Year Two of COVID-19: Don't Forget about Good Governance

By: Charles Grace

With 2020 in the rearview mirror and the 2021 proxy season underway, proxy disclosures are expected to be filled with details on how companies managed through unprecedented pandemic-driven business conditions, with particular focus on how compensation committees handled their 2020 annual incentive programs and outstanding long-term incentive cycles. Consistent with proxy advisor and investor expectations, companies are likely to take pains to provide compelling rationale in support of their 2020 decisions in the wake of all the challenges resulting from the onset of COVID-19. In turn, we expect that investors will be very much focused on assessing the reasonableness of company actions under the circumstances. That said, even though the early part of 2021 has seen COVID-19 continue to bring uncertainty to business operations and financial results around the world, we anticipate that investors will be expecting a more steady state of compensation committee activity in 2021 and, by the time the 2022 proxy season is here, investor focus is unlikely to be as COVID-centric as it is today. Accordingly, we believe it is important for compensation committees to resume discipline around a number of good governance policies and practices that seemed to fade into the background this past year amidst the pandemic frenzy.

In 2021, compensation committees would be well-advised to request (maybe, demand) that their management teams ensure that their 2021 calendars are filled with ample opportunity to review their corporate governance policies and practices. Furthermore, the potential for new regulatory activity from a Democratic-led SEC may force companies to assess their human capital-focused efforts and disclosures. While each company will have its unique circumstances and challenges that dictate the compensation committee's agenda, the following is a list of corporate governance areas that may require attention in 2021:

- *Environmental, social and governance (ESG) and human capital management (HCM) initiatives*
- *Stock ownership guidelines (and holding requirements)*
- *Clawback (recoupment) and forfeiture policies*
- *Stewardship of equity incentives and run rates*

- *Annual risk assessments and risk-mitigation features*

- *Committee charters and calendars (to keep pace with evolving corporate priorities)*

Focusing on these corporate governance matters is nothing new, but in 2020, at least some of these areas probably did not receive as much attention as in prior years. In many cases, boards and management teams were forced to pivot quickly and redirect their attention towards guiding their respective companies through these challenging and uncertain times. And for the most part, we expect investors will be more understanding in their Say on Pay voting this year with respect to how compensation committees spent a significant amount of their time concentrated on making tough incentive plan decisions while balancing corporate needs and executive retention concerns with the shareholder experience.

However, after another year of COVID-19 and its anticipated impact on 2021 business operations broadly, chances are that investors will be expecting a more typical cadence of compensation committee activity and focus. While the pandemic's impact on business operations and financial results will continue to be a significant focus for many companies, the impact will likely be less of a surprise in 2021 than it was in 2020. With that premise in mind, during the 2022 proxy season, we believe investors will resume focus not only on effective incentive plan design and reasonable pay outcomes, but also on the implementation of good governance practices generally.

Even if a company has already implemented many of the practices that are considered a part of every good governance program, it is important to understand that investor expectations are always evolving. Furthermore, COVID-19 is expected to be responsible for significant incentive plan design modifications in 2021, including reduced performance-orientation of the long-term incentive mix, wider performance ranges, lowered or less aggressive incentive targets, etc. Assessing (or re-assessing) corporate governance policies and practices could go a long way in helping investors conclude that a company's compensation committee remains committed to good governance and a disciplined approach, despite making COVID-driven incentive design and pay decisions that may have deviated from typical market norms.

While 2020 proved that business forecasts do not always go according to plan, we believe it is a safe assumption that making good governance a priority in 2021 will not only be welcome by investors, but it may be an important consideration in securing favorable Say on Pay outcomes and support for director elections in 2022.