Pearl Meyer

ADVISOR BLOG | NOV 2020

Is it Time to Re-Think the Influence of Institutional Shareholder Advisory Groups?

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Most of us are looking forward to the time when the pandemic can be viewed from the best vantage point—the rear-view mirror. While we see some unexpected stabilization in certain sectors, companies in many industries continue to struggle with deep declines in earnings, employment levels, and equity values. Still others have experienced unprecedented windfalls as a result of pandemic-related demand. Traditional approaches to compensation decisions may be inadequate in this unique environment.

Compensation committees make decisions in the context of multiple interests. Business strategy, marketplace practice, good corporate governance, views of stakeholders beyond shareholders, and regulatory considerations are all important factors. Ultimately, well-informed and defensible decisions are those that are balanced and accommodate these different interests in a manner consistent with company values, current priorities, and long-term strategy. Given these unprecedented times, is it appropriate to re-evaluate the priority rankings of these factors?

For example, institutional advisors such as ISS and Glass-Lewis have had growing influence on compensation committees, and it is now commonplace for compensation committee decisions to be coupled with the question, “How will ISS and Glass-Lewis view this?” We caution our clients to avoid using institutional advisor opinions as a prescription. While it is important for our clients to understand their views and potential reactions as context, we advise our clients that the higher priority should *always* be to act in the interest of the organization and its stakeholders.

Consider the challenge that many companies are facing right now with respect to annual incentives. It is our understanding that ISS will continue to evaluate incentive program changes on an individual company basis. It is recommended that any program changes should be coupled with contemporaneous additional disclosure of supporting rationale, to aid in ISS’s evaluation of plan changes. These disclosures may include the impact of specific pandemic-related challenges on the original incentive performance metrics, and how any plan changes address these challenges without rewarding poor management performance. This suggests a “case-by-case” evaluation process for incentive changes made in response to COVID-19 impacts that will be difficult to predict.

Most 2020 annual incentive targets were set before the full scope of the pandemic became clear. Then, many companies experienced a catastrophic second quarter that looked like the world was ending for some businesses, a third quarter rebound more robust than anyone could have imagined, and a fourth quarter that looks promising, but the pandemic is resurging, there’s a new administration coming, and the list of unknowns is growing.

Perhaps the urgency and complexity of the current situation calls for a board’s greatest value—the collective wisdom and judgement of its members to “do the right thing,” even if that happens to be contrary to institutional advisor guidance. For those boards concluding that the optimal path will deviate from institutional advisor guidance, we suggest steadfast courage and a renewed focus on upcoming disclosures and close shareholder outreach, as explaining your rationale may be more important than ever.

About the Author

Mark Rosen is a managing director and consulting team leader at Pearl Meyer. In his management role, he oversees a team of senior compensation consultants in the execution of the firm's growth strategy and in the development of consultants at various stages in their careers. Mark has consulted on executive and board compensation issues for more than 20 years for a broad range of public companies, as well as tax-exempt organizations and academic institutions. He has extensive experience with benchmarking, retirement plan design, governance issues, and tax and accounting considerations.

About Pearl Meyer

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