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Proxy Advisory Firms Issue Voting Policy Updates for 2020 Proxy Season

Proxy advisory firms Institutional Shareholder Services ("ISS") and Glass, Lewis & Co. ("Glass Lewis") have issued updated proxy voting guidelines for the upcoming 2020 proxy season. Notable policy updates issued by one or both of ISS and Glass Lewis include:

- Exclusion of Shareholder Proposals (Glass Lewis)
- Shareholder Proposals on Independent Board Chairs (ISS)
- Say-On-Pay (Glass Lewis)
- Executive Compensation Considerations (Glass Lewis and ISS)
- Evaluation of Committee Member Performance (Glass Lewis)
- Problematic Governance Provisions (ISS)

The full text of the 2020 proxy voting guidelines published by ISS and Glass Lewis may be accessed here and here, respectively.

EXCLUSION OF SHAREHOLDER PROPOSALS

In September 2019, the staff of the Securities and Exchange Commission ("SEC") announced changes to the long-standing process for SEC review of shareholder proposals submitted pursuant to Rule 14a-8. Starting with the 2019-2020 proxy season, the SEC may respond orally, instead of in writing, to a company's no-action request to exclude a shareholder proposal from a proxy statement. In addition, the staff has signaled that it may expand the types of situations in which it declines to state a view altogether on the exclusion of a particular shareholder proposal, particularly where the staff does not feel it is well-positioned to make an informed decision on exclusion. When the staff declines to state its views, the company is left to make its own decision whether to include or exclude the shareholder proposal. In response to this new SEC policy, Glass Lewis will generally recommend voting against all governance committee members when a company omits a shareholder proposal from its proxy statement and the SEC staff either (1) declined to state a view or (2) verbally permitted the exclusion, but the company failed to provide disclosure concerning the no-action relief. In order to avoid such a recommendation, a company would need to make disclosure regarding receipt of the proposal and the process with the SEC staff, which disclosure is not required under SEC regulations. Companies should proactively plan and implement procedures to document discussions with the SEC staff in light of the need to include such disclosures in the upcoming proxy statement.

SHAREHOLDER PROPOSALS ON INDEPENDENT BOARD CHAIRS

Under its existing policy, ISS will generally recommend a vote for shareholder proposals requiring that the chairman's position be filled by an independent director, taking into account several factors, including the company's current board leadership structure and the company's governance structure and practices. ISS has now added a list of specific factors that will increase the chances of a recommendation "for" the shareholder proposal, including:

- 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 recombination 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 or 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.

SAY-ON-PAY

Glass Lewis' updated guidelines add specificity on what it considers to be an appropriate response following significant shareholder opposition (at least 20%) to the say-on-pay proposal at the company's previous annual meeting. Glass Lewis expects companies to provide robust disclosure of engagement activities and specific changes made in response to shareholder feedback. Glass Lewis has also added that minimum appropriate levels of company responsiveness should correspond to the level of shareholder opposition, taking into account the magnitude of opposition in a single year and the persistence of shareholder disapproval over time.

OTHER EXECUTIVE COMPENSATION CONSIDERATIONS

Contractual Payments and Arrangements. Glass Lewis continues to disfavor contractual provisions and payments that it believes are excessively restrictive in favor of the executive, or that could potentially incentivize behaviors that are not in the company's best interest. For 2020, Glass Lewis expanded its guidelines, stating that it will now also consider the design of any severance entitlements.

Change in Control. Glass Lewis clarifies that it considers double-trigger change in control arrangements to be best practice. Further, excessively broad definitions of change in control are potentially problematic as they could lead to situations where executives receive additional compensation without a corresponding meaningful change in status or duties.

Short-Term Incentives. Glass Lewis clarifies that it expects proxy statements to include a robust discussion of any company decision to apply upward discretion with respect to short-term bonuses, including lowering goals mid-year or increasing calculated payouts.

Evergreen Provisions. Following the repeal of the performance-based pay exemption (under Section 162 of the Internal Revenue Code) under the Tax Cuts and Jobs Act of 2017, companies are no longer required to seek approval of their incentive plan metrics at least every five years. As a result, there has been a significant drop in the number of equity plans brought to a shareholder vote. ISS notes its concern in the post-tax reform environment around evergreen provisions that automatically replenish plan reserves and circumvent regular shareholder reapproval of such plans. Accordingly, ISS now cites an evergreen feature in a plan as an overriding factor in the U.S. Equity Plan Scorecard analysis and will generally recommend a vote against approval of any plan that includes an evergreen feature.

EVALUATION OF COMMITTEE MEMBER PERFORMANCE

Glass Lewis codified additional factors that it will consider it making voting recommendations relating to the members of the board committees, as follows:

Audit Committee. Glass Lewis will now consider recommending a vote against the audit committee chair when fees paid to the company's independent auditor are not disclosed. This change echoes Glass Lewis's existing policy that it will consider recommending a vote against audit committee members if audit and audit-related fees total one-third or less of the total fees billed by the auditor.

Compensation Committee. SEC rules require companies to submit a "say when on pay" proposal to shareholders at least once every six years to seek shareholder input on whether an advisory say on pay vote will be held every one, two or three years. Glass Lewis will now consider recommending a vote against all members of the compensation committee if the board adopts a frequency for its advisory vote that differs from the frequency approved by a plurality of shareholders.

Nominating and Governance Committee. Glass Lewis will generally now recommend voting against the governance committee chair when a company does not disclose individual directors' board and committee meeting attendance; or when a company discloses that a director attended less than 75% of board and committee meetings but disclosure is sufficiently vague that it is not possible to determine which director's attendance was lacking.

PROBLEMATIC GOVERNANCE PROVISIONS - NEWLY PUBLIC COMPANIES

For the 2020 proxy season, with respect to newly-public companies, ISS has bifurcated its policy regarding problematic governance provisions from its policy regarding multi-class capital structures with unequal voting rights. With respect to multi-class structures with unequal voting rights for newly public companies, ISS will generally recommend a vote against or withhold from the entire board (except new nominees, who are considered on a case-by-case basis) if, before or as part of the initial public offering, the company implemented a multi-class capital structure with unequal voting rights, unless the structure is subject to a reasonable, time-based sunset provision. To assess reasonableness, ISS will consider the company's lifespan, post-IPO ownership structure and the board's disclosed rationale for the sunset period; however, ISS clarifies that any sunset provision longer than seven years is per se unreasonable.

ISS will now address problematic governance provisions in a separate policy. Consistent with its current policy, ISS will generally recommend votes against or withhold from directors individually, committee members or the entire board if, before or as part of the IPO, a bylaw or charter provision is adopted that ISS finds problematic, including classified boards and supermajority vote requirements to amend governing documents. Under this policy, a reasonable sunset will also be considered a mitigating factor.

MISCELLANEOUS

Exclusive Forum. Glass Lewis' existing guidelines provide that Glass Lewis will vote against the governance committee chair if the board adopted a forum selection clause in the prior year without shareholder approval. Glass Lewis clarifies that it may make an exception when the forum selection clause is narrowly crafted to suit the particular circumstances and/or includes a reasonable sunset or termination provision included.

Share Buybacks. Share buybacks approved by shareholders are infrequent. However, ISS added a policy to its voting guidelines to supplement its existing policy of recommending a vote for management proposals to institute open market share repurchase plans. Under the new guidelines, ISS will now also recommend a vote for management proposals to grant the board authority to conduct open-market repurchases. ISS clarifies that it will only recommend "for" such management proposals in the absence of company-specific concerns, regarding, among other things, the company's long-term viability or manipulation of incentive compensation metrics.

Gender Pay Equity. Glass Lewis and ISS will continue to review on a case-by-case basis shareholder proposals that request a company to disclose median gender pay ratios. In such reviews, they will consider the company's current policies, disclosure related to diversity and inclusion and reporting on pay gap policies or initiatives.

ISS Clarification of New Nominee. ISS clarified the definition of "new nominee" to include any director who is being presented for election by shareholders for the first time. ISS also removed the term "new nominees" from the board and committee meetings attendance policy, as the determination of whether recently-added directors are exempt under this policy is based on whether they served the entire fiscal year under review, and not whether they have been previously elected by shareholders.

Board Diversity. The one-year transition period for ISS's gender diversity policy has expired, and ISS will now generally recommend voting against the chair of a nominating committee of a board with no female directors. ISS also clarified that the commitment to appoint at least one woman to the board within a year will only be a mitigating factor for 2020, not beyond. As of July 2019, all S&P 500 boards had at least one female director and 89% of Russell 3000 boards now have at least one female director.

PRACTICAL CONSIDERATIONS

The voting policies adopted by ISS and Glass Lewis reflect continuing emphasis on board composition, board accountability and provisions that are perceived as restricting shareholder rights. The 2020 proxy season may see unexpected shifts in proxy advisor influence. Over the past 18 months, the SEC has taken a number of public steps regarding proxy advisory firms. In September 2018, the SEC withdrew two no-action letters regarding proxy advisory firms. In August 2019, the SEC issued interpretative guidance on the applicability of federal proxy rules to voting advice. In November 2019, the SEC approved (by a 3-2 vote along party lines) proposed rules that would require disclosure by proxy advisory firms of potential conflicts of interest in their proxy voting advice and would require that public companies and certain other soliciting persons be given an opportunity to review and provide feedback on proxy voting advice before it is issued. The proposed rules are subject to comment, and it is unclear what, if any, effect this initiative will have on the 2020 proxy season. Given this uncertainty, it is more important than ever for companies to understand their shareholder base, including those that have historically been influenced by ISS and Glass Lewis, and continue to engage shareholders in advance of proxy solicitations to avoid surprises in the 2020 proxy season.