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Day
How To Handle Negative Proxy Advisor Recommendations
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Liz: Welcome back everyone. What we have now is a very practical panel about a situation that nobody wants to be in. But data shows that over 40% of Russell 3000 companies have received an against vote recommendation from ISS on their Say-on-Pay proposal at some point in the last 10 years or so. So, it's something that we all need to prepare for, unfortunately. And Ning Chiu of Davis Polk and Ron Mueller of Gibson Dunn are going to tell you how to do that. Ning is going to start off by talking about how to prepare in advance for the possibility. Ning.

Ning Chiu: Thanks, Liz.

Liz: Oh…

Ning Chiu: …scenarios and tips and practical issues that may come up. Because we both, unfortunately, have a lot of experience working with companies who get negative recommendations from ISS and or Glass Lewis, worst case both. So, one of the first things to be aware of is just scheduling. Just have a sense of when the reports are going to come out. And here I would divide the world into the S & P 500 companies that get a draft report from ISS. Because you get a draft and then, as you know, you have 48 hours to respond to that. So, you kind of have to schedule both things: when you might get a draft and when you're going to have to get the response back to them. And then the companies who do not get a draft who should be aware that by the time you get your report with a negative recommendation, investors have already seen that. So, your action may be a little different.

So, you should be aware of the fact that they usually send these out about two weeks in advance of your meeting. But early on in the season they could send it out as early as a month in advance of your meeting. So, if you have an earlier meeting, like an April meeting or something like that, then you may get your reports anywhere from two to four weeks before the meetings versus two weeks. As the season starts to compress though, it really does become two weeks. I think that they have a client deadline of like 13 days, so it's really no later than that. There were some that were pretty tight this year because everybody was under a lot of pressure and stress this year, and that includes ISS and Glass Lewis. So, early on this season companies in the earlier part of the season did get their reports about 30 days in advance. And then companies as it started to compress, some of them were very close to 13 days if not actually at the 13 days.

So, know when that is going to happen. Have a team assembled who is going to have to comment on the reports if you're an S & P 500 company and you get to do that. That would be exec comp people, HR people, you know, whoever your internal team is, outside counsel, if you have other advisors.

And also, and this is actually really critical, some of you probably are aware, usually most companies are aware in advance if they might have a problem. They might have a close one on Say-on-Pay, a close one on equity plans. They might have an issue that they spotted. Maybe you've done some work with your comp consultant and you're getting the sense that there's a probability of negative recommendation. Those are all things that you all should be prepared for and build into your schedule. I know your proxy schedule is very tight, but this is sort of a crucial point and a crucial time.

Ron Mueller: Yeah. Well, I think that the difficult thing is that when you are running short on time, a lot of times it's difficult to know whether that means is there a problem with your proxy that they're spending a lot of time on it or are you just with a reviewer that is handling a lot or are you late in the season. But it is, you know, it's important to think in advance. What may be the issues? And the other thing I recommend in addition to assembling the team like Ning was talking about, is also getting your prior year's reports handy. Because a lot of times you're going to want to look back and see well, wait a second, what did they say about this last year? I think that really, you know, having everything prepared like that will be helpful.

Ning Chiu: Yes. And that way you can also know if you did comment on last year's draft, what did they take? What did they not take? A lot of people are under the impression, and this is generally true, that they don't take a lot of comments. This is for ISS only, of course, and S & P 500 companies only, of course. That they don't take a lot of comments. They do take comments in a certain way, especially if you could back it up with something. If you have support for the comment to make it more of a fact versus an opinion in their view, they will take the comment. Sometimes they'll change the way the wording of a sentence is phrased if you have an issue with the way it is characterized.

And so, you have to be mindful of what to ask for. We're really here talking about reports with negative recommendations, but going to Ron's point about being aware of the entirety of the report, you may have a few things in your report even though you don't have a negative recommendation. Some people just look at the cover and go, 'Oh, wow, okay, no negative recommendations. We're done with this part of the process.' But there are some things that are called warnings, cautionary language that could come back next year.

And there have been occasions where it has come back in a conversation with an investor where they might mention something that was raised as a cautionary item in an ISS or Glass Lewis report even though you didn't get a negative recommendation. And some companies have been surprised by that. I did talk to an investor, it was more of a social investor, but they tend to vote against companies more than the way ISS recommendations are, which I think are nice as negative recommendations run around 14%. This investor votes against companies about 25%.

So, I asked about the differential, and they said they look at the cautionary stuff very closely. And sometimes if there's enough cautionary stuff, even if the recommendation is a for recommendation, they will vote against the company.

Ron Mueller: The other reason it's important to pay attention even if you get a positive recommendation is, as Ning was saying, people will focus on different things. One area we've noticed in particular is on the shareholder proposals. A lot of times either ISS or Glass Lewis will recommend with or not with management. But what's important is not only what they say in their analysis but being sure that they have fairly presented the company's analysis. And so, sometimes throughout the report when we're reviewing it, we will talk about well, we're not going to challenge ISS on this statement that they said, but we think that they should present the company's viewpoint on that as well. So, instead of saying this is wrong or changing this, we'll say we think it's important that you note this fact that was in the company's proxy statement.

And again, no guarantee for success on that. But it is something that they will take into consideration. We've been talking about the S & P 500 companies that get to review the ISS report in advance. But of course, even if you're not one of those or if you're dealing with Glass Lewis, it's, again, very important to look over the report to identify whether there are any factual inaccuracies or any of these viewpoint considerations that you want to raise. Both ISS and Glass Lewis do have comment portals where you can comment after the report has been submitted. And they take those seriously. I've had clients that have been successful in writing in and saying we think you did not highlight this important fact. And sometimes if you're very successfully, ISS or Glass Lewis may modify their recommendations. But other times they will at least issue a supplemental report that will set forth the company's response and maybe even their viewpoint on that.

Ning Chiu: Yes. Because it's electronic platforms, it's not incredibly difficult for them to send an update. So, sometimes they'll send a supplement that's essentially called an update and they'll just issue it on their client's electronic platforms. I would be cautious about what I pick to decide that it warrants making a comment about. And as Ron said, if you can support it from ,'well, our proxy said this and you summarized it, but it would be great if you also made this point because we think it really makes a difference.' And this is the case even if they recommend it for something. You may not be inclined to do it, but you might get investors' questions about it, so that's something just to be mindful of.

Speaking of investors, it is really critical for planning for an investor outreach right away, especially if you anticipate a potential problem. So, some companies will go so far as to, you know, in their calendar they'll build in the possibility of needing to talk to investors shortly after that report is released because it's very hard to get investors' attention, of course, during the height of the proxy season. So, they'll go ahead and get meetings scheduled and then if the ISS report comes out positively, they might still talk to those investors or they might not. Because you can then cancel the meetings after. You can decide. But at least you've got it on your calendar. You've got it on the calendar if you need directors on there, if you need senior management on it, you've got it on all of these people's calendars so then it would be important to at least have that on people's schedules so you can talk to them. Because at this point, you'll only have about maybe two weeks before your annual meeting.

So, one question we just got in the audience is can we clarify the 13-day deadline? It's 13 days in advance of the annual meeting. They have, again, my understanding is they have a commitment to their clients to get the reports out 13 days in advance of the annual meeting.

Ron Mueller: The other thing that planning in advance that Ning was just talking about is really figuring out who your shareholders are. Again, this is one area that we, some of the proxy solicitation firms, are particularly helpful in kind of saying, okay, well, here is who tends to follow ISS. Here is who tends to follow Glass Lewis. Here's who has their own criteria and may look at both reports but doesn't follow either. And so, that's really also a very important part of kind of knowing your shareholders. These days particularly with so much engagement going on, companies can say, "Okay, well, these are people we know we can reach to." But it is important to try to make sure that you have some of that more current information. There is a lot of reliance on 13-F filings. I know there's a rule proposal to change the reporting threshold. That could really upset this process if it moved forward. Ning, is there anything else you have in mind about?

Ning Chiu: Yeah. I think with the investor outreach, one of the things we saw this season…this happened more for certain types of companies, but because we're in this unusual circumstance now there's nothing we can say that will never happen again, so I'll mention it. Which is that as you all know, there was heavy market dislocation in March. Some people had record dates in March. So, there was massive turnover for a few industries, a few companies. I can't even say it's a few companies. It was definitely certain industries where there was a massive turnover in who their shareholders were as of the record date. That was a big surprise when a company had an issue. In some of these circumstances they were related to adoption of rates plans, for example, and not so much annual meetings, traditional issues. But when they went to try to figure out who their shareholders were as of the record date, they found, for example, a huge increase in the number of retail shareholders because of Robin Hood and some of those.

So, there was some big turnover that impacted smaller companies more than it impacted larger companies. But because of the unusual times we're living in, I think even things like knowing your shareholder can be a little more challenging if you've got market disruption like the kind we saw around March. And if that happened to be around the time of your record date or if an event happens around the time of your record date and it causes a lot of change over in your stock, that's just something to be aware of so that when you go and look and see who your investors are as of the record date—because remember that's the key. It's not who your investors are at the time you get the negative report, but who your investors are as of record date. The problem is some of them then, at least in one case that I had to deal with, it turned out they had sold. And they didn't really care so much about voting. And so, it was a big challenge for a company that had a negative recommendation where they found market dislocation and then by the time they went to talk to some of these people, some of these people were no longer interested. Now, that's not a common situation, hopefully. But it could happen. So, just something to be aware of.

By the way, the CLE code is 'dog', not case sensitive.

Ron Mueller: Well, Ning, we've talked about preparing, so now the report comes out. It has an adverse recommendation. I think the important thing is that there are a number of steps that companies go through in this situation. The first thing is to really look at your own disclosures. There's a lot of a tendency for some companies, not particularly companies, but sometimes when companies have not run into a negative recommendation in the past and they get their first one, they are like, oh, well, so and so, you know, the advisory firm got it wrong. Right? And there tends to be a little bit of this defensiveness, this denial, and how could they have gotten it so wrong. How could that come out like that?

But it's really important then to kind of go through and look at your own disclosures and drill down. And this is where I was talking about preparing by having the prior year's proxy report from that advisory firm so that you can go back and say, "Well, did they caution us about this last year? Or if not, what has changed?" And there are a number of things that can cause that voting recommendation.

One, of course, is that pay gets judged against performance. And so, if your pay has not changed but your performance has changed dramatically, then that may be something that the advisory firm thinks that the company did not do a good enough job responding to. The company just kind of repeated its prior disclosures. T

There are times that the company itself has changed its disclosure and kind of said, "Well, we talked about this last year. It was kind of a bit of detail about how our performance plan operated. Let's cut that out this year because everyone knows about it now." And yet, it could be something that was important to the proxy advisory firm. And they don't know when you cut it out if that was because you changed it and you didn't want to talk about it or what. And so, it is important to really drill down and look at what they are saying. Be levelheaded about it. Look at it from their point of view of what did we say and why did we get this type of response.

Ning Chiu: And I want to emphasize a point that Ron made because I do hear the same thing that Ron also hears, which is a company gets a negative recommendation for the first time and the first thing they say is, "We didn't change our program. We didn't change our program. We had the same disclosure. We didn't change our program." So, it's key to kind of not get stuck on we didn't change our program which gets repeated multiple times internally and with us. But, okay, you didn't change your program, so what changed? Did performance change? Did they change the peer group? Did some of your peers do better and so then even though you did neutral they did better which then means you did worse?

So, there are all sorts of things like that. And what we hear a lot, and I say we because I'm sure many of us hear the same things as advisors, is they were fine with our programs for the three years we've had it, so what's their problem with the program now? Their problem isn't with your program. Their problem is with what you paid. And so, that is a really critical distinction. Because we hear all the time, "Well, we didn't change anything, so why are we getting a negative recommendation?" And remember, they're measuring you against a group. So, even if you're at neutral, if everybody else got A's and you got an A-, you're an A- and everybody else suddenly got an A+, you're A- might be a C now. So, those are sort of, unfortunately, that's harder to predict. But that is something that we hear a lot and people are very surprised by it.

And it's like Ron said, it takes a lot of time when people say, "Oh, they got this wrong. They got that wrong." And I know everybody feels very strongly about how they got everything wrong, but you have a short window. So, it's kind of going for the win. Let's see what we can do. Can we get something reversed? Is that even an option? What can we tell investors? How can we explain this? So, sort of moving away from the denial stages Ron said and seeing if you can get things reversed.

So, Ron, how many things do you think in a year you can get reversed? A lot of people seem to think that's not a possibility. But every year I think we do get a couple.

Ron Mueller: I think we see it's becoming more challenging, I believe, because both companies are kind of becoming better on their disclosures. And I think the proxy advisory firms are a little hesitant to be viewed as being kind of hinging on one issue like that. And actually, often times the difficulty and the challenge in trying to figure out is this something that we can address real promptly and get the voting recommendation reversed, is that there may be one issue that kind of raised the flag. But then once ISS or Glass Lewis starts reviewing the whole program, they are concerned with a number of different points.

But I do think it's important to, that's what we were saying, focus on what is the concern, consider whether to reach out. Again, they both have processes where you can ask for a meeting. Whether you'll actually get that or not will depend on what the issue is and what time of the year it is. But is it certainly worth talking about and saying, "Well, is this something that either they misunderstood, or we didn't explain clearly enough? And if we give some additional disclosure, they will take that into account. Is there something that we can make a commitment about how this equity plan is going to be operated so that we can get their support on it?" And I think the thing that is important to keep in mind there is that not only is there a requirement to making some type of change if you're going to take that tact, but also, ISS and Glass Lewis will operate off of public disclosure. So, you may also need to make a filing that says this is how the committee is going to administer this plan.

Ning Chiu: And that's why you kind of have to prepare for this. Because it's possible that it can be reversed with a future commitment. Although, as Ron said, sort of the low hanging fruit is kind of gone at this point. There used to be a time when if you stopped paying tax **gross ups (22:15)** maybe that would fix it for pay practice. And most of that stuff is gone. But there are still situations where they either misunderstood something or you could continue to make a commitment or there's a characterization of something—and this is particularly true if they have a new policy and it's a fairly discreet policy like we saw in the past couple years with how you might characterize when an executive leaves the company. Whether you characterize that as retirement but then you paid them severance.

So, ISS questions whether maybe it was a true termination or how did that come about. So, something very discreet, fairly new policy, tends not to touch the CEO, for example. Those are some factors that might be able to lead to a reversal. But of course, then you would need public disclosure. Some companies are not willing to do that. You would need senior people to get involved. You might need the comp committee to approve something. Those are all things that it might just take too much to do within this period of time. Those are things though that you can consider in advance. Would we be willing to do some of that? And if we are, is having a negative recommendation something we don't want to deal with, and we'll pretty much do whatever it takes to potentially reverse it? Then get all that together and aligned.

But let's say you can't get a negative recommendation reversed. Then we just have to deal with it. And so, Ron going to start talking about preparing a response. And then we'll both kind of discuss that a little bit more.

Ron Mueller: Yeah. So, here again as Ning says, the scenario is the report comes out negative recommendation on an issue. You look it over and basically think that there is not a proper difference, or a consideration given to the business circumstance, the business case. You consider whether there are disclosures or points that you could make clearer or what's going to be the perspective of your shareholders on this issue. So, basically, it's game on. You're going to go out and engage with your shareholders to try to make sure that negative recommendation does not have an overwhelming impact on the voting result.

I think the first point to do is then really kind of prepare a list about what are your almost talking points, I think is the best way to think about it. And it's important to realize that. Think about where you are in the proxy season. If you are in the height of proxy season, you're going to want to have a very clear and crisp and concise message. I've seen situations where companies have said, "Well, there are these six things that are wrong in the proxy firm's voting recommendation analysis." And they prepare a detailed point by point response on each one of those. Part of the process is really kind of stepping back and saying what do we think is the critical point? What do we think is going to resonate with our shareholders? What may you have talked about in the past that you can cut out a conversation on now because you think your shareholders will understand it maybe better than the advisory firms did? But really trying to hone that method.

So, the first point is really to say how are we going to go about this? Are we going to address it specifically? Are we going to address it in the context of what was going on in our company and our industry? How do we want to present this issue? Again, I think the point is at this time you're really in advocacy mode. If you took debate in college or high school, you're narrowing down your key points and saying this is what we're going to talk about. And focusing on there may be different groups of shareholders that have different considerations.

Ning Chiu: Yeah. If you are talking to a passive investor, they might have a different consideration. And if you're talking to somebody you've talked to before. So, maybe you've talked about your pay programs. So, maybe for somebody who is a passive investor who you have talked to before and they understand your program, maybe you talk to them every year, this might be a short 10-minute or 5-minute call just to say, "We know you don't really follow these," guys, remember, you never want to intimate that any investor follows ISS and Glass Lewis blindly. They get very offended. And so, you might not even refer to the negative recommendation, in fact. You might just say, "By the way, before you vote on our Say in Pay, I want to make these two points."

As Ron said, you're going to have a very short window. This is not your regular engagement. They're getting all these desperate calls from all these other companies. A lot of them manage their **___ (27:31)** teams on a global basis, so you don't even see the things that they're dealing with and what they have to vote on in a global basis. So, that's a different conversation than perhaps somebody you've never talked to before. Because, you know, maybe you're reaching below your top shareholders. Maybe you have not spoken to them before. Maybe they're an active manager. Maybe they have an ESG bit. Maybe they'd like to talk to you about some of your shareholder proposals and some of your other disclosures. So, this is the time to not just have like one deck. You might have one deck, but not to have one discussion for everybody.

Before we end, I think we did want to talk to you a little bit…if Ron, you want to take the Glass Lewis feedback report, we wanted to mention that a little bit. And we also wanted to talk a little bit about what the next season might look like in light of the new rules and proxy advisory forms.

Ron Mueller: Sure. So, I think two key points to think about are whether you are filing additional soliciting materials. If you listened to this panel last year, I think both Ning and my colleague, Beth Ising, are proponents for filing the materials. Even there, there's an issue about do you file them in advance of talking to some shareholders to have a few conversations and then refine those materials. And you may have some shareholders that are key that say, "Well, we need you to address this in your materials." And so, sometimes there are some advantages to holding off before you file the materials.

Glass Lewis last year started a new program where companies can actually provide them materials which they will then distribute to their customers. And this process has actually been contemplated and built in a little bit to the SCC's, the possibility of feedback from issuance has been built in to some of the guidance that the SCC gave to investment managers on exercising their proxy voting authority.

One thing it is important to know is that if you are delivering those materials to Glass Lewis, those likely fall within the definition of soliciting materials because you know they're going to be posting them and distributing them out to shareholders. So, you should anticipate filing them at the same time with the SCC.

I think a number of companies did that last year. Again, it's really this consideration of well, it is making it directly to the Glass Lewis subscribers. On the other hand, if you're going to be filing it anyway, maybe you just rely on that and call up the shareholders directly and point them to the filings.

Ning Chiu: I think the sense from the companies that did it last year, and it wasn't an overwhelming response by any means, was that it was an easy process. It wasn't difficult. But at the same time, did it affect your vote? Probably not. So, if you're looking for something that affects your vote, just sending people materials may not do that. You might have to actually have a discussion.

In terms of any impact for next season because of the rule change…first of all, the rule change is not yet effective. But secondly, we don't really see any meaningful change. One of the things that might happen because some guidance was given to investors-- this was guidance to investors, so it's not part of the proxy advisory firm rules—that they need to take into consideration company's reactions to the proxy advisory firm report. So, they might feel that they need to wait to see if you file anything additional, which might lead some of them to vote later rather than sooner. Which may not end up being a net positive, actually, in our view. You may see some votes trickling in a little slower. It's possible that could be one consequence.

Ron Mueller: Yeah, that's what's was, you know, in the past, it was anticipated because you would always have…and I'm sorry, I'm getting a little echo. Is that okay?

Liz: You can keep…yeah, you're okay.

Ron Mueller: Okay. In the past, you would have the voting recommendations come out and part of the kind of robo-voting would happen the next day. And your management would panic because they would say, you know, suddenly, x percent of the votes are against our proposal. We always try to calm people down and say, "Give it time." Because that's just the robo-voting. Now, to the extent that goes away, people may say, "Oh, well, we got this negative recommendation, but it doesn't look like anyone is following it." And you want to be sure that people are prepared that they don't get beguiled into thinking oh, we don't have to kick into engagement mode. You should plan that you're going to have to do that anyway.

Liz: Good advice, Ron and Ning. And thank you both. That was an excellent discussion.

Markeys/pti:kb