

November 30, 2018

ISS and Glass Lewis Update Their Proxy Voting Guidelines for the 2019 Proxy Season

Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. (Glass Lewis) have both released updates to their proxy voting guidelines.¹ This Alert briefly summarizes the significant changes to each firm’s policies for the 2019 proxy season. Overall, these policy changes represent relatively modest updates from last year and appear to reflect the social and governance concerns of many institutional investors. Companies should review and consider the applicability of the new proxy voting guidelines in light of their individual facts and circumstances.

ISS’s revised policies will apply to annual meetings held on or after February 1, 2019 (except as otherwise noted), while Glass Lewis’s revised policies will generally apply to meetings held on or after January 1, 2019.

Key Updates to ISS’s Proxy Voting Guidelines

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 (including related to U.S. compensation policies) in December and updated proxy voting guidelines for any new 2019 U.S. shareholder proposals in January.

Board Gender Diversity

In 2018, ISS began noting in its proxy reports where a company’s board has no female directors; however, ISS did not use the lack of gender diversity as a factor in its voting recommendations on directors.

Under its new voting policy, ISS will generally issue adverse voting recommendations against nominating committee chairs (and other directors on a case-by-case basis) at companies in either the Russell 3000 or S&P 1500 indices where there are no women directors. There will be a one-year grace period before implementation of the new policy to “allow boards who wish to do so to recruit qualified women candidates.” In addition, the policy permits the absence of board gender diversity to be temporarily explained and excused in exceptional circumstances, including disclosure in a company’s proxy statement of a firm commitment to appoint at least one female director to the board in the near term.

In recent years, large institutional investors such as BlackRock, State Street and Vanguard have promoted greater gender diversity on public company boards and continue to ramp up these efforts. In addition, in September, California became the first state in the country to mandate that public companies headquartered within the state have at least one female director by December 31, 2019. Companies should therefore review and consider enhancements to proxy statement disclosures on board gender diversity, and companies with no female directors should evaluate their board composition and consider adding at least one qualified female director.

Board Attendance

ISS is codifying its case-by-case approach to directors with “chronic poor attendance,” which is defined as three or more consecutive years of less than 75% attendance at board and committee meetings without reasonable explanation. In cases of chronic poor attendance, ISS generally issues adverse voting recommendations against that director as well as (i) the chair of the nominating/governance committee after three years of poor attendance, (ii) all nominating/governance committee members after four years of poor attendance, and (iii) all board nominees after five years of poor attendance. Companies should consider proxy statement disclosure that explains the reasons for any director’s poor attendance. It is

¹ ISS, [2019 Americas Proxy Voting Guidelines Updates](#) (Nov. 19, 2018) and [U.S. Compensation Policies for 2019, Preliminary Frequently Asked Questions](#) (Nov. 21, 2018); Glass Lewis, [2019 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice – United States](#) (Oct. 24, 2018).

worth noting that the revised policy may also be applied in cases where there is a long-term pattern of absenteeism, such as poor attendance in the previous year and three out of the four prior years.

Management Proposals to Ratify Existing Charter or Bylaw Provisions

Similar to Glass Lewis's policy updates relating to conflicting and excluded proposals, ISS made several policy updates to discourage the practice of management seeking to ratify certain existing shareholder rights in order to exclude, under Rule 14a-8(i)(9) (the "directly conflicts" exclusion), a shareholder proposal that seeks more favorable shareholder rights. Under a new policy relating to board accountability, where boards ask shareholders to ratify existing charter or bylaw provisions, ISS will consider various factors when determining whether to issue an adverse voting recommendation against individual directors, members of the governance committee, or the full board. These factors include, among others, the board's rationale for seeking ratification, disclosure of actions to be taken by the board should the ratification proposal fail, and disclosure of shareholder engagement regarding the board's ratification request.

ISS also adopted a new policy pursuant to which it will generally vote against management proposals to ratify provisions of the company's existing charter or bylaws, unless those provisions align with best practice.

In addition, ISS updated its existing board responsiveness policy to treat a failed management ratification proposal similar to a shareholder proposal that received majority support. A failed ratification could therefore result in adverse voting recommendations against individual directors, governance committee members, or the full board if they failed to take appropriate actions in response to the failed management ratification proposal in the previous year.

Companies that receive shareholder proposals seeking more favorable shareholder rights (including with respect to the ability for shareholders to call a special meeting) should consider the advisability of putting forward "conflicting" management ratification proposals.

Compensation-Related Policies

U.S. Equity Plan Scorecard (EPSC). ISS will make only modest adjustments to its EPSC models for the 2019 proxy season. While the passing scores for all EPSC models will remain unchanged from 2018, there will be weighting and point reallocations among some of the individual factors within each U.S. EPSC model. ISS will also introduce a new negative overriding factor for highly dilutive equity compensation programs, which would be triggered when a company's equity compensation program is estimated to dilute shareholders' holdings by more than 20% (for the S&P 500 EPSC model) or 25% (for the Russell 3000 EPSC model). Also of note, points will be assigned based on the quality of disclosure of change-in-control vesting provisions of equity awards (including specific disclosure of the treatment of both performance- and time-based awards in a change in control); no points will be given if the plan is silent on the treatment of awards in a change in control transaction or if the vesting of awards is discretionary.

Economic Value Added (EVA) Data. Based on investor feedback, ISS determined not to introduce EVA-based measures into its quantitative pay-for-performance model for 2019, but will include EVA metrics in ISS research reports for informational purposes on a phased-in basis over the 2019 proxy season. ISS will continue to explore the potential for future use of EVA in its financial performance analysis.

Non-Employee Director Pay. Last year, ISS introduced 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." The policy was to become effective in 2019, but ISS indicated that it intends to revise its methodology for identifying non-employee director pay outliers and will delay issuing adverse director recommendations under this policy until 2020.

Shareholder Proposals

Environmental and Social (E&S) Issues. ISS considers a variety of factors in its analysis of E&S shareholder proposals and will now also consider whether there are significant controversies, fines, penalties, or litigation associated with the company's environmental or social practices when evaluating E&S shareholder proposals.

Key Updates to Glass Lewis's Proxy Voting Guidelines

Board Gender Diversity

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, including a disclosed timetable for addressing the lack of board diversity and any notable restrictions in place regarding the board's composition, such as director nomination agreements with significant investors.

Conflicting and Excluded Proposals

Glass Lewis codified its policy on conflicting special meeting shareholder proposals.

- In cases where management places on the ballot both a management and a shareholder proposal requesting different thresholds for the right to call a special meeting, Glass Lewis will generally recommend voting for the lower threshold (in most instances, the shareholder proposal) and against the higher threshold.
- In cases where there are conflicting management and shareholder special meeting proposals and the company does not currently have a special meeting right, Glass Lewis may consider recommending that shareholders vote in favor of the shareholder proposal and abstain from voting on management's proposal.
- In cases where companies have excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis will typically recommend against the ratification proposal as well as the members of the governance committee.

In addition, Glass Lewis will be monitoring SEC staff no-action letters that permit companies to exclude shareholder proposals under Rule 14a-8 and, in the event that it believes that the exclusion of a shareholder proposal was detrimental to shareholders, Glass Lewis may, in very limited circumstances, recommend against the members of the governance committee.

Environment and Social Risk Oversight

Glass Lewis has codified its approach to reviewing how boards are overseeing E&S issues. For large cap companies and in instances where Glass Lewis identifies material oversight issues, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of E&S issues. Glass Lewis will also note instances where such oversight has not been clearly defined by companies in their governance documents. In cases where it is clear that companies have not properly managed or mitigated environmental or social risks to the detriment (or potential detriment) of shareholder value, Glass Lewis may consider adverse voting recommendations against board members who are responsible for oversight of E&S risks. Companies should review board risk oversight disclosures (with respect to E&S issues, in particular) in last year's proxy statement, and consider making improvements, where appropriate.

Auditor Ratification

Glass Lewis codified additional factors that it will consider when reviewing auditor ratification proposals, including auditor tenure, a pattern of inaccurate audits, and any ongoing litigation or significant controversies which call into question an auditor's effectiveness.

Virtual-Only Shareholder Meetings

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. Companies that hold, or plan to hold, virtual-only shareholder meetings in 2019 should consider this new policy and assess whether any changes need to be made to existing proxy statement disclosures.

Compensation-Related Policies

Compensation Committee Performance. Beginning in 2019, when analyzing the performance of the board's compensation committee, Glass Lewis will consider an adverse voting recommendation against all compensation committee members where:

- a company has added new excise tax gross-up provisions in executive employment agreements, particularly in cases where the company previously committed not to provide any such entitlements in the future; and
- a company has materially decreased its proxy statement disclosure regarding executive compensation policies and procedures in a manner which substantially affects shareholders' ability to make an informed assessment of the company's executive pay practices. This policy change is related to the SEC's recent amendments to the smaller reporting company (SRC) definition, which would allow an expanded group of companies to take advantage of reduced disclosure requirements available to SRCs, including related to executive compensation. Companies that are newly-eligible for these simplified disclosure requirements should consider this new policy when determining how much to scale back their prior year's disclosures.

Grants of Front-Loaded Awards. Glass Lewis added a discussion of its analysis of grants of "front-loaded" awards, which are large grants (usually in the form of equity awards) that are intended to serve as compensation for multiple years. While the new policy does not detail the precise impact that granting such awards would have under Glass Lewis's review of a company's executive compensation program, it is clear that Glass Lewis will closely scrutinize such awards. In analyzing the grant of front-loaded awards to executives, Glass Lewis will consider the size of the award on an annualized basis (rather than the lump sum) and the company's rationale for granting such awards.

Contractual Payments and Arrangements. Glass Lewis updated its policy on contractual payments and arrangements (including signing bonuses and bonus guarantees, contractual severance and similar entitlements) and clarified the terms that may contribute to an adverse voting recommendation on a say-on-pay proposal. When evaluating severance and sign-on arrangements, Glass Lewis will consider general U.S. market practice (including as to severance multipliers) as well as the size and design of the entitlements (e.g., overly broad change in control triggers).

Clawbacks. Glass Lewis adopted a new policy that is focused on the specific terms of clawback policies, rather than merely whether a company maintains a clawback that simply satisfies the minimum legal requirements. Glass Lewis believes that clawbacks should be triggered, at a minimum, in the event of a restatement of financial results or similar revision of performance indicators upon which bonuses were based (though, significantly, the Glass Lewis policy would apparently permit board discretion regarding the imposition of the clawback). In cases where a company maintains only a "bare-minimum clawback" (such as one that corresponds to only the relatively narrow requirement of Section 304 of the Sarbanes-Oxley Act) the absence of more expansive recoupment tools may inform Glass Lewis's view of the company's

compensation program. While many companies implemented broader clawback policies in the wake of the passage of the Dodd-Frank Act, others have continued to wait for the SEC to finalize its clawback rulemaking proposal, which it issued in July 2015. Companies in the latter category should now also consider the new Glass Lewis policy in determining their approach to clawbacks.

Shareholder Proposals

Diversity Reporting. Glass Lewis revised its policy and will generally support shareholder proposals that request disclosure about the diversity of a company's workforce as well as those asking for details on how companies are promoting diversity within their workforce.

Materiality of E&S Issues. Glass Lewis has amended its guidelines to reflect the belief that, while all companies face risks associated with E&S issues, these risks manifest themselves differently at each company as a result of a company's operations, workforce, structure, and geography, among other factors. As a result, Glass Lewis will place significant emphasis on the financial implications of a company adopting, or not adopting, any proposed shareholder resolution. To assist in determining financial materiality, Glass Lewis will also consider the standards developed by the Sustainability Accounting Standards Board.

Written Consent. Under its revised policy, in cases where a company has adopted a shareholder right to call a special meeting at the request of shareholders holding 15% or less of the company's shares and reasonable proxy access provisions, Glass Lewis will generally recommend that shareholders vote against shareholder proposals asking companies to amend their bylaws to provide shareholders with the right to take action by written consent.

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