COVID-19 and corporate governance: leading proxy advisors weigh in

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In light of COVID-19 and the impact it is having on how companies conduct business, the two leading proxy advisors have provided guidance in relation to the pandemic. Institutional Shareholder Services, Inc. (ISS) and Glass Lewis, & Co. (Glass Lewis) recently shared their insights.

On March 19, Glass Lewis updated its approach to virtual meetings. The company advised it was relaxing its review of virtual shareholder meetings in light of COVID-19. In addition, on March 26, Glass Lewis published an article titled "Everything in Governance is Affected by the Coronavirus Pandemic. This is Glass Lewis' Approach" (the Governance Report),where it examined how COVID-19 affects corporate governance matters.

ISS has not officially provided written guidance on governance or virtual meetings. However, a leading shareholder and advisory firm informed us it has been in touch with ISS, who indicated that, for the 2020 proxy season, it will relax its policies regarding virtual-only meetings.

More detailed summaries of the proxy advisors' views are provided below.

ISS

ISS will require issuers to provide disclosure ensuring that a virtual shareholders meeting will not limit their right to participate. Specifically, ISS expects virtual meetings to be transparent and include two-way communication, allowing shareholders to ask questions, be critical of a company's performance or governance and present their proposals.

Glass Lewis

Virtual meeting release

On March 19, 2020, Glass Lewis issued an update covering its guidance on virtual shareholder meetings. Glass Lewis is generally neutral on virtual-only meetings, so long as they are structured to ensure meaningful shareholder participation. The company stated for the rest of the 2020 proxy season (March 1- June 30), it will relax its approach to virtual shareholder meetings and will generally not recommend against members of governance committees, as long as the issuer discloses its rationale for holding a virtual meeting. A reference to COVID-19 will suffice.

Governance affected by COVID-19 release

On March 26, Glass Lewis released its Governance Report. In the report, the company stated that it expects that many governance issues will be impacted by COVID-19, potentially into 2021. The company believes the best way to observe the effectiveness of governance is in a crisis. Companies that provide shareholders with effective disclosure, certainty and a consistent approach that considers the impact of its decisions, will be most successful.

Glass Lewis believes that while initial attention for many issuers will be on virtual meetings, focus will quickly shift to executive remuneration and balance sheets. While it is not an exhaustive list, the following are the key governance areas Glass Lewis discussed in its report.

Compensation and Balance Sheets – Glass Lewis believes those that take a proportional approach to the impacts on shareholders and employees are more likely to see wide support. Glass Lewis expects to see a marked increase in shareholder concerns on repricing, dilution, burn rates, hurdle adjustments, changes to vesting periods, caps and cuts on incentives. There will be a heavy burden of proof for boards and executives to justify their compensation levels in a drastically different market for talent.

Glass Lewis stated with regards to balance sheets and capital management, widespread pausing of buyback programs, suspending dividends and an increase in capital raisings and placements appear to be a forgone conclusion. It noted some companies will need to be flexible in their approaches to capital raisings.

Board Composition and Effectiveness – Given the disproportionate impact that COVID-19 is having on those 65 and older, boards that lack age and, to a lesser extent, gender, diversity may be severely impacted by COVID-19. Glass Lewis anticipates that there may be reductions in attendance and required changes to committees as companies address the mark-up of their boards. For boards to be effective companies will need to have effective software to ensure that meetings can continue virtually.

Activism and M&A - During the global financial crisis, poor governance and shareholder returns, particularly when avoidable, inspired a wave of shareholder activism, M&A, lawsuits and consolidation. Glass Lewis expects to see similar behaviour now.

Shareholder Proposals and ESG - Given that shareholder proposals are normally required to be submitted months in advance, those for the current proxy season would not have taken the impacts of COVID-19 into consideration. Approaching these issues from a long-term perspective, while ensuring companies are able to operate in the short to medium term, is crucial.

Companies should be mindful not to use the crisis to dismiss or hamper the ability of shareholder proponents to put forward resolutions, speak at virtual meetings or vote on such matters. Poor behaviour could encourage more activist attention and be reflected in future shareholder votes on directors and recommendations from proxy advisors.

Oil and Gas - While many sectors will be hit hard during this time, Glass Lewis specifically noted the impact to oil and gas companies. The accumulation of high and poorly-rated debt, the Saudi-driven plunge in oil prices and shrinking demand due to the pandemic and social distancing measures threaten the livelihoods of many companies in the sector. Glass Lewis will closely monitor how companies respond to protect shareholder value in exceptionally challenging conditions that will likely include many restructures and bankruptcies.

Glass Lewis' approach to governance matters

In reviewing companies' approaches and responses to governance matters in the COVID-19 era, Glass Lewis will practice discretion, prioritize disclosure, and timing and certainty on such matters.

Disclosure – Effective disclosure will be critical in making judgements about whether changes made as a result of this crisis are justified. Glass Lewis will assess the reasonableness of proposed changes by considering if they are consistent and in proportion to the impact on shareholder interests and employees. With regards to executive pay, Glass Lewis expects boards to proactively seek changes that align with employee and shareholder experiences, recognizing that executives might need to take a pay cut.

Timing and Certainty – Glass Lewis states that in times of crisis, decisions on material matters must not be delayed or significantly postponed. Companies that move decisively, in co-operation with shareholders, are more likely to contain the damage and identify opportunities for positive outcomes.

Please do not hesitate to contact any member of our Capital Markets Group with any questions. BLG has also created a COVID-19 Resource Centre to assist businesses on a variety of topics, including contractual risks, public disclosure requirements, schools and criminal law.

By

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