A New Backdrop

The COVID-19 pandemic is causing companies to rethink their arrangements for 2020

Natasha O'Connor is research manager, northern europe at glass lewis

In January 2020, as preparation began for the influx of the triennial remuneration policy proposals and the universal application of the new UK Code, we could not have fathomed the political, social and economic environment that would come to form the backdrop to AGM season 2020. The COVID-19 pandemic has upended best-laid plans and forced issuers to rethink some end of year decisions that now stand in stark contrast to the economic environment. In response, there have been numerous dividend withdrawals, cancellations of share buyback programmes, the freezing of salaries, the withdrawal of bonuses and the deferral of LTIP grants. Not only have agendas changed but, as a result of mandatory lockdowns, the AGMs themselves are now simply symbolic, designed only to be quorate. While the votes will still flow through the proxy system to be calculated, the access shareholders once had to an open forum for board Q&A has, in many cases, been eschewed in favour of pre-submitted questions answered via webcast.

Glass Lewis Response

Naturally, the consequences of the pandemic are far-reaching and, in the interests of transparency, institutional investors and their advisors, including Glass Lewis, have sought to temporarily update their policies to allow for the unforeseeable. In this ever-changing landscape, we are seeking to be responsive in the face of rapidly evolving guidance. Glass Lewis's approach to governance and broader ESG issues was clarified recently by vice president of research and engagement, Aaron Bertinetti. In a blog post detailing the updates to Glass Lewis policies, and discussion of the practical application of the same, Bertinetti states that: "At this stage, Glass Lewis expects all governance issues and most proposal types to be impacted by the pandemic and we will exercise our existing discretion and pragmatism to prioritise timing, certainty, disclosure and voting on any affected proposals.

"Glass Lewis acknowledges that some believe in a prescriptive approach to governance that favors ideological purity over pragmatic principles. We do not believe that discouraging pragmatism, discretion and context serves the interests of shareholders or companies – particularly during a crisis".

In reality, this is simply an extension of Glass Lewis' already nuanced approach to analysing issuer agendas; our approach has always been case-by-case assessments which are aided by transparent disclosure and sound rationale. This is particularly true in the UK where the Code encourages a comply or explain approach – we see a variance of well-explained deviations that garner significant shareholder support – with our policy guidelines affording us the flexibility to use our discretion, contextualising individual issuers' circumstances and responses.

Generally, however, it is our experience that issuers who have good governance structures in situ are usually best placed when crises such as the current one occur. Certainly, while the COVID-19 pandemic is unprecedented in our times, the financial crisis of 2008 will still be fresh in the memory for many. It is now that we are likely to see the efficacy of the structures in place and which issuers have applied the lessons learned, making their governance systems more robust and thereby better able to stave off unexpected risk. So, while this will be an AGM season like no other, there are consistent areas – excessive quantum, poor pay for performance, potential overcommitment and poor capital management – that act as signposts to potential gaps in governance. It is these areas that are at the forefront of our considerations for AGM season 2020 and we will seek to highlight these to our clients through our Proxy Papers.

Remuneration

Executive remuneration always has the potential to be a flashpoint for shareholder discontent with increases beyond those advanced to the wider workforce being heavily scrutinised in recent years. This year, with approximately 60% of the FTSE 350 putting up their triennial remuneration policy to shareholder vote, it is likely that any policy which is absent of structural safeguards – clawback, malus and extended holding periods – will be met with dissent. Further, given the current climate, remuneration committees should be wary of making long-term incentive awards whose quantum is calculated by reference to prevailing share price since these are unnaturally depressed at the moment. While cognisant of the difficulty of quantifying what level of deduction may be warranted, it is our expectation that committee use their discretion either at the time of grant, or at the time of vesting, to ensure that potential payouts are reflective not only of company performance, but also of the wider stakeholder experience. Alternatively, committees may choose to delay equity grants until market volatility has stabilised; however, we remain cognisant that that timeframe is not entirely clear.

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Moreover, we expect to see executives be prepared to waive potential salary increases and reduce bonuses for the forthcoming financial year, particularly where the issuer has had to cut dividends and/or reduce workforce pay or employment levels. Many issuers have already taken steps not only to waive increases, but also to take pay cuts and/or pay deferral until the crisis has abated. For Glass Lewis, alignment is key – the executive experience should not be more favourable than that of shareholders or the workforce. The duty of remuneration committees will weigh heavy in the forthcoming weeks and months, with an expectation of timely and decisive decision-making.

Potential Overcommitment

The potential overcommitment of directors is likely to be a contentious issue this year, with the demands of the crisis perhaps stretching those NEDs who were previously balancing well. While general time commitments vary by company and industry, those NEDs who also serve as committee chairs will inevitably find themselves dealing with unforeseeable drains on their time. The natural consequence is NEDs either relinquishing a number of their mandates or their attendance suffering. Retirements will, of course, have a concomitant effect on succession planning, potentially exposing those who do not have an 'in case of emergency' contingency plan in place. We have already seen the extension of 'tenured' chairs and NEDs as issuers seek stability in these uncertain times. Within reason, we are generally supportive of these extensions provided their impact on overall board composition is not negative, and that the board has put forward a sufficient rationale for their necessity.

Capital Raising

Early trends seem to indicate that most issuers are taking the retention of cash, via the cancellation of dividends and buyback programmes, seriously; however, for some, these efforts will not be enough. Capital raising through equity issuances is likely for those struggling with liquidity, and investor bodies have already recognised the potential need for quick capital injection by encouraging shareholders to re-evaluate what is considered an acceptable s561 exemption, potentially up to 20% of issued share capital. When assessing these issuances, either at the time of the 2020 AGM or retrospectively, we will look for a demonstrable rationale and an adherence to the guidance published by the Pre-emption Group on 1 April 2020.

Financial institutions, particularly the banks and insurers, should be mindful of maintaining, at minimum, their base capital ratio requirements and, where they require the issuance of convertible securities as allowed for by PRA guidance, should provide an explanation of the impact on potential dilution and said ratios.

Disclosure and Transparency

The key, as always, will be effective disclosure and robust rationales – these being critical to our determinations on deviations from best practice and our judgements as to board performance in responding to the impact of the crisis. We expect boards to, within reason, consult with their major shareholders on crucial areas rather than partake in unilateral decision-making. While recognising the tight timeframes in which many of these decisions are being made, it would seem to us to be prudent to garner some shareholder feedback on impactful decisions, otherwise risking high dissent in voting outcomes or, in extreme cases, defeat.

Conclusion

In these uncertain times, there is certainty that, for its part, Glass Lewis will continue to take a holistic view of the operation and composition of the board and the prevailing culture at the company as opposed to a mechanistic reading of UK Code requirements.

It is crucial that boards provide context for their decisions, especially where those decisions challenge governance norms or precedents, to ensure that Glass Lewis and other market participants can make informed decisions. n

To find out more about the impact of COVID-19 on AGMs visit icsa.org.uk/knowledge/resources/agms-and-impact-of-covid-19