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Meridian Client Update

Summary of Key Results from the ISS 2020 Annual Policy Survey ISS's recent Policy Survey previews potential changes to its proxy voting policies.

Each year, Institutional Shareholder Services (ISS) surveys institutional investors, public companies (“issuers”) and the consulting and legal communities on emerging corporate governance and executive compensation issues as part of its annual policy formulation process (the “Survey”). Public company “issuers” and their advisors are collectively referred to as “non-investors” in this Client Update. Possibly reflecting concerns about the influence of ISS policies, 66% of this year’s survey respondents were non-investors, while only 34% of respondents were investors, primarily large institutional shareholders.

ISS conducted this year’s Survey to obtain feedback on a wide range of questions, including questions related to the COVID-19 pandemic, board racial and ethnic diversity, and shareholder proposals seeking to separate the Board Chair and CEO roles. Each of these topics is discussed below.

Key Takeaways Based on Investor Responses

Historically, investor responses to Survey questions has helped to inform ISS’s modifications to existing proxy voting policies or implementation of new policies. Based on their responses, investors would prefer to see the following:

- ISS keeps its current or similar guidance in place into 2021
- Executive pay decisions informed by COVID-19 pandemic's impact on the economy, employees, customers and communities and the role of government-sponsored loans and other benefits
- The reasonableness of mid-year adjustments to annual incentive programs and payment of discretionary bonuses should be evaluated based on the underlying facts and circumstances and publicly disclosed justification
- Companies disclose the demographics of their board members, including directors’ self-identified race and/or ethnicity
- Board demographics reflect the company’s customer base and broader societies in which they operate
- Companies separate the role of Board chair and CEO
- Governance and risk oversight failures be considered when evaluating shareholder proposals calling for an independent Board Chair

COVID-19 Related Questions

The Survey asked respondents several questions relating to the impact of the COVID-19 pandemic on ISS policies, each of which is discussed below.

In April 2020, ISS issued policy guidance indicating that ISS was not modifying its 2020 proxy voting policies in response to the COVID-19 pandemic (see [Meridian Client Update dated April 15, 2020](#)). ISS stated that its proxy voting policies were sufficiently flexible for its analysts to appropriately take into account the impacts of the COVID-19 pandemic when formulating vote recommendations.

1. The Survey asked whether ISS's policy guidance related to COVID-19 pandemic should continue into 2021.

- 62% of investors and 87% of non-investors believe that ISS should keep the current or similar guidance in place in 2021.
- 27% of investors and 7% of non-investors believe ISS should keep the guidance in place for 2021, but only for markets, companies or industries severely impacted by the pandemic.

Meridian Comment. On September 16, 2020, during Corporate Board Member's Compensation Committee Summit, ISS's Patrick McGum, Special Counsel and Head of Strategic Research and Analysis, confirmed that **ISS will maintain its existing policy guidance on COVID-19 for 2021**. Nevertheless, we expect that ISS may update its policies during its regular end-of-year policy development process to explain how it will evaluate discrete issues regarding compensation decisions arising from COVID-19 pandemic impacts.

2. The Survey asked how ISS should evaluate decisions regarding executive compensation and performance in light of the impacts of the COVID-19 pandemic.

Investors and non-investors diverged on how ISS should evaluate decisions regarding executive compensation and performance in light of the impacts of the COVID-19 pandemic.

- 70% of investors and 33% of non-investors believe that the pandemic's impact on the economy, employees, customers and communities and the role of government-sponsored loans and other benefits should be considered by boards in making compensation decisions.
- 53% of non-investors, but only 10% of investors, believe that boards should have complete discretion to make compensation decisions, including whether to make adjustments to performance goals.

Meridian Comment. While investors appear to be interested in understanding whether executive compensation levels and decisions align with broader employee and other stakeholder experiences, we believe ISS is unlikely to adopt a policy under which those factors would impact its evaluation of Say on Pay proposals. We expect that ISS will continue to primarily focus on the alignment between executive pay and company performance. With that said, we anticipate that many investors will expect companies to disclose in their proxy statements how executive compensation decisions aligned with the broader employee and other stakeholder experiences, particularly in terms of human capital management and the business strategy and risks arising from the COVID-19 pandemic.

3. The Survey asked the appropriateness of companies adjusting payouts under annual incentive programs and/or making discretionary bonus payouts.

- 51% of investors and 54% of non-investors agreed that annual incentive program changes, including mid-year adjustment and discretionary payouts, may be reasonable depending on the circumstances and the justification provided.
- 21% of investors and 15% of non-investors believe that companies should avoid mid-year adjustments and make payouts based on original program design.

Meridian Comment. Given the investor feedback, we expect that ISS will evaluate adjustments to 2020 annual incentive programs and discretionary bonus payouts **on a case-by-case basis**. Absence of a compelling rationale for key compensation decisions, when combined with other problematic practices and/or a quantitative disconnect between pay and performance, could result in ISS recommending AGAINST a company's Say on Pay proposal.

Under its prior guidance, ISS will evaluate whether a company exercised "appropriate discretion" and provided "adequate explanation" of the rationale for changes to an annual incentive plan. During the Corporate Board Member's Compensation Committee Summit, ISS's Mr. McGurn cautioned that a company's need to retain executives during this period of economic uncertainty will **not** be viewed as a compelling rationale. He also noted that ISS will expect a company to disclose *specific* achievements by the named executive officers that warrant a discretionary bonus payout.

Board Racial and Ethnic Diversity Related Questions

The Survey asked several questions relating to the demographics of corporate boards, each of which is discussed below.

1. The Survey asked whether companies should disclose the racial and ethnic composition of their boards.

Investors and non-investors diverged on whether companies should be expected to disclose the demographics of their board members, **including directors' self-identified race and/or ethnicity**.

- 73% of investors and 36% non-investors indicated that boards should disclose the demographics of their members to the fullest extent possible and as permitted under relevant laws.
- 32% of non-investors indicated that companies should only disclose this information when it is mandated in the jurisdictions in which they operate.
- 22% of non-investors selected "other" as their response, with several respondents indicating that boards should be able to choose whether to disclose such information or that a company should only disclose such information if all members of the board agreed to such disclosure.
- 5% of investors and 10% of non-investors believe that boards should not disclose demographic information.

2. The Survey asked the importance for corporate boards to be racially and ethnically diverse.

Investors and non-investors diverged on the importance of racial and ethnic diversity on corporate boards.

- 61% of investors and 40% of non-investors indicated that boards should aim to reflect a company's customer base and the broader societies in which they operate by including directors drawn from racial and ethnic minority groups.
- 53% of non-investors and 33% of investors indicated that expectations about racial and ethnic diversity on corporate boards may reasonably differ based on factors such as local laws, company size and geographic location.

3. The Survey asked respondents what actions would be appropriate for investors to consider to encourage increased racial and ethnic diversity on corporate boards.

- 85% of investors and 92% of non-investors agreed that investor engagement with a company's board and management team is appropriate.
- 78% of investors but only 18% of non-investors believe that supporting a shareholder proposal urging a company to set workforce diversity targets or enhance their disclosure about workforce diversity levels is appropriate.
- Majorities of investors also believe it is appropriate to (1) support shareholder proposals that urge the board to consider at least one underrepresented minority in the slate of candidates for every open senior position, and (2) vote against members of the nominating committee (or other directors) where board racial and ethnic diversity is lacking.

Meridian Comment. In August 2020, ISS's Head of ESG sent a letter to many large public companies requesting companies to voluntarily provide to ISS information on self-identified race/ethnicity of each of the company's directors and named executive officers (NEOs). Given investor support for such information, there is pressure on proxy advisory firms to include the information to the extent available. However, the SEC does not require companies to disclose such information. We expect that ISS will continue to encourage companies to voluntarily publicly disclose such information.

Investors are increasingly coalescing around the view that corporate boards should be diverse across a variety of characteristics, including gender and race/ethnicity. In the next couple years, we expect that ISS will adopt a policy that a company's board should have a minimum number of self-identified racial/ethnic minority directors. Such a policy would in turn pressure companies to voluntarily disclose such information, irrespective of director sentiments or privacy concerns, in order to avoid adverse ISS vote recommendations.

Shareholder Proposals Seeking to Separate the Board Chair and CEO Roles

The Survey asked several questions relating to shareholder proposals seeking the separation of Board Chair and CEO roles, each of which is discussed below.

1. The Survey asked respondents' preferences to separating the roles of Board Chair and CEO.

Investor and non-investor preferences also diverged on the merits of shareholder proposals seeking to separate the roles of Board Chair and CEO.

- 85% of investors and 52% of non-investors indicated a preference to separate the role of Board Chair and CEO as a general matter or absent an emergency or temporary transition period.
- 48% of non-investors and 15% of investors did not have a single preferred board leadership structure.

Under ISS policy, material governance failures or evidence that the board has failed to oversee and address material risks facing the company increase the likelihood of ISS issuing a recommendation FOR a shareholder proposal seeking an independent Board Chair.

2. The Survey asked which types of governance or risk oversight failures would be significant when evaluating a shareholder proposal seeking to separate the roles of Board Chair and CEO.

As the below table shows, a significant majority of investors believe each of the governance or risk oversight failures identified by ISS in its Survey would be significant when evaluating such a shareholder proposal.

Which of the following governance or risk oversight failures do you consider to be significant when evaluating an independent Board Chair shareholder proposal?	Investors	Non-Investors
Significant misconduct or mismanagement by the company, board or senior executives resulting in legal and reputational risks	90%	78%
Unilateral board actions that have materially diminished shareholder rights without shareholder agreement or ratification	89%	46%
Significant failures of audit or internal control oversight	83%	55%
Insufficient board responsiveness to a majority shareholder vote (for example, against a say on pay vote or director election or for a shareholder proposal)	82%	48%
Significant concerns about failure to address risks to the business model or the company's long-term viability such as those related to climate change	81%	35%
Significant failures of human capital management	66%	30%

Meridian Comment. Under its current policy, ISS generally supports shareholder proposals seeking to separate the roles of Board Chair and CEO after taking into account a number of factors¹ that indicate the need for such separation of roles. Given investor preferences, ISS may revise its proxy voting policy to take into account the above governance or risk oversight failures as factors (in addition to those included in its current policy) when it evaluates shareholder proposals calling for an independent Board Chair. During the first nine months of 2020, ISS supported 63% of such shareholder proposals, with average shareholder support of 34%.

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The **Client Update** is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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¹ Under its current policy, in determining whether to support a shareholder proposal seeking to separate the Board Chair and CEO roles, ISS considers the scope of the proposal, the company's current board leadership structure, the company's governance structure and practices, company performance and any other relevant factors that may be applicable. In addition, ISS has identified specific factors that will be given substantial weight in ISS's determination whether to support such a proposal.