November 29, 2016

ISS and Glass Lewis Update Their Proxy Voting Guidelines for the 2017 Proxy Season

Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. (Glass Lewis) have both released updates to their respective proxy voting guidelines.[1] This Alert provides a brief summary of the significant changes to each proxy advisory firm's respective policies for the 2017 proxy season. ISS's revised policies will take effect for annual meetings that are held on or after February 1, 2017, while Glass Lewis's revised policies will generally apply to meetings that are held on or after January 1, 2017.

Key Updates to ISS's Proxy Voting Guidelines

After concluding its annual global policy review, consisting of a policy survey, a request for comments on proposed policy changes, and several roundtable discussions, ISS issued its policy updates for the 2017 proxy season. Below is a summary of the key policy updates applicable to U.S. companies.

Director Overboarding Policy

ISS's new overboarding policy, which it announced last year, will apply to companies in 2017. In particular, ISS will generally recommend voting against a director who serves as a CEO of a public company while serving on more than three public company boards (including the "home" company board) and any other director who serves on more than five total public company boards.

IPOs with Multi-Class Shareholder Structures

Citing an increase in the number of companies completing IPOs with multi-class capital structures, ISS updated its policy to provide for adverse vote recommendations for directors (individually, committee members or the entire board, except for new nominees, who will be considered on a case-by-case basis) if, prior to or in connection with a company's IPO, the company implemented a multi-class capital structure in which the classes do not have the same voting rights. ISS had previously viewed a public commitment by a newly public company to put the adverse shareholder provisions to a vote within three years of the IPO as a mitigating factor, but ISS now deems such a vote to be insufficient and believes that a reasonable sunset provision is necessary.

Non-Employee Director Pay

ISS expanded its framework for evaluating non-employee director compensation. Under a new policy, ISS will vote, on a case-by-case basis, on management proposals seeking ratification of non-employee director compensation based on whether the equity plan under which non-employee director grants are made should be supported (if it is up for approval) and an assessment of following qualitative factors:

- the relative magnitude of director compensation as compared to peer companies,
- the presence of "problematic" director compensation practices,

---

[1] ISS, *2017 Americas Policy Updates* (Nov. 21, 2016); Glass Lewis, *2017 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice – United States* (Nov. 18, 2016).

- director stock ownership guidelines and holding requirements,
- equity award vesting schedules,
- the mix of cash and equity-based compensation,
- meaningful limits on director compensation,
- the availability of retirement benefits or perquisites, and
- the quality of disclosure surrounding director compensation.

ISS will consider the same factors when evaluating whether to support a non-employee director equity plan that is determined to be relatively costly, taking a holistic approach to all of the factors instead of requiring that certain minimum criteria be met for each factor.

Equity Plan Scorecard

ISS revised the factors and weightings under its U.S. Equity Plan Scorecard policy. In addition to minor changes to various factor weightings, the updated policy will include one additional factor related to the payment of dividends on unvested awards. Under this new factor, full points will be earned if the equity plan expressly prohibits, for all award types, the payment of dividends before the underlying award vests and no points will be earned if this prohibition is absent or not applied to all award types. ISS noted that a company's general practice of not paying dividends until vesting will be deemed insufficient to receive points related to this factor.

Modifications were also made to the minimum vesting factor under the scorecard. An equity plan must specify a minimum vesting period of one year for all award types under the plan in order to receive full points. No points will be earned if the plan allows for individual award agreements that reduce or eliminate the one-year vesting requirement.

Restricting Binding Shareholder Proposals

Under a new policy, ISS will generally recommend voting against governance committee members if the company's charter imposes undue restrictions on shareholders' ability to amend the company's bylaws, including an outright prohibition on the submission of binding shareholder proposals or share ownership or holding requirements beyond those required by Rule 14a-8.

Other Changes

In addition, where there is a management proposal to increase share capitalization in connection with a stock split or share dividend, ISS will look to the "effective" increase. ISS also renamed and reorganized its policy regarding amending cash and equity plans, including approval for Section 162(m) tax deductibility, to more clearly differentiate the evaluation framework applicable to the different types of amendment proposals. Generally, ISS will vote in favor of proposals that seek approval of cash and equity plans for Section 162(m) purposes if the plan is administered by a committee consisting entirely of independent directors (determined under ISS's standards), except in the case where the plan is presented for the first time following an IPO or if the proposal is bundled with other material amendments, in which case its recommendation will be done on a case-by-case basis.

In addition to the above policy updates, ISS is expected to release a complete set of updated policies and FAQs in December and updated proxy voting guidelines for any new U.S. shareholder proposals anticipated for 2017 in January.

Key Updates to Glass Lewis's Proxy Voting Guidelines

Director Overboarding Policy

Similar to ISS, the overboarding policy changes that Glass Lewis announced last year will be in effect for the 2017 proxy season. Specifically, Glass Lewis will generally recommend voting against a director who serves as an executive officer of any public company while serving on a total of more than two public company boards and any other director who serves on more than five total public company boards. Note that Glass Lewis's policy applies to a director who also serves as any executive officer of a public company, not just as CEO.

Glass Lewis will not generally recommend that shareholders vote against "overcommitted" directors at the companies where they serve as an executive. In evaluating whether a director may be overcommitted, Glass Lewis noted that it would consider the following factors: the size and location of the other companies, the board roles of the director, whether the director serves on the board of any large privately-held companies, the director's tenure, and the director's attendance record.

Glass Lewis also indicated that it may refrain from recommending against (1) certain directors if the company provides sufficient rationale for their continued board service (including disclosure regarding the scope of the directors' other commitments as well as their contributions to the board) or (2) a director who (a) serves on an excessive number of boards within a consolidated group of companies or (b) represents a firm whose sole purpose is to manage a portfolio of investments that include the company. With respect to the latter point in clause (b), the guidelines reflect Glass Lewis's belief that a director serving as a private equity or hedge fund designee deserves special consideration. Accordingly, a private equity or hedge fund designee that serves on more than five public company boards would not be deemed overboarded.

Governance Following an IPO or Spin-Off

Glass Lewis clarified its approach to corporate governance at newly public companies. Where it believes the board has approved governing documents that significantly restrict the ability of shareholders to effect change, Glass Lewis will consider adverse recommendations for governance committee members or the directors that served at the time of the governing documents' adoption, depending on the severity of the concern.

Specific areas of governance that Glass Lewis will review include:

- anti-takeover mechanisms (e.g., poison pill or classified board),
- supermajority vote requirements to amend governing documents,
- exclusive forum or fee-shifting provisions,
- shareholders' ability to call special meetings or act by written consent,
- the voting standard for director elections,
- shareholders' ability to remove directors without cause, and
- evergreen provisions in the company's equity compensation arrangements.

Board Evaluation and Refreshment

Glass Lewis clarified its approach to board evaluation, succession planning and refreshment. Glass Lewis believes that shareholders should monitor the board's overall composition, including its diversity of skill sets, the alignment

of the board's areas of expertise with the company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules such as age or term limits.

Other Changes

Use of Non-GAAP Metrics. In addition, in the context of the SEC's recent increased scrutiny of non-GAAP financial measures, Glass Lewis reminded companies that if they use non-GAAP financial measures in their incentive compensation disclosures, they should also provide clear reconciliations between such non-GAAP measures and GAAP measures and clear explanations for the basis of any non-GAAP adjustments.

As a reminder, the disclosure of non-GAAP target levels in the CD&A is not subject to the requirements of Regulation G and Item 10(e) under Instruction 5 to Item 402(b) of Regulation S-K, but companies that use non-GAAP target levels must also include disclosure as to how such non-GAAP numbers are derived from the company's audited financials.

Please feel free to contact any member of Ropes & Gray's securities & public companies practice group or executive compensation & employee benefits practice group or your usual Ropes & Gray contact with any questions about this Alert.

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2016 Ropes & Gray LLP

ATTORNEY ADVERTISING