concerns. Glass Lewis says it will look for effective disclosure and rationale from companies regarding any compensation changes or actions taken by the company.

Virtual Meetings

Glass Lewis will refrain from recommending against members of the governance committee for shareholder meetings held virtually between March 1 and June 30, 2020, provided the company discloses the rationale is due to COVID-19. Glass Lewis expects companies that do not return to their hybrid or in-person meeting for subsequent meetings to disclose how they are structured to ensure meaningful shareholder participation.

Next Steps

The impact of the pandemic may not be immediate for shareholder proposals during the 2020 proxy season, but the implications are likely to extend into the years to come. While industries hardest hit by the temporary shutdown of the economy may encounter greater scrutiny, businesses across sectors are in the early days of making adjustments to their governance and compensation programs. How proxy advisory firms and shareholders evaluate these changes will play out as the full extent of the humanitarian and economic crisis unfolds.

To read more articles on how rewards professionals can respond to the COVID-19 pandemic, please click here.

For questions about the implications of these new guidelines or other governance-related topics, please contact one of the authors or write to rewards-solutions@aon.com.

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