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Proxy Advisory Firms Provide Guidance on Governance Matters in Light of COVID-19

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The 2020 proxy season is upon us and, as a result of COVID-19, many issuers likely require increased flexibility in order to deal with the uncertainty and economic challenges that they may be facing. In light of these circumstances, proxy advisory firms have responded by updating their voting policy guidelines to provide specific guidance for issuers on matters that are likely to be directly impacted over the coming months by COVID-19 and the world's response to this pandemic.

Institutional Shareholder Services (ISS) and Glass Lewis, the two largest proxy advisory firms, recently updated some aspects of their voting policy guidelines. Below we provide a summary of the key takeaways from these recent updates for issuers to consider this proxy season.

Virtual-only meetings

Both firms have made it clear that they will not react negatively to boards who opt to hold an online-only meeting this proxy season. Glass Lewis, as we reported in a recent article, has stated that for the duration of this 2020 proxy season (March 1, 2020 – June 30, 2020), it would refrain from recommending shareholders vote against members of the governance committee for holding virtual-only meetings, provided that the company discloses, at a minimum, its rationale for doing so, including citing COVID-19. ISS did not previously have a policy to recommend votes against companies who hold virtual-only meetings and has confirmed that they will not change their approach for this proxy season.

Executive compensation

In light of decreased share prices, shareholder concerns are expected to be markedly high, particularly with regard to 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. Glass Lewis has warned that companies seeking to maintain or bolster executive compensation during the current crisis will need to reconsider such plans, as trying to retain or appease executives at the expense of shareholders or other employees will be a certainty for proposals to get rejected and board nominees to be unsupported.

ISS expects that companies may be inclined to change compensation metrics in the short term, and encourages boards to contemporaneously disclose the reasons for making such changes to shareholders. ISS has also warned that any board that undertakes an option repricing action without shareholder approval may be subject to a negative vote recommendation.

ISS has also indicated that boards seeking shareholder approval for option repricing will be reviewed on a case-by-case basis. However, in their evaluation, ISS will consider the following in making its voting recommendation on the repricing:

1. whether the design is shareholder value neutral (a value-for-value exchange);
2. whether surrendered options are not added back to the plan reserve;
3. whether replacement awards do not vest immediately; and
4. whether executive officers and directors are excluded.

Balance sheets and capital management

Both ISS and Glass Lewis expect companies to resort to a more conservative capital management approach for the duration of the pandemic, including widespread pausing of buyback programs, suspension of dividends, and increased capital raises and placements.

ISS has confirmed that they will support broad discretion for boards seeking to reduce dividend payout ratios (below their historic levels or customary market norms) provided the companies disclose how they will use cash from the reduced dividend to support and protect their businesses. However, ISS is also warning companies of the intense scrutiny and potential reputational harm that will follow if such share repurchases are undertaken during, and in the wake of, the pandemic-related market plunge, especially if the company has also cut back its workforce.

Glass Lewis also warned of potential reputational harm if any curbing of returns or salaries are not proportional in their impact on shareholders and all employees.

Neither Glass Lewis nor ISS updated their policies regarding capital raises, but both firms recognized that many companies will require more flexibility to carry out capital raises than shareholders are conditioned to granting in accordance with strict best practice recommendations. ISS noted that, in line with their existing policy, ISS will continue to review requests to raise capital on a case-by-case basis. Similarly, Glass Lewis' current policy on capital raises also involves case-by-case analysis, and they will require management to justify a capital raise activity before they will support any such proposals.

We expect that both firms may be more lenient in their assessment of requests for capital raises given that such raises are necessary for many issuers in the current climate.

Leadership composition and effectiveness

Companies with boards lacking in age and gender diversity are in high-risk positions given recent COVID-19 studies that men, particularly those that are aged 65 and over, are more likely to become critically ill. There may also be increased likelihood of reduced attendance rates and changes in committee and board independence as overcommitted directors start reducing their board seats.

Given the exceptional circumstances, ISS and Glass Lewis have stated that they will apply their policies with the flexibility required to provide boards with broad discretion to ensure they have the right team in place. If the pandemic creates a need for a board to fill vacancies due to the incapacity of a director or to promptly add a director with critical expertise, both firms will evaluate the situation on a case-by-case basis taking into account the company's explanation for the change.

With regard to the voting recommendations based on attendance this year, neither firm provided an update, but we expect both firms to apply their current board attendance policy and recommend shareholders vote against any directors who failed to attend at least 75% of their board and key committee meetings held during the fiscal year, unless they can provide an acceptable reason.

Poison Pills and other defences

The current market disruption may have interrupted existing activist campaigns, but these same market conditions are likely to stoke new opportunities for activism. Some of these activities will be driven by survival or optimism and others will be driven by stalking private equity firms looking to obtain significant positions – at discount prices – in companies hit hard by the crisis. As such, it is expected that many boards will consider adopting poison pills to protect themselves in the wake of recent stock price shocks.

Both ISS and Glass Lewis will take a case-by-case approach to assessing shareholder rights plans. ISS noted that it 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. Glass Lewis has indicated that it will consider companies that are impacted by COVID-19 and the related economic crisis as reasonable context for adopting a poison pill provided the duration of the pill is limited to one year or less. Additionally, both firms will still require the company to disclose a sound rationale for adoption of the pill as a result of COVID-19. ISS will also consider other aspects of the plans (e.g. trigger threshold and exemptions) in making their voting recommendations.

Shareholder proposals

Since shareholder proposals are typically submitted months before the annual meeting, investors will need to be mindful that many of the shareholder proposals this proxy season may not adequately account for companies' current situations within the COVID-19 crisis. However, Glass Lewis has warned that companies should not use the crisis as an excuse to dismiss or hamper the ability of shareholder proponents to put forward their resolutions, speak at virtual meetings and have shareholder vote on such matters.

Glass Lewis will continue to employ a contextual approach in evaluating shareholder proposals and will recommend accordingly. ISS did not provide an update on shareholder proposals. Nonetheless, we expect proposals that could distract from the goal of surviving and preserving value during the current crisis to not receive a favourable recommendation from either advisory firm.

Key considerations

In order to navigate these governance issues during this unusual proxy season, it may be helpful to consider the approach and considerations employed by advisory firms like ISS and Glass Lewis when providing recommendations.

Disclosure and Explanation: Both ISS and Glass Lewis hold effective disclosure and rationales as critical to their exercise of discretion in making judgments about whether changes made as a result of this crisis are justified and address material shareholder concerns. They will also assess the reasonableness of proposed changes and outcomes by considering if they are consistent and in proportion to the impact on shareholder interests and employees. With regard to executive pay, both firms will expect boards to proactively seek changes that align with employee and shareholder experiences, recognizing that some executives might need to take a pay cut.

Timely and Certainty: Although Glass Lewis has indicated that their recommendations may be less favourable towards companies that delay or postpone significant decisions during this crisis period, they and ISS have committed to being flexible in order to grant boards the discretion they require to have the right team and people in place to make key decisions. Ultimately, both firms will exercise discretion when considering governance issues where there is a clear material benefit to shareholders, even if that entails delayed decision making.

Voting: The fundamental shareholder right is the ability to vote on key company decisions, and the implementation of this right to vote will be a significant factor in determining whether the board or their backed proposals receive recommended support from firms like ISS and Glass Lewis. Hence, it is crucial that virtual meetings held during this proxy season facilitate the voting process fully and fairly. For both firms, a fair process includes adequate disclosure regarding all aspects of the meeting, including reasons for the virtual meeting, and how such meeting will be structured. A fair voting process must also 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 if they wish.

The Capital Markets Group at Aird & Berlis has the expertise to assist you in navigating proxy season during this challenging time. If you have any questions, please reach out to Melanie Cole.

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