Simpson Thacher

Memorandum

ISS and Glass Lewis Issue Updates to Their Proxy Voting Guidelines for the 2016 Season

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Institutional Shareholder Services Inc. ("ISS") and Glass Lewis & Co. ("Glass Lewis") have both issued updates to their proxy voting guidelines for the 2016 proxy season.[1] ISS's revised policies will take effect for annual meetings occurring on or after February 1, 2016, while Glass Lewis's updated policies will take effect for meetings occurring after January 1, 2016.

I. Notable Updates to ISS's U.S. Proxy Voting Guidelines

A. Unilateral Bylaw/Charter Amendments

Under ISS's current policy, as adopted last year, ISS generally recommends a vote against or withhold from individual directors, committee members, or the entire board (except new nominees, who are considered case-by-case) if the board unilaterally amends the company's bylaws or charter "in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders," taking several factors into account. ISS has updated its policy to add that, in subsequent years, it will recommend a vote case-by-case on director nominees "[u]nless the adverse amendment is reversed or submitted to a binding shareholder vote." However, when a board unilaterally amends the company's governing documents to classify the board, establish supermajority vote requirements to amend the bylaws or charter, or eliminate shareholders' ability to amend the bylaws, ISS will generally recommend a vote against director nominees in subsequent years until the unilateral action is either reversed or submitted to a binding shareholder vote.

Furthermore, ISS has added that if a board amends the company's bylaws or charter prior to or in connection with the company's initial public offering ("IPO"), ISS will generally issue adverse vote

[1] *See* Institutional Shareholder Services, Inc., Americas Proxy Voting Guidelines Updates: 2016 Benchmark Policy Recommendations (Nov. 20, 2015); Glass Lewis & Co., Proxy Paper Guidelines, 2016 Proxy Season.

recommendations for individual directors, committee members, or the entire board (except new nominees, who will be considered case-by-case), "considering the following factors:

- The level of impairment of shareholders' rights caused by the provision;
- The company's or the board's rationale for adopting the provision;
- The provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholder right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- The ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure; and
- A public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering."

In the case of newly public companies, ISS take a case-by-case approach on director nominees in subsequent years unless the provision is reversed or is ratified by a shareholder vote.

B. Director Overboarding

Under its current policy, ISS recommends a vote against or withhold from individual directors who:

- sit on more than six public company boards; or
- are CEOs of public companies and sit on the boards of more than two public companies besides their own.

In the latter case, ISS issues its withhold vote recommendations only with respect to the CEOs' outside directorships.

While ISS has determined to retain its current limits on CEOs' directorships, it has reduced the number of public company boards on which non-CEO directors should serve to a total of five boards. ISS will provide issuers a one-year transition period until February 1, 2017 "to allow time for affected directors to address necessary changes if they wish"; ISS will not issue a negative vote recommendation in 2016 simply because a director is deemed overboarded under the revised policy, though it will indicate in its analysis that the director serves on more than five public company boards.

C. Voting for Director Nominees in Contested Elections

ISS currently takes a case-by-case approach to the evaluation of directors in contested elections, considering several enumerated factors. This analytical framework is applicable not only to director nominees in a proxy contest, but also to proxy access nominees. ISS has updated its policy to add that in the case of proxy access candidates, it will consider not only those enumerated factors applicable, but also "additional factors which

may be relevant, including those that are specific to the company, to the nominee(s) and/or to the nature of the election (such as whether or not there are more candidates than board seats).”

D. Compensation Disclosure by Externally Managed Issuers

According to ISS, externally-managed issuers (“EMIs”) “typically do not disclose any details about their compensation arrangements or payments made to executives by external managers,” rendering it impossible for shareholders to make an informed decision regarding the EMIs’ say-on-pay proposals. Accordingly, ISS has updated its “Problematic Pay Practice” policy to add “Insufficient Executive Compensation Disclosure by Externally Managed Issuers (EMIs)” to the list of practices that may result in an adverse recommendation with regard to a company’s say-on-pay proposal. Specifically, ISS’s new policy indicates that for EMIs, ISS will “generally vote against the say-on-pay proposal when insufficient compensation disclosure precludes a reasonable assessment of pay programs and practices applicable to the EMI’s executives.”

E. Equity Retention Proposals

With regard to shareholder proposals asking companies to adopt policies requiring senior executives to retain a portion of net shares acquired through compensation plans, ISS has revised its case-by-case approach to clarify the factors it will consider in its case-by-case analysis. ISS will take into account:

- “The percentage/ratio of net shares required to be retained;
- The time period required to retain the shares;
- Whether the company has equity retention, holding period, and/or stock ownership requirements in place and the robustness of such requirements;
- Whether the company has any other policies aimed at mitigating risk taking by executives;
- Executives’ actual stock ownership and the degree to which it meets or exceeds the proponent’s suggested holding period/retention ratio or the company’s existing requirements; and
- Problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.”

Most notably, adding to its analytic framework the first two of the above factors – the percentage/ratio of shares required to be retained and the retention duration – has allowed ISS to eliminate its separate policy for requests that executives retain 75% of shares acquired through compensation plans; as revised, ISS’s policy will now be applicable to all proposals calling for the requirement that senior executives retain a portion of net shares acquired through compensation plans.

II. Notable Updates to Glass Lewis' U.S. Proxy Paper Guidelines

A. Dueling Shareholder and Management Proposals

Given the Securities and Exchange Commission's recent release of Staff Legal Bulletin 14H, which leaves open the option for issuers to submit a shareholder proposal alongside a management proposal on the same issue, Glass Lewis has articulated an approach to analyzing dueling proposals. In reviewing dueling proposals, Glass Lewis will consider the following factors:

- "The nature of the underlying issue;
- The benefit to shareholders from implementation of the proposal;
- The materiality of the differences between the terms of the shareholder proposal and management proposal;
- The appropriateness of the provisions in the context of a company's shareholder base, corporate structure and other relevant circumstances; and
- A company's overall governance profile and, specifically, its responsiveness to shareholders as evidenced by a company's response to previous shareholder proposals and its adoption of progressive shareholder rights provisions."

B. Exclusive Forum Provisions

Under its current policy, Glass Lewis recommends that shareholders vote against the chair of the nominating and governance committee if the board includes an exclusive forum provision in its governing documents in connection with its IPO and does not put the provision up to a shareholder vote following the IPO. Revising its approach for the 2016 proxy season, Glass Lewis has indicated that it will no longer recommend a vote against the chair of the nominating and governance committee in this situation; instead, it "will weigh the presence of an exclusive forum provision in a newly-public company's bylaws in connection with other provisions that [it] believe[s] will unduly limit shareholder rights such as supermajority vote requirements, a classified board or a fee-shifting bylaw." Glass Lewis will continue to recommend that shareholders vote against the chair of the nominating and governance committee, however, when a board has unilaterally adopted an exclusive forum provision outside the context of a spin-off, merger or IPO.

C. Environmental and Social Risk Oversight

Glass Lewis has codified its policy regarding directors' responsibilities for overseeing the management of environmental and social risks. Glass Lewis views "the identification, mitigation and management of environmental and social risks as integral components when evaluating a company's overall risk exposure" and believes that "[d]irectors should monitor management's performance in managing and mitigating these environmental and social risks." Accordingly, Glass Lewis has clarified that it will recommend a vote against directors responsible for risk oversight "in consideration of the nature of the risk and the potential effect on

shareholder value" where "the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively impact shareholder value."

D. Nominating and Governance Committee Performance

Glass Lewis has added to its existing policy on nominating and governance committee performance that it "may consider recommending shareholders vote against the chair of the nominating committee where the board's failure to ensure the board has directors with relevant experience, either through periodic board assessment or board refreshment, has contributed to a company's poor performance."

E. Director Overboarding

Starting in 2017, "Glass Lewis will generally recommend voting against a director who serves as an executive officer of any public company while serving on a total of more than two public company boards and any other director who serves on a total of more than five public company boards." In 2016, Glass Lewis will continue to base its voting recommendations on its existing thresholds of three boards for a director who is also a public company executive and six boards for a director who is not also a public company executive. Like ISS, Glass Lewis may express its concerns, in its 2016 reports, regarding directors considered overboarded under its new policy.

F. Transitional Awards

Glass Lewis has expanded its policy on awards granted outside the company's standard equity-based incentive programs to address transitional awards. The revised policy indicates that companies should:

- clearly disclose sign-on arrangements and provide "a meaningful explanation of the payments and the process by which the amounts are reached"; and
- provide "the details of and basis for any 'make-whole' payments (which are paid as compensation for forfeited awards from a previous employer)."

The revised policy further adds that, with regard to severance or sign-on arrangements, Glass Lewis "may consider the executive's regular target compensation levels or the sums paid to other executives (including the recipient's predecessor, where applicable) in evaluating the appropriateness of such an arrangement."

G. Equity Compensation Plans

Glass Lewis has updated its policy on equity-based compensation plan proposals to clarify the quantitative and qualitative factors it uses to analyze such plans. Glass Lewis's quantitative analysis aims to "determine whether the proposed plan is either absolutely excessive or is more than one standard deviation away from the average plan for the peer group on a range of criteria, including dilution to shareholders and the projected annual cost relative to the company's financial performance." The quantitative assessment, which is actually comprised of several different analyses, will look at the plan's cost and the company's granting

pace and will compare the company's program both with absolute limits that it believes "are key to equity value creation and with a carefully chosen peer group." Each of the analyses in the quantitative assessment, as well as their constituent parts, will be weighted, and Glass Lewis will score the plan in accordance with that weight.

Glass Lewis will then consider "qualitative aspects of the plan such as plan administration, the method and terms of exercise, repricing history, express or implied rights to reprice, and the presence of evergreen provisions." Additionally, Glass Lewis will review "the choice and use of, and difficulty in meeting, the awards' performance metrics and targets, if any." Glass Lewis, believing that "significant changes to the terms of a plan should be explained for shareholders and clearly indicated," may also look at a company's size and operating environment when "assessing the severity of concerns or the benefits of certain changes."

Finally, in certain situations, Glass Lewis may consider the company's executive compensation practices, as applicable.

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1 (212) 455-3815 or yafit.cohn@stblaw.com, or any other member of the Firm's Public Company Advisory Practice.

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