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Day 3
Navigating ISS & Glass Lewis
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Liz Dunshee: Hi, everyone. Welcome back. I'm excited for this panel that we have coming up here, "Navigating ISS and Glass Lewis." This is always a popular discussion. This year I'm excited, too, that we hopefully will have reps from both ISS and Glass Lewis. We have David Kokell, associate director and head of compensation research at ISS, and then soon we are expecting to be joined by Julian Hamud, the senior director of executive compensation research at Glass Lewis.

We also are getting the perspectives of Ning Chiu of Davis Polk and Bob McCormick of PJT Camberview.

I will turn it over to Ning to set the stage for the discussion. Ning?

Ning Chiu: Thanks, Liz. So I'm more like a traffic director here. We have, and just because this a crowd that is likely to be very good about wanting to keep track of things and pretty organized, I will just kind of give you the framework for what we're going to do today.

We have about ten things were going to walk through, 2020 season takeaways, policy changes, and really helpful advice that we're probably going to get from David and Julian. Because Julian isn't able to join us yet, what we're going to do is we'll go ahead and start and then when Julian joins us, we'll go back and pick up Glass Lewis' perspective on these same issues, so just wanted to give everybody a heads up.

So we're going to start now with Bob leading us through highlights of the exec comp issues that impacted this past season and David can jump in with any commentary from that. After that, David will give us some stats from the 2020 season from ISS's perspective.

Bob McCormick: Thanks, Ning. Obviously the 2020 season was dramatically impacted by the goal pandemic. I think it's hard to view it without that lens, without that context. I think one of the challenges was that the performance that most investors were looking at was based on 2019 performance, and in many cases that continued to be very strong for lots of companies. So when they were looking at the Say-on-Pay vote in particular and then compensation just in general, they were looking at it with the lens of, "Well, it's 2019 performance versus 2019 compensation decisions," some of those going back a couple years depending on how far back the advisors may want to look at, it's usually three years or so.

So that kind of was one of the sort of starting points, right? But then there was an additional lens applied as, "Have there been any compensation changes made as a result of the pandemic?" I this varied quite a bit depending on the industry, certain industries, of course, were impacted significantly more. Other it was a very limited impact and others may have actually benefited to some extent in terms of deliveries and those sort of more unique kind of situations where having people work from home actually bolstered their business.

When investors were looking at compensation, there wasn't a whole lot of new design changes, but it was more kind of implementation of programs and I think companies were stuck in some cases, "Well, how do we ensure that the compensation programs we've had in place, which have been effective, operate in a pandemic-like environment. Do we need to make any changes to the compensation programs in the short-term to ensure that our people remain incentivized and motivated? Are there longer-term changes that we need to make because of the longer-term impacts?"

So a lot of these were discussions. The way companies looked at it in some cases was an executive sharing the pain of the downturn in the economics of the company by taking salary cuts, in some cases the entire salary was foregone. In other cases there were broader sharing of the pain among the more senior executive ranks at companies.

I think one of the things we didn't see is sort of broader compensation adjustments across the entire employee group. In fact, some companies made commitments to ensure employment I think as a way towards providing a strong morale boost to the employees.

One thing what we saw some companies do, there was some variations of do they look at short-term compensation program changes to ensure that continued motivation retention, or maybe longer-term. I think there was significantly greater sensitivity amongst shareholders to longer-term changes to compensation programs with the perspective and some evaluation of compensation programs necessarily over a longer period of time, and therefore there should be some sort of wait and see approach to some extent.

I think the short-term programs there's more of a potential for making some adjustments about companies that were in an industry that was impacted that the company really wasn't really responsible, so to speak, for the downturn. I think that's where shareholders were a little bit more open-minded. I think the broader theme here is there was significant, obviously, attention paid to compensation like usual with the pandemic sort of lens or perspective, some open-mindedness to changes that were really, to parts of the program that were really outside the control of shareholders, but a bit more of a cautious or wariness about changes to longer-term programs, which could eventually end up paying out for the executives.

I think going forward shareholders will continue to be looking at compensation very closely and companies that did make changes I think will be in a position to provide a good strong rationale for those changes, and I think that's something that we're beginning to see from companies as evaluating impact to them and the market, and I think for those companies, I'll just close with saying, those companies that not only were in industries that were impacted, but that engaged in some layoffs or took bailouts, there's probably even a bit more sensitivity there to compensation changes.

So I think in terms of some of the impact on the season, still same high level of support for Say-on-Pay but I think probably going forward we'll probably see more of the impact going forward than it was necessarily this year.

Ning Chiu: Thanks, Bob. Welcome to our panel, Julian. Glad you could make it. We were just starting with, just to catch you up, we were just starting with a look back to the 2020 season with Bob giving us the highlights, and then I was going to turn it over, first to David to go ahead and give ISS's perspective on the 2020 season, what you saw, and at this point, David, if you wouldn't mind just going ahead and giving us the stats, and then, Julian, I'll turn it over to you for the same thing.

One thing that people are always interested in is what led to some of your negative recommendations. We know you had some, so what were some of the key issues that led to those things?

David Kokell: Sure. I don't think this year's proxy season, when I was trying to think of a major singular theme, really one didn't come to mind, given that obviously the focus is on 29 pay decisions before the impact of the pandemic. In fact, the pandemic reached US shores just as this proxy season was kicking off, but I will say it was sort of a hot-button year, if you will. So there's a few things I'd like to note outside of the pandemic context. Obviously I know we're eager to get into COVID related pay discussion, but I did want to highlight certain issues that led to some adverse recommendations in this past proxy season.

One of those, and once again this is sort of a continuing trend, is the issue of problematic severance and related disclosure issues playing an increasing rose in those against recommendations. But outside of that, the usual pay for performance issues were noted, problematic one-time awards, or problematic incentive program design and related disclosures often came up. I know we'll be getting into each of those a little bit more in detail later.

I did want to point out some good news. We saw that the performance **___(0832)** equity mix was at an all-time high, by our calculations at 57% on average of the equity mix for S&P 500 CEOs. This despite some voiced skepticism, I'll say, by certain shelter groups around the efficacy of performance equity. But we're also finding that companies are doing a very good job in terms of responsiveness disclosure, although we do continue to identify some pitfalls around responsiveness.

Of course, that all being said, next year will be a very different story as we expect that the pandemic-related pay decisions and disclosures will certainly be dominating the landscape.

Ning Chiu: David, did you have any stats on how many adverse recommendations that you gave out. I feel like it's kind of like getting bad grades, sorry, but how many people got bad grades? What was the curve? And what was it relative to last year? And then next year when we have this conversation it must be up a little. We'll see if that changes dramatically or not.

David Kokell: Right, right, sure, I'm happy to share that. I have some stats with regard to the amount, the percentage of against recommendations versus the quantitative screen, but I do want to just preface though that obviously the quantitative screen simply triggers whether or not there's an in-depth dive of a qualitative review, and it's that qualitative review that will always determine that ultimate go recommendation of the Say-on-Pay proposal.

But for the high concerns, that severe quantitative disconnect between pay and performance, approximately 46% of those companies receiving a high concern received an against recommendation on the proposal.

For the medium concerns, that was one-third, 33%, and then for the low concerns this past proxy season it was at 4%. On the low concerns, that typically stems from issues around either a problematic contractual provisions or pay issues for other executives and the CEO responsiveness or sometimes severance issues.

How it compares to last year, overall it was about the same rate, but I will say that our against recommendation was a little bit lower for the high concerns and a little bit higher for the medium concerns. I don’t think there's a particular reason for that, but I did want to provide that, in case you're interested.

Ning Chiu: So just to translate a little to what you said, if you had a high concern on the quantitative test, you have a more than majority percent chance this year that you did not get a negative recommendation?

David Kokell: That's correct.

Ning Chiu: So I think for some people it's pretty clear why you would get a high concern, high pay, or maybe you just had a bad TSR year and everybody else did better, and low concern, like you said, sometimes they're very unique issues. What kind of triggers a medium concern? What tends to drive that?

David Kokell: I don't think, I mean, obviously, honestly, I don't think there's a great answer on what typically triggers a medium versus high, although I will say that the high concern threshold is pretty high. For the Russell 3000, at least for the multiple median task, that's a 3.33 above the median pay level, so usually I would say that oftentimes it relates to a one-time pay decision, either a one-time grant that inflated pay or an irregular grant practice perhaps where we see large grants maybe every few years.

But for the medium, it could be a variety of situations. I will say it's not always a lagging performer. There have been cases where we actually recommended against proposals for some very strong performers and I think in discussions with companies they may have been surprised, thinking that the strong performance will sort of insulate them from an against recommendation. I will say that was something that came up at a number of the prominent tech companies this past year where they had very strong TSR performance sustained, but a qualitative evaluation nonetheless of the pay programs really showed insufficient performance-based elements, so heavy use of time-vesting equity or purely discretionary bonuses without much details on the qualitative, even the qualitative factors that determined those bonuses.

In those cases, where we just don't have any really strong performance basis to the pay at all, those companies are still likely to receive an adverse recommendation, even if it hasn't translated to poor performance.

Ning Chiu: We did get a request, David, if you don't mind, just running through numbers again. I think it was 47 for the high…

David Kokell: 46% against rate for the high, 33% against rate for the medium, and a 4% for the low.

Ning Chiu: Great, thank you. So, Julian, if you could also recap what the highlights of the proxy season from your perspective as well as any statistics that Glass Lewis may e able to provide.

Julian Hamud: Absolutely. Thank you again for having me. So from Glass Lewis' perspective, this was an awfully quiet year given all of the turbulence we were seeing in the news, literally every day at this point. I think the three main themes when it comes to what we saw in the proxy season, there were a lot of chickens coming home to roost, so a lot of large, high-level items that the board and executive team have kind of together negotiated with several companies, sort of came to a head within the first three months of the year, and that played out on the Say-on-Pay front for a number of firms. I think there was a lot of interplay between Say-on-Pay and Say-on-Performance at the shareholders **___(1409)**

Another thing that we saw was sort of some early warnings against **___(1414)** grants, where performance had been negatively impacted by other factors before. It sort of remains to be seen how much that's going to be indicative of shareholders' appetites or that type of decision making in response to the pandemic context, but in that, for calendar 2019 decisions are bound, I think there were some pretty strong signals from a number of shareholder bases that there were red flags around that.

Then again, in terms of the viral elephant in the room, it was relatively quiet because of the timing of the disclosures and again most of the companies **___(1451)** based on calendar 2019 information. We did see a number of companies make token changes to salaries or other components of pain for top talent, but those didn't really seem to move the needle, at least from many shareholders' perspectives, and I think we'll see a lot more about how companies develop those going forward.

From Glass Lewis' side, though, it was also a pretty normal course year for us. We saw slightly elevated rate against recommendations from around 14.5 to 17, to 15.8% for Say-on-Pay and pretty much flat against rate for equity proposals in the 14 percentage point range. This is not unsurprising given some of the triennial factors that come up because there were just more meetings and the impact from our change to the CGLytics model and CGLytics peers argued Pay-for-Performance model was fairly understated. There were a lot of changes in grades but overall distribution remained really consistent with previous years, in fact, a little bit flatter in fact.

Overall, the number, kind of the movement in terms of individual grades per company, was pretty comparable year over year, so we didn't see huge swings in companies' Pay for Performance grades that were related to our new methodology there.

Ning Chiu: So Julian, one of the things that people find really curious about the grades, I think Bob probably also shares a sentiment, although maybe he has the backstory better than some other people, you could get an F and still get a 4 recommendation, and then I don’t know if you can get an A and get a negative recommendation, but you can definitely get a C and still get a negative recommendation. So how to the grades correlate with the recommendation? I think that's always been a bit of a puzzle for people.

Julian Hamud: It's also a tough one because the grades don’t follow the standard school letter grade system. A C grade is the center of the road rather than barely passing, from our perspective. One of the interesting things that year over year as companies continue to improve their disclosures and continue to advance from where things started in 2011 with Say-on-Pay voting, our support rate for **___(1704)** grade has increased pretty significantly.

So for the most recent proxy season, we scored at over 40% of F grades and something like two-thirds of D grades. Again, pay is a very dynamic concept. You're looking at the current state of **___(1718)** for top management at a company relative to a static three-year look back.

Even as we saw this year, between the end of that fiscal year and the time you're voting proxies, an enormous amount of change in the company and personnel and the market place could happen, and a lot of the main reasons we deviate from that grade relates to those dynamic factors.

At a high level, I would say that the Pay for Performance grade is a frame for the picture. There are factors that might support it, there are factors that might say it doesn't tell the full reality on the ground. My teams spends an enormous amount of time making sure we understand the ins and outs not only of the program, but for what happened to a company in a given year.

Ning Chiu: Thanks. Let's talk now about, of course, the big story of the season, even for pay, which is COVID. I know that you all had to kind of react like everybody else did midyear. David, if you could start with talking about any explicit or maybe policy changes that you felt you had to make at ISS. I know that you put a fairly lengthy piece that covered all sorts of different things as did Glass Lewis, but if you could talk about what you considered from a pay perspective in light of COVID, any changes that you made so far, any changes your considering make, which we'll also talk about when we get into your advice on what companies should be thinking going forward, but maybe we start with sort of the immediate, mid-stream changes that both of you had to make.

David Kokell: Sure, and I think that the best way to describe it is we're currently in the process of considering those changes. We have recently, in fact last week, held a number of investor round tables on COVID-related issues, not just compensation but board governance issues. We had a number of questions on the policy survey that recently closed, so we're still digesting that feedback.

But I can sort of given an overview of the themes that we received in the feedback that I think will likely affect our approach, and I think it's fair to say that we'll have some significant changes, at least from the qualitative portion of our Pay for Performance analysis in that we do expect to operate under a more flexible approach with regard to COVID-related pay decisions.

So in other words, in many cases, things that would normally be considered a red flag under normal circumstances may not be viewed necessarily as problematic under these unprecedented environment. That may include, for example, mid-cycle changes that are ordinarily frowned upon, or perhaps the increased use of discretion.

But I do want to say a warning that that said, there's still going to be investor expectations around reasonable and judicious use of discretion as well as scrutiny on the quality of disclosure around those decisions, so we'll be looking very closely at the disclosure as well.

We're just continuing to parse through the feedback of these, but I am eager to share those themes that we've heard, particularly with regard to the various pay elements. I can jump into that now if you'd like or I can pass it over to Julian, however you'd prefer.

Ning Chiu: Let's pass it over to Julian for a second and we'll talk about a high level and then yes, we would very much like to hear about the specific elements, absolutely. I have some, as does Bob, some specific questions around those elements and advice for people.

Julian Hamud: Thank you, Ning. So we'll be actually announcing some of kind of the high level guidance around how we're looking at some of these specific issues in the near future. Again the situation is fluid, but our general perspective is that governance is supposed to apply for good times and bad times.

Obviously bad times don't usually include black swan events that really disrupt every aspect of day-to-day life, much less commerce. But from our perspective, some of those same things that were a bad idea in 2019 are still a bad idea in 2020, and conversely for the favorable future is in good designs.

We've sort of broken it down into three main areas where we're looking for, three main principals that were going to be applying to COVID-related changes. The first is going to be alignment. Regardless of what a company has to do for a given situation or can make the rubber meet the road the way that it should, there should still be an alignment between shareholder and executive interest. That's demonstrable and has some risk and reward elements entailed to it.

The second is prudence. Based on the performance of most companies over the last three months even, we think it's become really front and center that making, rushing into huge changes to the pay program isn't necessarily a good solution because these are problems that are going to develop very quickly and for a lot of companies that issued large equity awards in March just by the share count alone, there has been an enormous appreciation that's mimicked the marked not necessarily, but in some cases certainly, the specific contributions of the executives.

The last one I would say is compromise. Again, there are situations where those governance principles and those designs are going to have to accommodate the current reality. Where that does happen we expect to see strings attached, we expect to see a commensurate benefit for the executives and for the shareholders, retention awards should really retain, for example.

Ning Chiu: So something like retention awards, Julian, you mentioned, retention awards should really retain. Now sometimes you can't tell that in one year, right? Would it be the kind of thing where, and I'm just, I know an example in a vacuum may be a little unfair, but if there was a retention award maybe in the first year, you might give people a little bit of a break and then you wait and see if that retention award plays out and if it actually does retain. Is that sort of what you mean by something like that?

Julian Hamud: I think the point I was trying to make is more that form should match function. We see examples of companies that say in order to retain the executive, we increase the cash bonuses for a given year. There's no strings attached to that. There's not good hooks or good ties that bind in response to that. But where there's meaningful vesting or performance conditions tied to a reasonable award with upside opportunity, for example, it's a lot easier for us to say that the board was intending to accomplish something and the structures that are in place, the designs that they've developed, are likely to support that.

Obviously to your point, it's impossible to guarantee retention, otherwise the design of a pay program would be a much easier topic for everybody involved in the conversation. But in the absence of certainty, the best we can do is make sure that the structures are aligned with what the expectations should be.

Ning Chiu: So it's more of a question of long-term versus short-term structure.

Julian Hamud: Of course.

Ning Chiu: We have a lengthy list, just for the audience, when we talked about this as we were preparing, we had a lengthy list of all the different COVID-related discussions we could have about different elements, so we'll try to cover as much as we can because we know different people are living through different things, different companies have different concerns, so for some companies that are doing largely similar to last year in terms of TSR anyway, even if maybe some other metrics are not, your concerns may be very different than if you're in a certain type of industry. So that's why we wanted to try to cover a little bit broader scope.

We'll start with Pay for Performance. We also try to cover incoming executives, departures. I know one-time awards are always very popular, especially if retention is a problem, as Julian mentioned, which I'm sure it is for some people, as well as termination and severance.

So we'll start with some of those things and then, of course, the ever popular targets, goals, sort of elements. We'll talk about compensation elements first and really focus on if these are things that you're deciding that's a little bit out of the norm as a company, what can you do in terms of your disclosure to explain why, that would be compelling not just to ISS and Glass Lewis, but from their conversations with their clients and investors.

Bob is well, as an advisor standpoint, jump in in that perspective as well.

So we'll start with David on that.

David Kokell: Yeah, sure. Let me just quickly cover base salary and the question of either the freezes or the temporary reductions, a question that we posed to investors were how meaningful will that be viewed. A lot of the feedback pertained to sort of, I think what Julian said before, is how much does it move the needle.

Obviously, base salary is an increasingly smaller portion of the total pay package, so I think in many cases reductions were short-lived. We saw within a few months many companies had reverted back. I don’t know what impact that would really have on the total pay, I think it's more at that point a symbolic gesture.

We did hear, and we agree, that a more meaningful action with regard to base salary would be to also adjust the targeting for the annual and long-term incentives that are targeted as a percentage of the base salary. Ideally that would be targeted to the lower salary and not to the original, perhaps contractually provided, salary amount. That would be obviously something that would be considered a more meaningful action as it would have more impact on the total pay package.

I will say, let me skip over to the long-term incentives, the feedback we had largely heard from around the equity and long-term programs, it's that they don’t expect, investors are really not expecting that many changes there. They think with longer-term programs, these less than a year shocks, and no shocks have maybe been seen, obviously been seen more operationally than on stock price for most sectors. It would be premature at this point to either make changes on the fly to mid or outstanding equity cycles, or any kind of major changes or shifts in the nature of awards for those granted next year going forward.

So to answer the big questions, would large-scale shifts toward time equity be viewed as favorable or adequate? No. The answer would be no. The expectation would still be that a majority of equity awards maintain performance criteria. We also specifically were interested in perhaps whether companies would be moving towards what are termed measurement periods, maybe three one-year periods in a true long-term, similar to what we saw at the tail end of the great recession back in 2009. The answer there was also largely no, that would not be appropriate, that there still needs to maintain strong differential between the annual program and the long-term program.

I think where we are going to **___(2821)** that flexibility more than ever is going to be with regard to the annual incentives, and that's where we've heard from companies and we've also heard from investors, the expectations where there's going to be some larger scale changes. This was a specific question we had on our policy survey about what would be an appropriate response and the large majority of respondents indicated that either mid-cycle adjustments to metrics performance targets, or measurement periods, or perhaps even a temporary suspension of the annual program and the use of discretionary awards could be a reasonable response, depending of course on the justification provided, i.e., the quality of disclosure and the reasonableness of resulting payouts.

I think it's safe to say we're going to have comfort with either of those actions so long as those necessary disclosure points are there . What do I mean by necessary? Well, what I think, I've laid out, I can lay out four main things that I think are going to be very important to include if you have these types of changes in your annual incentive program.

I think first of all, obviously, is disclosure on the specific challenges that were incurred, that rendered the original program either obsolete or the original goals impossible to achieve or meaningless and it's going to need to be clearly delineated how those outside challenges, those external factors, were outside either the control of management and certainly not reflective of any kind of performance issues.

We've also heard that whatever action you do take that additional disclosure as to why the opposite action was not prudent for investors' interests, either why the original program is not being maintained or if you are suspending the program, why was that the appropriate action versus making mid-cycle adjustments. My guess is for those companies that were severely impacted that even six months or short-term forecasts were just not possible, especially given that six months in we were still in a position where we don’t know how long the pandemic will in fact be lasting.

Importantly, if there is going to be a movement to a discretionary program, there still needs to be a performance basis to that award, even if it's not based on that original objective performance criteria. Generic references to performance are not going to cut it. In fact, we heard from investors their frustration with performance factors such as "strong leadership during difficult times," those types of things, we've heard drive investors mad a little bit because it's kind of just boilerplate meaningless. Even if you're moving to discretionary awards, hopefully even if they're qualitative based, that there's some good criteria that can be analyzed for the basis of whatever dollar amounts you're landing on for those bonuses.

Then lastly, of course, how did the resulting payouts compare to the original program design? My guess is if you're suspending the program, the original program would probably pay out almost nothing.
I do want to give a cautionary note, though, that we've heard that if you're going to take the extraordinary action of mid-cycle changes or suspending of the program, investors are going to be very skeptical about any kind of above target payouts in those scenarios, so it's going to be probably an uphill disclosure battle, I would say, that if you're going to suspend the program and you pay near maximum bonuses for that year, that's going to be something that's going to be met with some scrutiny.

Ning Chiu: So again this is an example in a vacuum, but if you are in the middle of a three-year cycle, as an example, but because of the pandemic and you're in an industry where that could be shown pretty clearly, nothing makes any sense anymore, none of the targets that you have put forth, none of the goals you put forth, so you could potentially suspend that program and you would work through changing your annual incentive program so long as you're disclosures make sense, but the advice you're giving, David, very strongly is that you still need to have some kind of performance criteria for that annual.

So maybe something like, "We managed to not lay off more than X percent of our employees" or something like that, or "We managed to not close more than X percent of our stores" or "We managed to maintain our credit rating." I'm making up the performance criteria, but something concrete like that. Would that be kind of in the line of what you're talking about?

David Kokell: That's exactly right. Even if, and maybe not even as necessarily as objective or quantitative as that criteria, although that would be, those kind of metrics would be fantastic and that's something that we would certainly be relaying in our research reports. I think that the worst case scenario is sort of the compensation committee in its discretion determined that bonuses would be paid at target in light of the challenges faced by the pandemic without any kind of other discussion on what was the performance basis that led them to decide on target, for example.

Ning Chiu: And maybe they wouldn’t even be performance criteria, but maybe they would just be indicators of actions that leadership took that is reflected, so they're not necessarily one-to-one tied to what was paid, but these are all the factors that we looked at in the business that showed that we took these very strong actions and managed to maintain our business in as much of a steady state as we could possibly be in and that's why we paid what we paid. Something like that.

David Kokell: That's exactly right. Like I said earlier, a purely discretionary payment under normal circumstances would be a red flag under ISS's approach, however, this year that will be different as long as the disclosure **___(3413)**

Ning Chiu: Julian, what is Glass Lewis thinking in this respect, to sort of COVID-related type of changes that some companies are probably going to have to make?

Julian Hamud: I think David touched on a lot of the important points that I think are on our radar as well. Changes to inflight programs, short or long-term, are one of those things that are just going to happen for a lot of companies out of necessity. I think the best advice I can give any company is to go beyond the boilerplate wherever possible and to the extent that you feel comfortable communicating additional details to the market. And again, at this point, the pandemic really is a boilerplate issue.

Discussion of alternatives or the relative benefits of a given approach are also extraordinarily helpful for understanding not just what was done, but why it was done. To that point, I think these are, hopefully at least, temporary conditions at the end of the day. Where we can see kind of an assurance from the board or in the proxy statement that it is a temporary measure to address a temporary problem, it's very different than an ambiguous new normal for programs.

So we do have I think a slightly higher appetite even than many of our clients, first looking at discretionary components in programs or changes inflight, but when there is a clear indication of the nature of those changes being short-term or with a sunset, it's a lot easier for us to convey them as a reasonable response rather than capitalizing on a difficult situation for all parties.

With respect to the bonuses and long-term plans, I think the concept of alignment is still where are heads are at. Shareholders have a very, very good picture of how a company is doing based on their values, and those aren't always going to be entirely based on the performance of the share price.

The picture that is painted in terms of describing why a bonus decision was made when there is more discretion is going to be under a lot of scrutiny from shareholders who may, in many cases, be looking beyond factors like revenue or shareholder return.

Ning, you made some really good points about store closures or layoffs as the potential considerations. While it's not something that we are going to be including in our decision calculus, there seems to be a fair appetite for investors, or at least a lot of interest on the investor's side, for understanding how those relate to a company's broader performance and maybe, I should say, how those relate to the Say-on-Pay use specifically.

Again, where there are changes, we do still want to make sure that there is fair compromises and that the overall pay and performance picture is maintained. There are a lot of ways to get to that alignment, and where there is more board discretion required, I think again it still has to just match the realities on the ground.

One of my favorite conversations from a panel I attended about a year ago was where a prominent investor said that his favorite thing to do was read proxy statements that paint the rosiest picture of a company that had an utterly terrible year. There needs to be at least a measure of realism in these disclosures. If it was a very difficult year, and you presented a laundry list of the things the company did well to say this is why bonuses were paid well above target, there's going to be consternation and a lot of shareholders are simply not going to let that fly.

We are also looking specific to kind of target as a yardstick. Pay is always a relative component but looking at what was intended to be paid for delivering at expectations is a good measure for understanding outcomes in a given year and unless there's very strong relative and absolute outperformance, above target payouts for most metrics in most companies is going to be something that we look at with a lot of scrutiny.

Ning Chiu: So I want to go to Bob and just kind of get his perspective as an advisor on some of the things you guys said, but I did want to come back and pick up two things. I'll just give you a heads up on that I think will be of real strong interest to people.

First of all, one is if you're at the end of a three-year cycle or if you're thinking about your long-term, is this a year where maybe you don’t have a new long-term plan? Maybe you just suspend that until next year? Maybe this isn't the year to do it? So that's one question to come back to.

But, Bob, what are your thoughts as an advisor to companies about taking this perspective that David and Julian have given and translating that to what companies can do for themselves?

Bob McCormick: Yeah, it's interesting. I think a lot of companies are challenged. They obviously recognize that alignment is vitally important, to Julian's point. But I think they're also struggling with if they’ve been impacted by the pandemic in dramatic means and they’ve completely had to re-shift their strategy, shrink their targets, and with those they outperform their peers, how will that be treated, right? So compared to the broader market they may look pretty poor, but if they're the tossed hobbit, so to speak, how will that actually work towards them being evaluated? If their operational metrics that they continue to outperform peers and maybe the market hasn’t fully reflected that, their TSR is still suffering, but on other performance metrics they’ve done really well, I think we're helping them think through those issues and explain.

The disclosure is vitally important. You can't just be saying, "Well, because of the pandemic, we did this." What was the actual impact? If 70% of companies change or withdrew their guidance, that's an indication of them just not knowing exactly what the impact is going to be, so I think being very forthright about that.

Also being forthright, what is the impact on employees, a lot of focus on human capital management, we haven't really talked about that as an issue on this panel, but I'm sure it's kind of underlying lots of discussions around employee safety, those who can't work from home, how you ensure their employment let alone their safety.

How do you make some potential adjustments to ensure that they are continuing to be compensated and retained. If there are means to retain employees because of risk of losing them, we're helping clients think through, let's provide specific examples, maybe not of the individual, but where there's been some poaching in the industry. So it's not a theoretical, "oh, we did this because there might be some turnover," but there has been some turnover. So really thinking through some of the more practical impactful aspects of COVID on the company.

I think if we look at, some companies have thought about, "Maybe we just sort of start over our performance cycle, at maybe the end of 2020, or even at the end of the first half with the market recovery," is that going to be acceptable to shareholders, saying, "Listen, this is sort of a lost quarter, lost half, let's reexamine whether it makes sense to reset our expectations in terms of the baseline and where we want to get to, because it doesn't make sense to retain these performance targets that are nearly impossible to meet, what sort of motivation and incentivizing aspect of that does that factor in.

And if we do make changes, how to we communicate that? Some are thinking do we extend the performance period so it's not just a reset of the year, but let's think about do we need to extend a little bit further time for those awards to be earned so it doesn't seem like it's a shortening of the performance period and a bit of a way that might be unpalatable to shareholders.

I think for those companies in particular that are more tangentially impacted by, say, travel, so you have airlines, hotels, maybe suppliers to some of those industries, that are a couple steps removed for some of those that might not be immediately apparent to some investors who are covering thousands of companies, so it's helping them explain that there actually was indeed a serious impact on the company. It wasn't through poor oversight of management or by the board, it's really similarly impacted, maybe just not as commonly known as companies in other industries. So help them think through these issues and not providing based discussions, but much more fulsome disclosure and I think that's going to be an important part of engagement of how has this been impacting the company beyond human capital management but the strategy, because I think most companies have done a really good job of addressing ensuring employee safety, but how does it, what sort of strategic changes needed to be made and how compensation changes tied to those strategic changes are ultimately going to be helpful in the longer-term.

Ning Chiu: So Bob just mentioned a lot of things. I'll let David and Julian react to any of the things he mentioned. The hobbit one, I forget your exact term, Bob, but the peer analysis, if you look at yourself against maybe an index that's heavily weighed towards very successful companies that are not as affected, then you may not look so good, but if you start delineating that and take out the index and start looking at your exact industry, maybe you can be the tallest hobbit, I think that's what Bob said.

Then also, as we said, maybe this isn't the year to reset anything in the middle that's already ongoing, or re-shift things, but what about setting new targets, new long-term goals, maybe this isn't the year to do that.

Or anything else that Bob mentioned, David or Julian, you want to react to that, and then we'll go on to engagement and how people should talk to investors and how people should talk to you.

Julian Hamud: Yeah, I broadly agree with Bob. I think he brings up a lot of really good points about the complexities of the situation for a lot of companies. I think something that David has touched on as well, there is a concept of what to do if there is a reset. From our perspective, it shouldn’t be a hall pass when there is a change to these. It shouldn't be a freebie for maybe underperforming even on a prior plan that gets new life, so drawing a line and resetting goals or anything like that isn't in our view inherently inappropriate, but holding executives accountable for the previous trajectory of the plan is also important.

If there was a really significant negative trend and key metrics for a long-term plan and the full cycle for all of the award resets entirely starting June 2020, that looks very different than drawing, well, this was last year, let's look at the last two years on their own.

Obviously, this raises a lot of questions the accountants are going to have a bear of a time with. But from just a perspective of keeping that alignment strong, that's one way that we certainly would like to see that happen.

David Kokell: Yeah, I'll speak to the resetting of the goals and the one point, Ning, the hypothetical you brought up with regard to potentially maybe not even having a long-term program. In fact, let me just touch upon that, because I would say it's fair to say if a company were to come back and say, "We're not even going to have a long-term program, we're only going to have an annual incentive program next year," I would caution that company. I think that's going to be met with some opposition. I think it sends the wrong signal and what the signal might be is that we don't really have any long-term corporate strategy.

Of course, it may be different, it may be more challenging, it may be more qualitative, it may be less certain, I'd say, but sending the signal that it's impossible to have any kind of long-term incentive to incentivize executive performance, to me would signal larger problems at the company than the fact that there is no long-term incentive program. That would probably be viewed as a problematic action.

With regard to the resetting of the goals, I think there's a viewpoint out there in the marked that ISS just doesn't like lower performance targets from the prior year. I would say that's about half accurate. What we've always heard from investors, just in the normal context even, is that there may be reasonable circumstances that would justify a lower performance target than the achieved level from the prior year, but in those cases, the payout opportunity should commensurately reflect that lower performance level, and that's often what I would say is the vast majority of times is missing.

So what we see is the target bonus remaining at one million even if the revenue target has been chopped by half in the subsequent year, and we've heard from investors that if you're going to be targeting much lower revenue, even if you feel like it's still a reasonably challenging goal, that target payout opportunity, the dollar value, also needs to be reassessed and changed accordingly. I would say that that expectation is going to remain even if the reason is related to the pandemic impact.

Ning Chiu: So let's turn to engagement and, Julian, if you want to start on first of all when should they talk to you, what should they talk to you about, and we had a little bit of discussion about this during the prep session about these issues that I think the audience would really benefit from. Timing is going to be a serious problem this year because people are considering all sorts of things, but they haven't decided, so the when is actually going to be just as critical as what they talk to you about. Do they come to you with a full-baked plan? Do they come to you with, "We're thinking A, B, or C?" Do they come to you before, after they talk to shareholders, both times?

So in terms of Glass Lewis' perspective, what do you think, Julian? And then David. I don't want everyone picking up their phone and calling both of you 30 times this season, so you might want to be extremely clear about where the guideposts are and where the limits are.

Julian Hamud: Absolutely. I think the engagement is something that we as an organization have been enormously invested in and has been a huge area of growth in terms of what we do outside of proxy season. Over the last 12 months we've completed something like 600 public companies and just for the United States alone. Most of those were one-time part of the investment roadshow conversations, but we do have issuers that reach out to us to try different kind of objectives.

Some firms want to do some pre-planning before their investor roadshow to know what's on our mind or maybe what's on some of our clients' minds, so that they can help shape their agendas. Some of them like to debrief from those investor roadshows with us to talk about what they heard, what they're looking at, and get our perspective or maybe even just for some pre-proxy season preparations.

I think the least frequent usage we get from, on the issuer's side, I should say, is where they come to us with a plan that is at some point in the development process to get our input. Now obviously, it's not my place, not my team' place, to say, "This is what your incentive plan should look like, this is what you should do for 2021." We don’t offer any services or anything like that to help you design that plan.

We're always happy to say when we see decisions like this, this is our general policy for it and here is some potential parallel examples that you might be able to look at from the history. This is our bread and butter and we know compensation, so we're always happy to cite those examples without offering any kind of design tips or tricks per se.

So I think from your perspective as an issuer, think about what you were trying to achieve through the engagement with Glass Lewis. I say that very pointedly because there should be an objective other than just making sure we hear your investor roadshow presentation. Come with questions. They can be in the weeds and we will have people who can answer them. Come with things that you might have heard feedback on from shareholders or other stakeholders and you want to get our perspective on.

The more tailored you can make your agenda and the questions, either before or after your investor roadshow, or even in the first month and a half of 2021, the better of a conversation and the more dialogue, the more in-depth dialogue we can have about the issues that would help you connect better with your shareholders.

Ning Chiu: Julian, just to be clear, do you still have the policy where you won't talk to people once a proxy statement is filed? That always surprises some companies, so I just want to make that, make sure people understand that. This is after a proxy statement is filed, on filed.

Julian Hamud: Thank you so much for the reminder. We can generally meet with you for eight months of the year if you file your proxies in April. The summer is a little bit difficult, but for June through pretty much middle of February, we are willing to have engagements with your firm as long as there are no definitive or preliminary proxy materials filed. So as soon as there is a proxy statement of any type, we can't have a direct, face-to-face type engagement.

If there's ever anything that you see in our proxy papers that you're unhappy with, for example, we will always still take written feedback and make sure that we review comments, criticism, or concerns in depth and with a very keen eye for making sure the research is accurate, but we can't take the types of broad conversations, obviously in the middle of April where things get a little busy.

David Kokell: Yeah, that actually applies for ISS as well. As a rule, we generally don't engage after the proxy has been filed except in extraordinary circumstances. Although there are oftentimes when the analyst has question on a disclosure and then an ISS invoked engagement request is not unusual.

We want to avoid the appearance of mere lobbying, please support us XYZ, so we also prefer to engage before that. But I would say it's also our preference, and we find it most productive, to engage after the company has spoken to its shareholders, particularly in responsiveness cases where the proposal has received low support. In that vein, I would say I've found it better to have someone on the call with us who has participated in those engagements.

At the same time we don't engage with executives on their own pay as a matter of process. We find that the most productive engagements are with directors themselves and hearing the feedback that they've heard from their investors and how it relates to the changes that they're going to make.

I don't find useful, sort of just routine engagements, just walking through very basic paperwork and updates. I think if you plan to outline those clearly in the disclosure, there's no real benefit for a company to have a call with ISS just to walk through those. It's probably not the best use of either party's time, I would say. But particularly when you have any kind of major actions, or one-time decisions, things out of the ordinary course, that's the best time to reach out to us and put that on our radar.

I would say what we find particularly helpful is when companies come prepared with either decks because we will look at those decks as we're going through the analysis. We hold onto all that material and go back to it once we're writing the analysis to make sure that we're refreshed on the context of any related decisions.

And then lastly I would say if a company wants to talk to us about a particular recommendation, it's been very helpful if they have particular questions in mind, I would say. Sometimes we get requests that a company wants to talk about it against recommendation with no further details. We generally will decline that request unless we have some kind of idea what particular questions or aspects of the analysis for which they had questions.

Ning Chiu: So one of the things you both said, and I think this is something that's worth emphasizing, because I think one of the things on our agenda is misconceptions or myths that people have about engaging with you, people coming in to you with the same kind of deck that they give to investors, this regular communication they have with investors that we all advise companies to do just so they can be in front of investors so you can get to know them and those kinds of things, those are not really helpful to either of you, and it's not necessarily a good use of people's time to do that with you because you rely so much on proxy disclosure.

It is, in fact, you don't rely on anything but public disclosure, I think that's another way to say it, so people shouldn't be telling you a bunch of things that they would otherwise normally just have a conversation with about investors, not material things, but just a bunch of extra things, when they just have a chat with an investor as part of a regular dialogue, you are not going to be able to rely on any of that and its probably, this year both of you, I'm going to predict, are going to be very stressed with a lot of engagement requests, so I'm trying to help make it useful for people.

Don't go to David and Julian with your regular investor decks. Ask them specific pointed things, tell them what investors have said, and tell them how investors have reacted, tell them what you're going to disclose, because that's all they can rely on. Would that be fair?

David Kokell: I think that's absolutely right and I think one myth sometimes when I engage with companies subsequent to an adverse recommendation, there may be some surprise because they'll say, "David, we talked to you in the off season and everything seemed kosher." I would just caution, we say at the beginning of every engagement that we cannot guarantee how we will or will not recommend on any given proposal until we are actually reviewing the public disclosure. As you mentioned, that's what we're entirely relying on.

So we're not going to be able to say whether something is definitely good or problematic until we look at the full picture, not just the disclosure but also of company performance once we see that because oftentimes that performance period has not been completed. I would say that it's important to remember that there's no hidden benefit by engaging, you're not more likely to receive support, where the benefit comes from is providing that important context to decisions, especially for those that are not following ordinary course.

Julian Hamud: I would certainly echo that as well. I think one of the least pleasant conversations we have is with an engage in a second or third engagement after the proxy season where the issuer says, "We told you everything you needed to know. There is perfect disclosure of this decision" and we said, "The proxy statement just said it was important and that was the end of the sentence." I like to explain that the best use we can get out of those engagements can be as spotlight or as a highlighter.

Point us towards something that will be in your proxy statement that is important for a decision that's going to come up that is going to raise a red flag. You know if there's going to be, in most cases you'll know if there is something that is going to catch shareholder or Glass Lewis or ISS's attention, but just making sure that we know there's a disclosure in the proxy statement that's coming up that we need to seek out and make sure gets compared, is a great use for those types of conversations as well.

Ning Chiu: So the timing's going to be a challenge. Oh, go ahead, Bob. Sorry.

Bob McCormick: Just very quick question. Given the current state of reality, are you open to Zoom meetings or video meetings or that means you'd have to dress up and you'd rather just do it over a telephone? Unlike me, who doesn't dress up.

Ning Chiu: Do you have a preference? I think that's what Bob's asking, do you have a preference for video versus phone? And who normally comes on your side? And then we'll end there. Who normally joins on your side?

Julian Hamud: At Glass Lewis, no real preference. I think some folks will be dialing in on a landline or a cellphone so you might not catch on video, but we certainly don't have any objections. I guess just don't show up in the office; there won't be anyone there right now. As far as who will show up, you can normally kind of help to make sure you get the right people by specifying in your agenda. If you have a shareholder proposal or ESG concerns, let us know ahead of time and we can make sure that specialist in that area are available for the conversation. Ditto compensation, ditto auditor issues, whatever the area is, we can make sure that we have analysts or management as needed for specific areas on the call.

David Kokell: Yeah, I would echo a lot of that. We leave the video versus audio only at the discretion of our analysts. Some actually prefer to see faces and go on video, so you might actually, it's not unusual to see a mix of some people on audio and some people on video.

But in terms of who's on the call, the agenda of the call really determines that. In fact, we'll generally decline an engagement request without a detailed agenda because we want to make sure that we have all the right people on the call, so if it does involve compensation issues, a member of my team, a compensation specialist, will be on that call, usually it's one that specializes in the relevant sector of that company.

And then of course, if there are non-compensation issues, we'll make sure we get the right team, whether it be board governance or ENS team members involved as well.

Ning Chiu: I am going to turn it over to Liz, but before I do, I just want to say thank you to everybody who helped with this panel and who was willing to go through all the different questions that I asked. This is a really great panel that we do year after year, I think Liz could echo that as well, and I always look forward to it and we always get such good useful information from all of you. Thank you so much on my end.

Liz Dunshee: Yes, thank you. I echo that. Thank you, David, Bob, Julian. Thank you, Ning, for moderating. This is always a great panel and this year I not only learned a lot about ISS and Glass Lewis, I also picked up a new term that I'm going to be using, "the tallest hobbit."

Ning Chiu: The tallest one.

Bob McCormick: Got to be careful, it could be hobbit forming.

[Laughter]

Ning Chiu: That's a really bad one, even for you, Bob.

[Laughter]

Bob McCormick: Sorry.

Liz Dunshee: We now have a short break and the next panel begins at the top of the hour, which is 4:00 p.m. Eastern time. That is our popular "Hot Topics: 40 Practical Nuggets in 60 Minutes." I hope you can all make it. Remember to navigate back to the agenda tab and enter the session through there. Thanks.

Ning Chiu: Thank you.

David Kokell: Thank you.

Bob McCormick: Thank you.

Julian Hamud: Thank you.

Markeys/pti:kc