Proxy Advisors Issue Policy Guidance on COVID-19

Institutional Shareholder Services (ISS) and Glass Lewis recently issued guidance on the application of their proxy voting policies in light of the COVID-19 pandemic.

Since we are now in the heart of proxy season, corporate boards and management teams have raised questions regarding whether ISS and Glass Lewis would consider the impact of the COVID-19 pandemic in either their proxy voting policies or the application of those policies. In response, both ISS and Glass Lewis have recently issued "guidance" on the application of their policies in the current context.

ISS COVID-19 policy guidance provides insights into how ISS will assess 2019 pay decisions impacted by COVID-19 pandemic and disclosed during the 2020 proxy season. For calendar year companies, the general applicability of this guidance is somewhat muted since 2019 pay decisions and outcomes generally were not affected by the COVID-19 pandemic, and the overwhelming majority of these companies filed their 2020 proxies in advance of the guidance.

ISS may update this guidance throughout the year as may be required by changing circumstances. For the 2021 proxy season, ISS may update its proxy voting policies in response to the COVID-19 pandemic based on feedback it receives from institutional shareholders and others during its regular end-of-year policy development process. Although focused on the current proxy season, ISS COVID-19 policy guidance may reflect ISS's long-term view on the application of its proxy voting policies during the 2021 proxy season and beyond.

Unlike ISS, Glass Lewis COVID-19 policy guidance is primarily focused on the 2021 proxy season.

Key Takeaways

- **ISS is not modifying its 2020 proxy voting policies in response to the COVID-19 pandemic.**
- ISS notes that its proxy voting policies are sufficiently flexible for its analysts to appropriately take into account the current circumstances when formulating vote recommendations.
- ISS suggests that companies should contemporaneously disclose compensation program changes and other matters.
- Glass Lewis guidance is forward looking to the 2021 proxy season; however, the guidance makes no changes to Glass Lewis' existing proxy voting policies (other than Glass Lewis altering its policy on virtual-only shareholder meetings).

ISS Policy Guidance

The ISS policy guidance is intended to address proxy voting policy issues that are likely to be directly implicated by the pandemic and the global response to it. However, the ISS guidance does not materially change any of its current proxy voting policies. ISS believes its current voting policies provide its "research teams the ability to exercise appropriate discretion and use case-by-case analysis in response to company-specific, sector-specific and market-specific facts and circumstances," even during the economic challenges and business uncertainties arising from the COVID-19 pandemic.

This Client Update reports on the portion of ISS guidance that relates to ISS proxy voting policies implicated by the following issues:

- Compensation issues, including changes in performance metrics in outstanding incentive plans, modifications to performance goals or targets and stock option repricing;
- Governance issues, including director attendance and changes to the board of directors or senior management; and
- Administrative issues, including meeting postponements and virtual-only meetings.

Compensation Issues

ISS did not change any of its proxy voting policies on the compensation issues described below and discussed in its guidance. However, ISS does offer reminders on several key issues and suggestions on enhanced disclosures that companies might wish to make regarding material changes in their compensation programs.

- **Changes to performance metrics, goals/targets used in 2020 annual incentive plan**. *ISS will continue to evaluate under its **existing policies** the appropriateness of mid-performance period adjustments of performance metrics, goals and targets used in 2020 annual incentive plans*.

  ISS will evaluate changes to an annual incentive plan, on a case-by-case basis, to determine if directors **exercised appropriate discretion**, and **provided adequate explanation** to shareholders of the rationale for changes to the incentive plan. In its guidance, ISS encourages companies to provide *contemporaneous* disclosure to shareholders of the nature, scope and rationale for such adjustments. ISS notes that "such disclosures will provide shareholders with greater insights now and next year into the board's rationale and circumstances when the changes are made." Companies that decide to make contemporaneous disclosures should reference those in next year's proxy statement to remind proxy advisors and investors of the disclosure in the prior year's proxy.

- **Changes to performance metrics, goals/targets for outstanding long-term incentive awards**. *ISS will continue to evaluate under its **existing policies** changes to performance metrics, goals/targets for outstanding long-term incentive awards.*

  Generally, ISS is not supportive of mid-performance period changes to outstanding long-term incentive awards. ISS will continue to evaluate changes to long-term incentive 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. We have observed cases where a mid-performance period change in performance metrics (combined with other problematic pay practices) can cause ISS to issue a negative vote recommendation on a company's Say on Pay proposal.

- **Changes to long-term incentive plan design for future awards**. *ISS will continue to evaluate under its **existing policies** changes to long-term incentive plan design for future awards.*

  In its guidance, ISS acknowledges that some boards may consider altering the structures of their long-term plans to take into account the new economic environment. Nevertheless, ISS will continue to assess such changes under its current proxy voting policies. Generally, this will not be an issue during the 2020 proxy season since any fundamental changes in long-term incentive plan design will not likely occur until the end of the year or early next year, in which case the changes would be reported in a company's 2022 proxy (or possibly 2021 proxy if the changes are approved prior to the issuance of the 2021 proxy and determined to be material to understanding 2020 compensation).

- **Stock option repricing**. *ISS will continue to evaluate under its **existing policies** option repricing or exchange programs.*

  If a company seeks shareholder approval/ratification of repricing actions, ISS will evaluate the proposal on a case-by-case basis. For U.S. companies, ISS will generally issue a negative vote recommendation on any option repricing proposal that occurs within one year of a precipitous drop in the company's stock price. ISS will also consider other factors, including 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 from the repricing program.

  At this time, we do not anticipate many major public companies seriously considering option repricing or exchange programs in the near term.

Governance Issues

ISS did not change any of its proxy voting policies on the governance issues described below and discussed in its guidance.

- **Director attendance**. *ISS will continue to evaluate under its **existing policies** the adequacy of director attendance.*

  In its guidance, ISS notes that U.S. regulation-mandated attendance disclosure rules count telephonic/electronic participation as full participation in board and committee meetings, which means that **virtual meetings will count** as attendance at those meetings. ISS will generally vote against a director (except a nominee who served only part of the fiscal year) who attends less than 75% of the aggregate of their board and committee meetings for the period for which they served, unless the company publicly discloses an acceptable reason for absences.

- **Changes to the board of directors or senior management**. *ISS will continue to evaluate under its **existing policies** changes to the board of directors and senior management, which provide substantial latitude to companies to make changes under unforeseen circumstances.*

  If boards need to fill vacancies due to the disability or incapacity of a director or need to urgently add critical expertise to their ranks to address concerns created by the pandemic, appropriate case-by-case consideration will be given, assessing any explanation provided by the company regarding the changes to the board composition. Similarly, ISS believes that a company's board should have broad discretion to fill senior executive roles on an interim basis due to the disability or incapacity of a member of the management team.

Administrative Issues

ISS guidance addresses the following administrative issues, neither of which are covered under any of its proxy voting policies.

- **Virtual-only meetings**. *ISS has no proxy voting policy covering virtual-only meetings.*

  In its guidance, ISS has confirmed that it will not issue an adverse vote recommendation if a company should hold a virtual-only meeting due to the COVID-19 pandemic. If a company opts to hold a "virtual-only" meeting, ISS guidance recommends that the company disclose the reason for holding a virtual-only meeting and to provide shareholders with a meaningful opportunity to participate as fully as possible, including being able to ask questions of directors and senior management and to engage in dialogue.

- **Meeting postponements**. *ISS has no proxy voting policy covering postponement of annual shareholder meetings.*

  In its guidance, ISS 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." We believe that such positive note will be included in a company's ISS proxy report but will have no influence on ISS voting recommendations on any matter.

Glass Lewis Policy Guidance

Glass Lewis expects that the COVID-19 pandemic will continue for up to 18 months. Given the extraordinary impact the pandemic is already having on companies and global markets, Glass Lewis has provided its outlook and perspective on how the COVID-19 pandemic will impact corporate governance. Glass Lewis will use "context, discretion and pragmatism" in its evaluation of proxy voting matters and consider extenuating and unusual circumstances arising from the pandemic.

The following is a high-level summary of the Glass Lewis guidance, ***which does not change any of its current proxy voting policies, except for virtual-only meetings***.

- **Compensation issues**. Shareholders are most likely to support changes in compensation programs that are "proportional" under the circumstances, and consider the impacts on shareholders and employees.

- **Board composition and effectiveness.** The COVID-19 pandemic is likely to reduce director attendance rates, cause changes in board composition, force "overboarded" directors to reduce the number of their directorships and cause boards to consider the health risks associated with the age and gender diversity among current members**.** Further, the current environment will be an important test of succession planning and board renewal programs.

- **Oil and Gas industries**. Glass Lewis does not appear to be specifically changing any policies with respect to the energy sector companies despite their dire circumstances. Glass Lewis only notes that it will be closely monitoring how these companies respond to protect shareholder value in exceptionally challenging conditions.

- **Virtual-only meetings**. Glass Lewis changed its proxy voting policy on virtual-only shareholder meetings. For companies opting to hold a virtual-only meeting during the 2020 proxy season (March 1 through June 30), Glass Lewis will generally refrain from recommending voting against governance committee members provided that a company discloses its rationale for holding a virtual-only meeting, and specifically references COVID-19. Glass Lewis will apply its standard policy on virtual-only meetings to shareholder meetings held after June 30, 2020. To avoid a negative vote recommendation against governance committee members, Glass Lewis expects robust disclosure in a company's proxy statement demonstrating that shareholders will have the same participation rights they would have at an in-person meeting.

Meridian comment. To the disappointment of many, neither ISS nor Glass Lewis are making any meaningful revisions to their proxy voting policies due to the COVID-19 pandemic. Later this year, we expect that ISS and Glass Lewis will issue new policies that address discrete issues arising from the pandemic, which will likely include more detailed policies on evaluating 2020 pay decisions that were impacted by the pandemic. In the interim, organizations that make changes to existing incentive programs should be actively discussing and developing a compelling rationale for such changes.

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