

## Glass Lewis and ISS 2019 Voting Guidelines

### I. Overview

Both Glass Lewis and ISS, the leading providers of corporate governance and proxy advisory services, have now published their 2019 proxy voting guidelines. The Glass Lewis guidelines will take effect for meetings held after January 1, 2019.<sup>1</sup> The ISS guidelines will be applied for shareholder meetings held on or after February 1, 2019.<sup>2</sup> The updates to both of their guidelines focus on board gender diversity, conflicting management and shareholder proposals, and social and environmental matters, among other changes. In addition, minor-clean up changes have been made to each set of guidelines. Below is a summary of the changes in the guidelines affecting U.S. companies.

### II. Glass Lewis Voting Guidelines

#### **Board Gender Diversity**

For any shareholder meetings held after January 1, 2019, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members. In doing so, they will closely examine the company's disclosure of its board diversity considerations and other relevant contextual factors. Depending on other factors, such as size of company, industry and governance profile, they may extend this recommendation to vote against other nominating committee members. However, they may refrain from recommending that shareholders vote against directors of companies outside the Russell 3000 index or when boards have provided a sufficient rationale for not having any female board members. Such rationale may include a timetable for addressing lack of board diversity, as well as any restrictions in place regarding the board's composition, such as director nomination agreements.

#### **Conflicting and Excluded Special Meeting Proposals**

In situations where management and shareholder proposals request different thresholds for the right to call a special meeting, Glass Lewis will generally recommend the lower threshold. When there are conflicting management and shareholder special meeting proposals and the company does not have a special meeting right, they may consider recommending that shareholders vote in favor of the shareholder proposal and abstain on the management proposal. When companies have excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, they will typically recommend against the ratification as well as members of the nominating and governance committee. Glass Lewis will also note instances when the Securities and Exchange Commission ("SEC") has allowed companies to exclude shareholder proposals, which may result in recommendations against members of the governance committee.

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<sup>1</sup> See Glass Lewis, 2019 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice, available at [http://www.glasslewis.com/wp-content/uploads/2018/10/2019\\_GUIDELINES\\_UnitedStates.pdf](http://www.glasslewis.com/wp-content/uploads/2018/10/2019_GUIDELINES_UnitedStates.pdf).

<sup>2</sup> See Institutional Shareholder Services Inc., 2019 Americas Proxy Voting Guidelines Updates: Benchmark Policy Changes for U.S., Canada, and Latin America (November 19, 2018), available at <https://www.issgovernance.com/file/policy/latest/updates/Americas-Policy-Updates.pdf>; see also Institutional Shareholder Services Inc., Executive Summary: Global Proxy Voting Guidelines Updates and Process: 2019 ISS Benchmark Policy Changes (November 19, 2018), available at <https://www.issgovernance.com/file/policy/latest/updates/Executive-Summary-of-ISS-Policy-Updates-and-Process.pdf>.

## **Environmental and Social Risk Oversight**

In the new guidelines, Glass Lewis has formalized its approach to reviewing how boards are overseeing environmental and social issues. For large cap companies and where Glass Lewis identifies material oversight issues, they will review a company's overall governance practices and identify which directors or committees have been charged with oversight of such issues, and will note when such oversight role has not been clearly defined. When they question whether companies have not properly managed or mitigated environmental or social risks to the detriment of shareholder value, they may recommend that shareholders vote against board members responsible for oversight of such risks. In the absence of explicit board oversight of environmental and social issues, they may recommend that shareholders vote against members of audit committee.

## **Ratification of Auditor: Additional Considerations**

Glass Lewis identified additional factors that they will consider when reviewing auditor ratification proposals, including the auditor's tenure, a pattern of inaccurate audits and any ongoing litigation or significant controversies that call into question an auditor's effectiveness. In limited circumstances, they may recommend a vote against auditor ratification due to these factors.

## **Virtual-Only Shareholder Meetings**

For companies holding their annual meetings after January 1, 2019 solely by virtual means, Glass Lewis will examine the company's disclosure of its virtual meeting procedures and may recommend voting against governance committee members if the disclosure does not ensure that shareholders will be given the same ability to participate as at in-person meetings. Examples of effective disclosure include: (i) whether and how shareholders can ask questions during the meeting, (ii) any procedures for posting on the company's website questions raised and answers given during the meeting, (iii) instructions on accessing the virtual meeting platform, and (iv) how to receive technical support during the virtual meeting.

## **Executive Director Compensation**

Glass Lewis has expanded their discussion of several executive compensation topics and how these factor into their voting recommendations. When new excise tax gross-ups are provided for in executive employment agreements, they will consider recommending against compensation committee members, particularly in situations where companies had pledged not to provide such entitlements. Additionally, they will consider general U.S. market practices, as well as the size and design of entitlements, when analyzing severance and sign-on arrangements in the context of a say-on-pay proposal. When evaluating the risks associated with grants of front-loaded awards, they will take quantum, design and the company's rationale for granting awards under this structure into consideration. Regarding "clawback" provisions, they will be more focused on the specific terms of clawback policies beyond whether a company maintains a clawback that merely satisfies the minimum legal requirements.

In light of the 2018 changes to the definition of "smaller reporting company,"<sup>3</sup> Glass Lewis will consider the impact of materially decreased disclosure in determining their recommendations regarding a company's

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<sup>3</sup> In June 2018, the SEC raised the thresholds in the definition of "smaller reporting company" ("SRC") to companies with less than \$250 million of public float, or less than \$100 million in annual revenue and either no public float or a public float of less than \$700 million. *See Amendments to Smaller Reporting Co. Definition*, Release No. 10513 (June 28, 2018). This change has significantly expanded the number of companies eligible to comply with reduced disclosure requirements, which require SRCs to disclose summary compensation table information for only two years rather than

compensation committee, and may recommend voting against members of the committee where such leaner disclosure substantially impacts shareholders' ability to make an informed assessment of the company's executive pay practices.

The guidelines also include language clarifying their approach to peer groups, pay-for-performance, the use of discretion, director compensation and bonus plans.

## **Other Updates**

The new guidelines also clarified Glass Lewis's existing approach to the following topics:

- For director recommendations based on company performance, in addition to the performance of the stock price, Glass Lewis will consider a company's overall corporate governance, pay-for-performance alignment and responsiveness to shareholders.
- Glass Lewis believes indemnification or liability insurance is appropriate to protect directors and officers against certain claims so that they feel comfortable taking measured risks that may benefit shareholders, as long as the terms of such agreements are reasonable.
- When companies propose adoption of both a "Net Operating Loss Poison Pill" and an additional bylaw amendment restricting certain share transfers, Glass Lewis may support both if they find the terms reasonable.
- In the case of OTC-listed companies, when shareholders are not provided information about the composition of the board, its key committees or other basic governance practices, Glass Lewis will generally hold the board's governance committee responsible, or the chair of the board when no governance committee is disclosed.
- Glass Lewis believes a quorum requirement for shareholder meetings should be high enough to ensure that a broad range of shareholders is represented, but low enough that the company can conduct necessary business. A majority of outstanding shares entitled to vote is an appropriate quorum for shareholder meetings, but Glass Lewis would support a reduced quorum of at least one-third of shares entitled to vote if a company seeks shareholder approval of such lower threshold. Their recommendation will also depend on the specific facts and circumstances of the company, including size and shareholder base.

## **III. ISS Voting Guidelines**

### **Board Gender Diversity**

Beginning in 2018, ISS proxy research reports began noting when a company's board lacked gender diversity, but ISS did not issue any adverse voting recommendations on this basis. Effective for meetings held on

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three, and for the top three named executive officers rather than five. Further, SRCs need not include a compensation discussion and analysis, or tables detailing grants of plan-based awards.

or after February 1, 2020, for companies in the Russell 3000 or S&P 1500 indices with no female directors, ISS will recommend a vote against (or withhold from) the election of the nominating committee chair, or other directors who are responsible for the board nomination process on a case-by-case basis. Mitigating factors include (i) a firm commitment, as stated in the proxy statement, to appoint at least one female to the board in the near term, (ii) the presence of a female on the board at the preceding annual meeting or (iii) other relevant factors as applicable. Instead of effectuating this policy immediately, ISS is giving companies a year-long grace period to allow boards the opportunity to recruit qualified female candidates.

The guidelines provide three rationales for the change in ISS's board diversity policy: (i) investors favor gender diverse boards;<sup>4</sup> (ii) board gender diversity has been positively correlated to better company performance in some studies;<sup>5</sup> and (iii) gender diverse boards are the market norm.<sup>6</sup>

### Management Proposals to Ratify Existing Charter or Bylaw Provisions

ISS will generally recommend a vote against management proposals to ratify provisions of the company's existing charter or bylaw, unless the governance provisions align with best practice. Additionally, ISS will recommend a vote against (or withhold from) individual directors, members of the governance committee or the full board when boards ask shareholders to ratify existing charter or bylaw provisions, considering the following factors:

- The presence of a shareholder proposal addressing the same issue on the same ballot;
- The board's rationale for seeking ratification;
- Disclosure of actions to be taken by the board should the ratification proposal fail;
- Disclosure of shareholder engagement regarding the board's ratification request;
- The level of impairment to shareholders' rights caused by the existing provision;
- The history of management and shareholder proposals on the provision at the company's past meetings;
- Whether the current provision was adopted in response to the shareholder proposal;
- The company's ownership structure; and

<sup>4</sup> The ISS guidelines cite its 2018 policy survey results, which showed that only 3% of investor respondents stated that they did not consider a lack of board gender diversity to be problematic, and over 80% of investors respondents found an absence of gender diversity at the board level problematic. See Institutional Shareholder Services Inc., 2018 Governance Principles Survey: Summary of Results (September 18, 2018), available at <https://www.issgovernance.com/file/policy/2018-2019-iss-policy-survey-results-report.pdf>.

<sup>5</sup> The ISS guidelines cite a series of studies in support of this statement. See Conyon, Martin J. and He, Lerong, Firm Performance and Boardroom Gender Diversity: A Quantile Regression Approach, (March 16, 2017); Deloitte, Global Center for Corporate Governance, Women in the boardroom: A global perspective, P. 3-4, Fifth Ed. (2017); PwC, Governance Insights Center, PwC's 2017 Annual Corporate Directors Survey, p. 11-12; Vivian Hunt, Dennis Layton and Sara Prince, McKinsey & Co., Diversity Matters, (February 2, 2015); Marcus Noland, Tyler Moran and Barbara Kotschwar, Peterson Institute for International Economics, Is Gender Diversity Profitable?, February 2016.

<sup>6</sup> Among other statistics in support of this statement, the ISS guidelines state that as of September 15, 2018, according to DataDesk data, only three companies in the S&P 500 had no female directors and 84% of companies in the Russell 3000 Index have at least one woman on the board. According to the 2017 U.S. Board Study: Board Diversity Review, in 2017 87% of the companies in the S&P 1500 had at least one woman on the board.

- Previous use of ratification proposals to exclude shareholder proposals.

ISS is implementing this policy in light of the significant increase during the 2018 proxy season in board-sponsored proposals to ratify existing charter or bylaw provisions in response to guidance from the SEC staff that granted certain companies' requests for no-action relief if companies sought to exclude shareholder proposals from their ballots by including a conflicting management-sponsored proposal to ratify one or more of their existing governance provisions citing Securities Exchange Act Rule 14a-8(i)(9).<sup>7</sup> ISS views these ratification proposals as attempts to block shareholder proposals that requested more shareholder-friendly governance provisions from appearing on ballots. ISS contends that shareholders have demonstrated their ability to thoughtfully vote when both management and shareholder proposals on the same issue appear on the ballot.

### **Board Responsiveness to Opposition to Ratification Proposals**

In conjunction with the abovementioned new policy that formalizes ISS's approach for analyzing management-submitted ratification proposals of existing charter or bylaws provisions, ISS is updating its policy on board responsiveness to reflect that the failure of such a management proposal to receive majority support will trigger a board responsiveness analysis at the following annual meeting. Going forward, ISS will make voting recommendations case-by-case on individual directors, committee members or the entire board of directors if the board failed to act on a management proposal seeking to ratify an existing charter or bylaw provision that received opposition of a majority of the shares cast in the previous year.

### **Board Meeting Attendance**

In cases of directors with chronic poor attendance at board and committee meetings (defined as three or more consecutive years of poor attendance without reasonable justification), in addition to recommending a vote against these directors, ISS will generally recommend a vote against (or withhold from) appropriate committee members or the full board. ISS may also apply the policy in cases where there is a long-term pattern of absenteeism, such as poor attendance the previous year and three out of the four prior years. ISS implements the policy as follows: ISS will recommend withhold (i) from the chair of the nominating or governance committee after three years of poor attendance by a director, (ii) from the full nominating or governance committee after four years and (iii) from all nominees after five years.

### **Director Performance Evaluations**

As part of its effort to identify companies that have long-term underperformance relative to their peers and a significant number of board entrenchment features, ISS is moving the consideration of five-year total shareholder returns to the initial screen, rather than being part of a secondary step in director performance evaluations. Going forward, ISS will measure poor performance by one-, three-, and five-year total shareholder returns, leaving as part of the second step of the evaluation consideration of the company's operational metrics and other factors as warranted.

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<sup>7</sup> Securities Exchange Act Rule 14a-8(i)(9) allows companies to exclude a shareholder proposal from a proxy statement if the proposal "directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting." 17 C.F.R. § 240.14a-8(i)(9).

## **Reverse Stock Splits**

ISS will recommend a vote for management proposals to implement a reverse stock split if: (i) the number of authorized shares will be proportionately reduced or (ii) the effective increase in authorized shares is not greater than the allowable increase calculated in accordance with ISS's Common Stock Authorization policy. For such proposals that do not meet either of the above conditions, ISS will make voting recommendations case-by-case based on the following factors: (i) stock exchange notification to the company of a potential delisting, (ii) disclosure of substantial doubt about the company's ability to continue as a going concern without additional financing, (iii) the company's rationale or (iv) other factors as applicable.

## **Social and Environmental Proposals**

ISS is updating its policy on social and environmental proposals to formalize additional factors that are already taken into consideration in ISS's case-by-case analyses of these proposals. Specifically, the update makes it more explicit that significant controversies, fines, penalties or litigation associated with the company's environment or social practices are considered when evaluating whether a social and environmental shareholder proposal enhances or protects shareholder value.

## **Economic Value Added (EVA) Data**

Although ISS has been assessing the potential use of EVA data in the Financial Performance Assessment screen of its pay-for-performance model, ISS will not be introducing EVA measures in the model for 2019 and will continue using GAAP accounting performance measures in the 2019 proxy season. Going forward, ISS will continue to explore the potential use of EVA to add additional insight as part of its financial performance analysis.

## **IV. Conclusion**

The 2019 Glass Lewis and ISS guidelines provide helpful insight in anticipation of the coming proxy season and reveal an increasing focus on board gender diversity, conflicting management and shareholder proposals, and social and environmental matters.

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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, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or [hbanks@cahill.com](mailto:hbanks@cahill.com); Bradley J. Bondi at 202.862.8910 or [bbondi@cahill.com](mailto:bbondi@cahill.com); Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Geoffrey E. Liebmann at 212.701.3313 or [gliebmann@cahill.com](mailto:gliebmann@cahill.com); Kimberly Petillo-Décosard at 212.701.3265 or [kpetillo-decosard@cahill.com](mailto:kpetillo-decosard@cahill.com); or David A. Rand at 212.701.3189 or [drand@cahill.com](mailto:drand@cahill.com).