November 28, 2017

ISS and Glass Lewis Update Their Proxy Voting Guidelines for the 2018 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 2018 proxy season. ISS's revised policies will take effect for annual meetings that are held on or after February 1, 2018, while Glass Lewis's revised policies will generally apply to meetings that are held on or after January 1, 2018.

Key Updates to ISS's Proxy Voting Guidelines

After concluding its annual global policy review, consisting of two policy surveys, a request for comments on proposed policy changes, and four roundtable discussions, ISS issued its policy updates for the 2018 proxy season. In addition to the key policy updates applicable to U.S. companies summarized below, 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 2018 in January.

Non-Employee Director Pay

Citing its 2017 Board Study's finding that median non-employee director pay at S&P 1500 companies has risen every year since 2012 and the increased level of investors' interest in the magnitude of non-employee director pay packages, ISS has adopted a new policy that provides for adverse vote recommendations for board and committee members who are responsible for approving non-employee director compensation where there is "a recurring pattern (i.e. two or more consecutive years) of excessive [non-employee director] pay magnitude without a compelling rationale or other mitigating factors." Since a negative recommendation from ISS would be triggered only after a pattern of excessive non-employee director compensation is identified in ***consecutive years***, this new policy update will not impact ISS's vote recommendations in 2018.

Poison Pills

ISS updated its policy on poison pills in order to simplify its approach and to reinforce the principle that poison pills should be approved by shareholders in a timely fashion. Under its revised policy, ISS will recommend against all board nominees, every year, at a company that maintains a long-term pill that has not been approved by shareholders. Commitments to obtain shareholder approval of a long-term pill in the year following adoption will no longer be considered by ISS as a mitigating factor. Also, boards with 10-year pills that are currently grandfathered under ISS's policy will no longer be exempt and will receive negative recommendations. ISS noted that it is aware of 90 previously-grandfathered companies that adopted or renewed 10-year pills. In connection with the sunset of grandfathering, ISS also eliminated its separate policy regarding "deadhand" or "slowhand" provisions as these pills will be covered under ISS's updated policy.

[1] ISS, 2018 Americas Proxy Voting Guidelines Updates (Nov. 16, 2017); Glass Lewis, 2018 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice – United States (Nov. 22, 2017).

Short-term pill adoptions will continued to be reviewed on a case-by-case basis. However, under its updated policy, ISS will focus more on the rationale for a short-term pill's adoption rather than on the company's governance track record.

Board Gender Diversity

ISS will begin to identify in its proxy reports where a board has no women directors; however, ISS will not use a lack of gender diversity as a factor in its vote recommendations on directors. Separately, under its board composition principle (one of four fundamental principles that ISS applies to its vote recommendations on director nominees in uncontested elections), ISS added a specific statement regarding the benefits of diversity in boardrooms, stating that "[b]oards should be sufficiently diverse to ensure consideration of a wide range of perspectives."

Compensation-Related Policies

Say-on-Pay/Say-on-Pay Frequency. ISS updated its guidelines to specify that a company's failure to include a required say-on-pay proposal or say-on-pay frequency proposal in its proxy materials could result in a negative recommendation for its compensation committee members and potentially the full board.

Compensation Committee Responsiveness. ISS also refined its policy to clarify its approach to assessing say-on-pay responsiveness. The updated policy more specifically describes the factors that ISS analyzes when assessing the robustness of a board's responsiveness. The policy also clarifies that ISS's evaluation of the breadth of shareholder engagement may take into account the timing and frequency of the company's engagements as well as the company's participants in such engagements (specifying a preference for independent director participation). In addition, ISS will not only consider whether a company made changes to its executive compensation program and/or disclosure in response to shareholder concerns, but also the quality of those changes relative to the shareholder feedback received.

Pay-for-performance. ISS updated its policy on its pay-for-performance evaluation to reflect the incorporation of its Relative Financial Performance Assessment, which compares a company's rankings to its peer group with respect to CEO pay and several financial performance metrics over three years, into ISS's quantitative pay-for-performance evaluation methodology. ISS indicated that further details of its updated quantitative screening methodology will be provided in an updated ISS white paper.

CEO Pay Ratio. An ISS representative appearing at an industry conference indicated that CEO pay ratios will not impact ISS's vote recommendations in 2018. ISS will, however, include this information in its proxy reports to investors.

In addition to the above changes, ISS also made some technical changes to its policies on the pledging of company stock, the one-time transfer of stock options, and burn rate commitments.

Shareholder Proposals

Gender pay equity. In the 2017 proxy season, shareholders at more than a dozen companies voted on shareholder proposals on gender pay equity, more than twice the total from 2016. Gender pay equity proposals typically request that a company produce a report on whether it has a gender pay gap or a report on the company's policies and plans to reduce any existing gender pay gap. Although all of the 2017 gender pay equity proposals failed to obtain majority support, ISS expects that proponents will continue to submit gender pay equity proposals in 2018. As a result, ISS has adopted a new policy under which it will evaluate gender pay equity proposals on a case-by-case basis, taking into account the following factors:

- the company's current policies and disclosures related to both its diversity and inclusion policies and practices;
- the company's compensation philosophy and use of fair and equitable compensation practices;
- whether the company has been the subject of recent controversies, litigation or regulatory actions related to gender pay gap issues; and
- whether the company's reporting regarding gender pay gap policies or initiatives lags its peers.

Climate change. While ISS has not changed its current approach of generally supporting shareholder proposals requesting that a company disclose information on the risks it faces related to climate change, ISS has slightly revised its policy on climate change risk proposals to better align it with the Task Force on Climate-Related Financial Disclosures' (TCFD) recommendations, which promote greater transparency of the board's and management's oversight of climate-related risks.

Key Updates to Glass Lewis's Proxy Voting Guidelines

Board Gender Diversity

Glass Lewis updated its policy guidelines to include a discussion of how it considers gender diversity on boards. In 2018, Glass Lewis will not make voting recommendations solely on the basis of the diversity of the board, but it will be among the factors that Glass Lewis will consider when evaluating companies' oversight structures. Beginning in 2019, Glass Lewis will generally recommend voting against the nominating committee chair (and, depending on certain other factors, other nominating committee members) if a board has no female members. However, Glass Lewis may exempt directors of non-Russell 3000 companies or companies that provide a "sufficient rationale" for the absence of female board members or disclose a plan to address the lack of board diversity.

Dual-Class Companies

Glass Lewis also added a discussion on companies with dual-class share structures, noting its belief that dual-class voting structures are "typically not in the best interests of common shareholders" and reflect negatively on a company's overall corporate governance. Accordingly, Glass Lewis will generally support recapitalization proposals to eliminate dual-class share structures and oppose proposals to adopt a new class of common stock. While its general approach to the evaluation of the corporate governance at newly public companies has not changed, Glass Lewis has added the presence of dual-class share structures as an additional factor that it will consider when evaluating whether shareholder rights are being severely restricted indefinitely.

Board Responsiveness

Glass Lewis lowered the shareholder dissent threshold from 25% to 20% in its policy on board responsiveness. Under the revised policy, any time 20% or more of a company's shareholders vote contrary to management's recommendations (e.g., against a director nominee, against a management-sponsored proposal, or for a shareholder proposal), the board should demonstrate some level of responsiveness to address the concerns of shareholders, particularly in the case of a compensation or director election proposal. For dual-class companies, Glass Lewis will carefully examine the level of approval or disapproval attributed to unaffiliated shareholders when determining whether board responsiveness is warranted.

Director Commitments

While its director overboarding policy remains unchanged, Glass Lewis clarified its approach to evaluating outside commitments of directors who serve in executive roles other than CEO (e.g., executive chair). When determining whether to apply its limit of two total board positions for public company executives, Glass Lewis will evaluate the specific duties and responsibilities of the executive role in addition to the company's disclosure regarding that director's time commitments.

Virtual Shareholder Meetings

Glass Lewis has updated its policies to address the "relatively small but growing contingent" of companies that have elected to hold online-only or virtual-only annual shareholder meetings. In 2018, Glass Lewis will not make voting recommendations solely on the basis that a company is holding a virtual-only shareholder meeting. Beginning in 2019, Glass Lewis will generally recommend voting against governance committee members where the company plans to hold a virtual-only shareholder meeting and the company does not provide robust disclosure in its proxy statement that assures shareholders that they will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

Compensation-Related Policies

Pay-for-performance. Although it did not change its pay-for-performance model, Glass Lewis clarified its grading system by providing details on what each of its letter grades means. For example, Glass Lewis notes that, unlike a school letter grade, a "C" does not indicate a significant lapse; rather, a "C" under Glass Lewis's grading system identifies companies where the pay and performance percentile rankings relative to peers are generally aligned (i.e., the company neither overpays nor underpays its executives relative to its peers).

CEO Pay Ratio. Similar to ISS, Glass Lewis will display a company's pay ratio as a data point in its proxy papers, but will not incorporate it into its 2018 voting recommendations.

Shareholder Proposals

Climate change. Glass Lewis expanded and codified its policy on climate change-related shareholder proposals and will generally support proposals requesting that companies in certain extractive or energy-intensive industries provide information concerning their climate change scenario analyses and other climate change-related considerations.

Proxy access "fix it" proposals. Glass Lewis clarified its policy on proposals seeking to amend certain provisions of existing proxy access bylaws (commonly referred to as proxy access "fix it" proposals). Glass Lewis will generally support fix it proposals that directly address unnecessarily restrictive proxy access provisions and oppose such proposals in cases where a company has adopted proxy access provisions that reasonably conform with broad market practice.

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