CORONAVIRUS RESOURCE CENTER

The More Things Change, the More They Stay the Same: Compensation-Related Guidance from ISS and Glass Lewis in Light of COVID-19

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Both of the large institutional shareholder services have issued policy statements over the past two weeks regarding principles they intend to apply in their review of compensation programs following the profound and unquestionable economic disruption caused by COVID-19. Though different in tone, both firms' statements acknowledge that most public companies will likely need to address how best to modify existing and/or craft new employee incentives in light of the effects of the virus. Both also suggest that there has been little to no change to the general principles to be applied and the recommendations to be made to shareholders in connection with their review.

Institutional Shareholder Services. On April 8, ISS issued a policy document entitled "Impacts of the COVID-19 Pandemic." This guidance (which may be found here) offers the following three reminders as to compensation matters:

- ISS generally looks unfavorably on "midstream or in-flight" modifications to performance goals under short- and long-term incentive programs and will assess any changes to long-term awards on a case-by-case basis. The guidance encourages companies to make early disclosure of changes so that the rationale for the changes can be analyzed in advance of the next annual meeting of shareholders. Some of these changes will require disclosure on Form 8-K; others will not require disclosure until the Compensation Discussion & Analysis filed with the next annual proxy. Companies will need to consider the advisability of making any sort of advance disclosure not otherwise required by the SEC's rules and may ultimately think twice about doing so if they conclude that there will be no benefit to doing so under ISS's normal review process.

- Go-forward changes to incentive programs will be analyzed under ISS's normal review methodologies.

- Stock option repricings continue to be disfavored and, notwithstanding the rout in stock price that has occurred in many sectors, will generally be opposed if occurring within a year of a precipitous drop in stock price. The guidance tells us that ISS plans to evaluate repricings under its existing case-by-case approach. ISS reminds companies that the following are favorable factors in any repricing exercise: (1) a value-for-value exchange that is cost-neutral to shareholders; (2) no share recycling; (3) a new vesting schedule for the repriced awards; and (4) exclusion of executive officers and directors from the repricing. For issuers that contemplate repricings, it will be very important to articulate the ways in which the proposed repricings are pro-shareholder, which we expect will be the case for many repricings arising in the current environment because a repricing will conserve cash, reduce ineffective overhang, lower burn rate, and motivate and retain the key employee base.

Glass Lewis. On March 26, Glass Lewis released its own guidance. Remarkable for its pugnacious tone in light of the challenges posed by current circumstances and short on specifics, Glass Lewis has advised the following (the report may be found here):

- Poor performance before COVID-19 will not be accepted as an excuse for employee-favorable changes to compensation programs. While "a marked increase in shareholder concerns on repricing, dilution, burn rates, hurdle adjustments [and] changes to vesting periods" is expected in the current environment, these concerns are unlikely to be respected as genuine: "Companies with strong pay structures will be challenged to abide by them, and firms with less robust programs will be forced to choose between lying in the bed they've made or changing arrangements and all but guaranteeing shareholder ire."

- The programs and/or changes most likely to be respected are those that "share the pain" between employees and shareholders.

- Companies should consider whether there will be a greater market for key talent after the pandemic subsides and during the subsequent recovery and therefore whether key human capital can be obtained more cheaply: "The stark reality is that … executives … should not expect to be worth as much as they were before the crisis, because their free market value as human capital has now changed. There is a heavy burden of proof for boards and executives to justify their compensation levels in a drastically different market for talent." Our own view is that this charged rhetoric is both naïve and surprisingly anti-shareholder: as we saw in 2001 and again in 2009, the inevitable recovery of the economy will almost certainly be a time when

attracting, motivating and retaining key talent differentiates the prospects of some companies' rebounds from others.

Changes to compensation programs, whether midstream or go-forward, are inevitable in light of the pandemic and related recession. Both firms' guidance suggests that boards of directors and compensation committees will need to carefully consider the reasons for these changes, and, for companies that decide to make changes, it will be crucial to have a careful, thoughtful and strategic plan for communicating to shareholders the rationale for the actions taken. Companies that decide to "stay the course" will need to be no less careful and strategic in planning and communication. Each disclosure, whether in a Form 8-K or in the next Compensation Discussion & Analysis or proxy proposal, should be treated as an opportunity to show the alignment of the company's compensation programs with its shareholders' best interests. Companies will also need to decide whether engagement with shareholder advisory firms on these matters will advance these important commercial goals or will be unhelpful.

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Please do not hesitate to contact us with any questions.

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