Glass Lewis and ISS 2020 Voting Guidelines

I. Overview

Both Glass, Lewis & Co. ("Glass Lewis") and Institutional Shareholder Services Inc. ("ISS"), the leading providers of corporate governance and proxy advisory services, have now published their 2020 proxy voting guidelines. The Glass Lewis guidelines[1] will take effect for meetings held on or after January 1, 2020, and the ISS guidelines[2] will take effect for meetings held on or after February 1, 2020. Below is a summary of the key changes in the guidelines affecting U.S. companies.

II. Glass Lewis Voting Guidelines

Excluded Shareholder Proposals

In September 2019, the Securities and Exchange Commission ("SEC") announced a new policy pursuant to which its staff could concur, disagree or decline to state a view on a company's no-action request to exclude a shareholder proposal under Rule 14a-8 of the Securities Exchange Act of 1934, as amended.[3] In light of this announcement, Glass Lewis believes that companies should only omit proposals in instances where the SEC has explicitly concurred with a company's argument that a proposal can be excluded from its proxy statement, and Glass Lewis likely will recommend a vote against members of a company's governance committee if the company omits a shareholder proposal without having received no-action relief from the SEC.[4]

Additionally, the SEC has previously stated that its staff may respond orally, instead of in writing, to some no-action requests.[5] Under the updated Glass Lewis guidelines, if the SEC verbally responds to a company's no-action request, Glass Lewis expects the company to provide disclosure regarding the no-action relief. Where there is no written record provided by the SEC and a company fails to provide disclosure concerning the no-action relief, Glass Lewis will generally recommend that shareholders vote against the members of the company's governance committee.[6]

Governance Committee Performance (Meeting Attendance)

In its 2020 guidelines, Glass Lewis has specified additional factors it will consider in evaluating the performance of governance committee members. Glass Lewis generally will recommend voting against the members of the governance committee when: (1) directors' records for board and committee meeting attendance

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[1] *See* 2020 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice United States ("Glass Lewis Guidelines"), *available at* https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf.

[2] *See* Institutional Shareholder Services Inc., Proxy Voting Guidelines Updates for 2020: Benchmark Policy Changes for U.S., Canada, and Latin America ("ISS Guidelines"), *available at* https://www.issgovernance.com/file/policy/latest/updates/Americas-Policy-Updates.pdf.

[3] *See* Announcement Regarding Rule 14a-8 No Action Requests, *available at* https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests.

[4] Glass Lewis Guidelines, at 1.

[5] *See* Announcement Regarding Rule 14a-8 No Action Requests, *available at* https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests.

[6] Glass Lewis Guidelines, at 1.

are not disclosed; or (2) when a director attends less than 75% of board and committee meetings and the disclosure is sufficiently vague that it is not possible to determine which specific director's attendance was lacking.[7]

Audit Committee Performance (Auditor Disclosure)

In its latest guidelines, Glass Lewis has also specified additional factors that it will consider when evaluating the performance of audit committee members. Glass Lewis generally will recommend voting against the audit committee chair when fees paid to a company's external auditor are not disclosed, reflecting Glass Lewis's belief that without this disclosure, shareholders are unable to make informed judgments on the independence of the company's external auditor.[8]

Compensation Committee Performance (Frequency of Say-on-Pay) and Company Responsiveness

The 2020 Glass Lewis guidelines also specify additional factors to be used in evaluating the performance of compensation committee members. Glass Lewis generally will recommend voting against all members of a compensation committee if the board adopts a frequency for its say-on-pay vote other than the frequency approved by a plurality of the company's shareholders.[9] This position reflects Glass Lewis's belief that the adoption of a frequency for a company's say-on-pay vote other than that approved by shareholders would ignore the will of shareholders.[10]

In its 2020 guidelines, Glass Lewis has also expanded the discussion of what it considers to be an appropriate response following low shareholder support for a company's say-on-pay proposal at the previous annual meeting by requiring robust disclosure of engagement activities and specific changes made in response to shareholder feedback.[11] Absent such disclosure, Glass Lewis may recommend voting against an upcoming say-on-pay proposal.[12]

Exclusive Forum

Additionally, Glass Lewis has modified its approach to situations where a board adopts an exclusive forum provision without shareholder approval.[13] An exclusive forum provision is a charter or bylaw provision specifying a particular forum (typically a court in the corporation's jurisdiction of incorporation) as the exclusive forum in which stockholder derivative suits, fiduciary claims and other intra-corporate actions may be brought.[14] Under its current policy, Glass Lewis generally recommends voting against a company's governance committee chair where the board has adopted an exclusive forum provision without shareholder approval. Under the updated guidelines, Glass Lewis may make an exception where it can be reasonably determined that the provisions of a forum selection

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[7] *Id.*

[8] *Id.*

[9] *Id.* at 2.

[10] *Id.*

[11] *Id.* at 2.

[12] *Id.*

[13] *Id.*

[14] *Id.* at 15.

clause are narrowly crafted to suit the unique circumstances facing the company.[15]

Supermajority Voting

Glass Lewis has previously discussed its current policy concerning shareholder proposals requesting that companies eliminate their supermajority voting provisions.[16] Under the updated guidelines, where shareholder proposals seeking to eliminate supermajority voting provisions are submitted at controlled companies, Glass Lewis may recommend that shareholders vote against such proposals, reflecting Glass Lewis's belief that supermajority provisions may act to protect minority shareholders.[17]

Gender Pay Equity

Glass Lewis has also previously discussed its current approach to shareholder proposals that request that companies disclose the difference between the median earnings of male and female employees.[18] In the 2020 guidelines, Glass Lewis has indicated that it will review proposals that request that companies disclose their median gender pay ratios (as opposed to proposals asking that such information be adjusted based on factors such as job title, tenure, and geography) on a case-by-case basis.[19] Glass Lewis generally will recommend voting against these proposals where companies have provided sufficient information concerning their diversity initiatives as well as information concerning how they are ensuring gender pay equality.[20]

Contractual Payments to Executives and Change in Control

In its updated guidelines, Glass Lewis has clarified its position on contractual payments and arrangements, indicating that it generally disfavors contractual agreements that are excessively restrictive in favor of executives or that could potentially incentivize behaviors that are not in a company's best interest, such as: (1) excessively broad change-in-control triggers, (2) inappropriate severance entitlements, (3) inadequately explained or excessive sign-on arrangements, (4) guaranteed bonuses (especially multi-year), (5) failure to address any concerning practices in amended employment agreements, and (6) excise tax gross-ups.[21] Glass Lewis currently considers double-trigger change-in-control arrangements, which require both a change-in-control and an employment termination or constructive termination in order to be triggered, to be best practice.[22] Under the updated guidelines, to the extent any change-in-control arrangement is not explicitly double-trigger, it may be considered a single-trigger or modified single-trigger arrangement.[23]

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[15] *Id*.

[16] *See* 2020 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice: Shareholder Initiatives ("Glass Lewis Shareholder Initiatives") at 2, *available at* https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_Shareholder_Initiatives.pdf.

[17] *Id*.

[18] Glass Lewis Shareholder Initiatives, at 2.

[19] *Id*.

[20] *Id*.

[21] Glass Lewis Guidelines, at 36.

[22] *Id*.

[23] *Id*.

Short-Term Incentives

In its 2020 guidelines, Glass Lewis also clarified its policy relating to short-term incentives by indicating that, where a company applies upward discretion when determining awards under a short-term incentive plan, including by lowering goals mid-year or increasing calculated payouts, the company should provide a robust discussion of why the compensation committee felt it was necessary to exercise such discretion.[24]

III. ISS Voting Guidelines

Board Gender Diversity

ISS has previously provided that, effective for meetings held on or after February 1, 2020, for companies in the Russell 3000 or S&P 1500 indices with no women on their boards, it will recommend a vote against or withholding from voting for the election of the chair of the nominating committee, or other directors on a case-by-case basis. The transition period has now elapsed, and under the ISS 2020 guidelines, if a company lacks any women on its board, ISS will recommend a vote against or withholding from voting for the election of the chair of the nominating committee, or other directors on a case-by-case basis, absent a firm commitment from a company to achieve gender diversity within one year.[25] In addition, ISS clarified that such a commitment from a board with no women on it previously will only be a mitigating factor until February 1, 2021.[26]

Problematic Governance Structures of Newly-Public Companies

Under its current policy, ISS generally will recommend voting against or withholding from voting for directors individually, committee members, or the entire board (except new nominees, who are considered on a case-by-case basis) if, prior to or in connection with a company's public offering, the company or its board (1) adopted bylaws or charter provisions materially adverse to shareholder rights, or (2) implemented a multi-class capital structure in which the classes have unequal voting rights.[27]

The updated guidelines create two distinct policies in order to separately assess problematic governance provisions and dual class capital structures. Under the 2020 guidelines, ISS will consider the presence of sunset provisions with respect to such practices in determining its voting recommendation. Specifically, as to matters referred to in clause (1) above, the inclusion of a reasonable sunset provision will be considered a mitigating factor in determining whether to issue an adverse voting recommendation.[28] As to matters referred to in clause (2) above, the inclusion of a reasonable time-based sunset provision generally will be required to avoid an adverse voting recommendation.[29] In assessing whether a time-based sunset provision for dual class capital structures is reasonable, ISS will consider the company's lifespan, its post-IPO ownership structure and the board's disclosed rationale for the selected sunset period, but no sunset period greater than seven years from the date of the IPO will be considered reasonable.[30]

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[24] *Id.* at 33–34.

[25] ISS Guidelines, at 6.

[26] *Id.*

[27] *Id.* at 7.

[28] *Id.* at 8.

[29] *Id.*

[30] *Id.*

Restrictions on Shareholders' Rights

ISS has seen a general increase in the number of companies submitting proposals to shareholders seeking ratification or approval of requirements in excess of those in Rule 14a-8 regarding submission of binding bylaw amendments.[31] In response, the 2020 guidelines clarify that ISS generally will recommend that shareholders vote against or withhold from voting for members of the governance committee until shareholders are provided with an unfettered ability to amend the bylaws or a proposal providing for such unfettered right is submitted for shareholder approval.[32] The updated guidelines also clarify that subject matter restrictions (*i.e.* prohibitions on shareholders' ability to amend the particular bylaws that govern their ability to amend the bylaws) are also considered undue restrictions on shareholders' rights and would therefore receive an adverse voting recommendation.[33]

Independent Board Chair

Under its current policy, ISS generally will recommend voting for shareholder proposals requiring that the chairman's position be filled by an independent director, taking into consideration the following factors: the scope of the proposal; the company's current board leadership structure; the company's governance structure and practices; company performance; and any other relevant factors that may be applicable.[34]

The new guidelines add the "rationale" of the shareholder proposal to the list of factors that ISS will consider in determining its voting recommendation.[35] In addition, the updated guidelines specify a list of factors that will increase the likelihood of a "for" recommendation by ISS with respect to shareholder proposals requiring that the board chair's position be filled by an independent director, including:[36]

- A majority non-independent board and/or the presence of non-independent directors on key board committees;
- A weak or poorly-defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role;
- The presence of an executive or non-independent chair in addition to the CEO; a recent combination of the role of CEO and chair; and/or departure from a structure with an independent chair;
- Evidence that the board has failed to oversee and address material risks facing the company;
- A material governance failure, particularly if the board has failed to adequately respond to shareholder concerns or if the board has materially diminished shareholder rights; or
- Evidence that the board has failed to intervene when management's interests are contrary to shareholders' interests.

[31] *Id.* at 9.

[32] *Id.*

[33] *Id.*

[34] *Id.* at 10.

[35] *Id.*

[36] *Id.*

Share Repurchase Programs

While ISS generally recommends voting favorably with respect to a board's decision to engage in a share repurchase program, it also recommends voting against abusive practices in rare instances. ISS has updated its guidelines to codify its existing approach to what it considers abusive practices, including (1) the use of targeted share buybacks as greenmail or to reward company insiders by purchasing their shares at a higher than they could receive in an open market sale, (2) the use of buybacks to boost earnings per share or other compensation metrics to increase payouts to company insiders, and (3) repurchases that threaten a company's long-term viability.[37]

Evergreen Provisions in Equity Plans

Due to the repeal of the performance-based pay exemption under Internal Revenue Code Section 162(m) in 2017, which previously required companies to seek approval of their incentive plan metrics every five years in order to qualify for the performance-based pay exemption, ISS has observed a significant drop in the number of equity plans brought to shareholder vote.[38] Under the updated guidelines, ISS will consider the inclusion of an evergreen feature (i.e. automatic share replenishment) in an equity plan as an overriding factor in its Equity Plan Scorecard analysis of equity plans, and generally recommend a vote against such a plan in an effort to address concerns that such a provision circumvents regular shareholder re-approval of such plans.[39]

Labor Force Pay Gap Reporting

ISS has added "race or ethnicity" to its guidelines on shareholder proposals requesting a report on a company's pay data by gender or a report on a company's policies and goals to reduce any gender pay gap.[40] ISS believes that the update will align the current policy with the types of shareholder proposals being filed.[41]

IV. Conclusion

The 2020 Glass Lewis and ISS guidelines provide important, helpful insight in anticipation of the coming proxy season and reveal a continued focus on governance concerns related to social issues and compensation practices.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email Helene Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Elai Katz at 212.701.3039 or ekatz@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Ross Sturman at 212.701.3831 or rsturman@cahill.com; Joseph Cho at 212.701.3589 or jcho@cahill.com; or Tina Davis at 212.701.3473 or tdavis@cahill.com.

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[37] *Id.* at 12.

[38] *Id.* at 14.

[39] *Id.* at 15.

[40] *Id.*

[41] *Id.*