CORPORATE GOVERNANCE Q&A

Jennifer Carberry, Director of Marketing – US, spoke with Bill Ultan, Managing Director, and Susan Choe, Senior Director, of Morrow Sodali's Corporate Governance Consultancy, about their observations from the recent proxy season and what to expect in 2021.

Bill, what shifts have you observed between last year and this year's proxy season in terms of voting, shareholder proposals and other key areas of institutional focus?

BU: In general, voting results were not dramatically different year over year, but there were a few specific areas of note. We saw an increase in support for independent chair proposals as well as for some social referendums regarding lobbying activity and workforce diversity. On director elections, we continue to see more institutions focusing on overboarding, leading them to adopt more restrictive policies that have increased opposition for certain director nominees.

Susan, in light of the two concurrent events, the COVID-19 pandemic and the racial injustice movement, what are the key themes that companies should prepare for in advance of the fall engagement season?

SC: There are a number of them that I can highlight but let me focus on a few that are top of mind. The global health crisis rapidly accelerated the way companies think about the way we work, which is the natural transition given the technology that is in place. As COVID-19 progressed, the prominence of the "S" in ESG became magnified to new levels, with investors seeking answers on how companies are prioritizing the health, safety, and well-being of its workforce, including their mental health, to ensure that they remain engaged, motivated, and resilient to the ongoing challenges of living and working through a pandemic. Additionally as the racial injustice movement took shape, it amplified the issues around human capital management and took the topic to new heights. During the fall season, companies should fully expect investors to probe on a company's racial equity policies and programs, how the board is overseeing these efforts to promote greater racial equity, and its integration into long term strategy. That said, companies should continue to expect a robust discussion on climate change. We believe that investors will continue to put pressure on companies to take action to better manage greenhouse gas emissions in order to mitigate climate risk. More importantly investors will expect board oversight and director fluency on the topic, which will better demonstrate the company's commitment to the matter. Lastly, we expect the scrutiny on executive compensation programs to be unprecedented in 2021. Boards will need to proceed with extreme caution and manage optics and expectations given current views of an all stakeholder model.

BU: If I could just expand on a point Susan made around board risk oversight, we've seen in recent years requests for directors to participate in shareholder engagements with more regularity, especially with certain large investors. We anticipate that this trend will continue to grow in the year ahead. The ability of directors to speak to key risk areas, including the topics of corporate culture and corporate purpose, is going to be extremely important – and especially to be able to do it with a command of these issues.

Susan, especially in the US, executive pay is an area of perpetual interest and to a certain extent, controversy. What are some of the key areas of vulnerability that companies face and what steps can be taken to minimize the risk of opposition to Say on Pay in 2021?

SC: The pandemic has impacted different industries to varying degrees, with certain industries like airlines, hospitality, and retail being the hardest hit while certain companies in pharma, biotech and utilities continue to fare relatively well. For companies where layoffs, furloughs and pay cuts were announced, and performance has been deeply affected, pay increases especially on nonperformance-based pay, will not be viewed favorably. Also with depressed stock prices, market volatility, and the need for cash preservation, a slew of associated issues must be considered such as burn rate concerns, potential repricing of stock options and determining the size of the equity grants so that they do not lead to windfall gains once the markets recover. For companies where the current performance metrics and their goals no longer make sense, the compensation committee will need to either make changes to the program mid-stream or use substantial discretion at the end of the performance period. If either of these decisions lead to payouts that are not commensurate with performance, especially if the committee exercises positive discretion, then there will be significant questions regarding the committee's decision-making process. Even for companies that have fared well, managing the optics of rewarding management for good performance may be a challenge due to the current environment. Additionally, the market is unique right now because there isn't much relative comparison to be made outside of some general similarities. Each company's story really is different. While compensation committees are struggling to do the right thing, whether it be paying for great performance for effectively navigating the crisis or perhaps paying in line with how shareholders have fared, this is the year in which we will need to overexplain our story through engagements and in proxy disclosure. It will be critical to communicate that the decisions the committee made come fiscal year end are in the best interest of the company for the long term. And that certain short-term decisions were made to get through the crisis and support long-term strategy. One additional point on proxy advisors. We would hope that proxy advisors will be a bit more flexible in their assessments in 2021, but if they do remain rigid and stringent in their views without taking company-specific situations into proper context, we suggest focusing the efforts on a company's top investors, and placing less emphasis on proxy advisory firm perspectives.

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Bill, if you had to pick a governance topic that investors have continued to scrutinize, what would that be and are there other recent developments of significance?

BU: Board composition certainly is an area that continues to get more scrutiny, as it incorporates a number of different issues, including diversity in all of its definitions and overboarding. To Susan's earlier comments regarding the focus on diversity and corporate culture, the make-up of boards and the search processes that boards go through to identify new candidates – ensuring that they are looking at a diverse pool of individuals – is going to be extremely important. I also would extend my comments to senior management as well, where I believe we also will see a similar focus on composition. One additional topic I would mention is the activism side of diversity. We are already aware of a few institutions, namely New York City Employees' Retirement Systems (NYCERS) and Calvert Asset Management, that are targeting specific companies and requesting disclosure of workforce diversity and specifically EEO-1 data. These overtures appear to be precursors to shareholder proposals for the coming 2021 season, making workforce diversity an important issue for companies to be managing and thinking about.

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Susan, we have all heard that due to COVID-19 and the Black Lives Matter movement, the "S" in ESG has gained significant prominence. What actions can companies take to demonstrate their commitment to social issues?

SC: Board and management actions that demonstrate an effort to foster a diverse, inclusive and informed workforce will certainly be critical. Additionally, the Black Lives Matter movement in particular has placed significant focus on opportunities that companies provide from the recruitment stage and throughout one's career with training, programs and policies that ultimately lead to a healthy pipeline of minority candidates, especially from the black community, for advancement - and eventually in leadership positions, including the boardroom. Obviously, although these changes cannot occur overnight, we expect to see greater investor demand for ethnic diversity throughout the organization, including at the board level.

Bill, due to the global health crisis, it seems that a vast majority of companies held their annual meetings virtually. What are your expectations for 2021?
Do you see a significant shift from physical to virtual only meetings? Are there any notable implications for companies as they prepare for 2021?

BU: It's not surprising given world events that virtual meetings very quickly became the norm. I am not sure what we would have done years back before this technology existed, but fortunately it exists today. While there were some challenges technologically and otherwise, most meetings went off fairly smoothly. Between March and June, approximately 75% to 80% of all **annual meetings** were virtual; it is very difficult to say what the proportion will be for 2021, although I am reasonably confident that there will be more virtual meetings than there were pre-pandemic. I am aware of a number of companies that would prefer to get back to physical meetings, but circumstances certainly remain unclear at this stage as to whether or not that will be feasible and safe. I expect that the capability to conduct a virtual meeting, including the competence of individual companies as well as that of the providers, will be improved. I have a couple of thoughts regarding concerns with virtual meetings that companies should be aware of. I believe it is important to conduct a virtual meeting in the same manner that a company would do so for a physical meeting, so directors should be in attendance and if a company typically has a management or board presentation, they should continue to offer this. In addition, issuers should ensure that they are allowing questions during the meeting and responding to questions as much as possible, including giving proper time allotment for questions and for the proponents of shareholder proposals.

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Susan, are there any proxy season trends or updates that you can highlight?

SC: With the heightened focus on sustainability matters, an increasing number of companies, especially large cap companies, have formed a separate sustainability committee to oversee certain key issues in this area, including climate change. We expect this trend to continue in the coming years. On human capital management, we already spoke of the prominence of the S in ESG, but even prior to the health crisis and the racial injustice movement, we slowly began to see companies adapting the names of compensation committees to reflect oversight of human capital management, talent management, succession planning, diversity and inclusion, and so forth. With the two ongoing crises, we expect more boards to take similar action. Also, we believe this is the year that really underscores how **governance**, compensation, environmental, and social issues come together, and the importance of each of these critical areas to long-term strategy. As an example, there will be a greater push to incorporate sustainability metrics into executive compensation programs. While a substantial number of companies holistically tie a company's sustainability progress to executive performance, many investors are and will be seeking companies to quantitatively tie environmental and social metrics to their executive pay program.

SUSAN CHOE

Susan Choe is Senior Director of the Corporate Governance Group at Morrow Sodali LLC. She helps companies assess and strategically manage their corporate governance, executive compensation, ESG and stockholder engagement imperatives. She advises boards and senior management on prevailing trends, market practices and overall investor climate on key emerging governance and compensation topics to help minimize the risk of stockholder activism.

Susan also advises directors and senior management on stockholder and proxy advisory firm engagements and solicitation strategies, including leading director and management prep sessions, providing guidance on key talking points and cultivating relationships with top institutions. She works year-round with clients in preparing for annual and special meetings and leads the draft proxy review process with a keen focus on executive and director compensation, corporate governance and sustainability disclosures and communication.

Prior to relocating to our London headquarters in the Fall of 2018, Susan was based in our New York City headquarters.

BILL ULTAN

Bill Ultan is a Managing Director at Morrow Sodali and a member of the firm's Senior Leadership Team. As manager of the firm's Corporate Governance Consulting Group with over 30 years of experience in the field, Bill has guided companies through a wide range of governance and takeover challenges, including contentious shareholder proposals and compensation-based initiatives, proxy contests, tender offers, and other corporate control matters.

He previously was a senior member of the firm's Stock Surveillance and Proxy Solicitation departments. Bill's vast experience has been gained through years of observing shareholders and proxy advisory firms, assessing compensation practices and governance policies, and analyzing voting results and solicitation strategies.

He prepares many strategic assessments and counsels officers and directors of public companies across a diverse range of industries and market capitalizations.

JENNIFER CARBERRY

Jennifer is Director of Marketing US for Morrow Sodali. Prior to joining the firm, Jennifer was Director of Marketing for a private equity firm with portfolio investments focused primarily in the technology and financial services sectors. Previously, Jennifer held the senior marketing and investor relations with two public companies.

Jennifer began her career in the hedge fund markets, where she conducted research for a financial consultant specializing in alternative investments. Jennifer is a cum laude graduate of Columbia University.