Memorandum

ISS and Glass Lewis Issue Voting Policy Updates for the 2017 Proxy Season

November 28, 2016

Earlier this month, both Institutional Shareholder Services Inc. (“ISS”) and Glass Lewis & Co. (“Glass Lewis”) issued updates to their proxy voting policy guidelines.[1] ISS’s revised policies will take effect for meetings held on or after February 1, 2017; 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

As discussed in further detail below, ISS’s notable additions and modifications to its U.S. proxy voting guidelines affect policies falling broadly into two categories: the election of directors and executive and director compensation. Critically, ISS determined not to implement its proposed policy regarding general share issuance proposals for companies listed in the U.S. but incorporated outside the U.S. Under ISS’s proposed policy, ISS would have recommended “in favor of general share issuance authorities (i.e., those without a specified purpose) up to a maximum of 20 percent of currently issued capital, as long as the duration of the authority is clearly disclosed and reasonable.” ISS has indicated that due to concerns raised in “comments submitted by the issuer community, ISS will not introduce this policy for 2017, and will continue to study the issue.”

A. Policy Updates Relating to Director Elections

1. Restrictions on Shareholders’ Ability to Amend the Bylaws

   Noting that “[s]hareholders’ ability to amend the bylaws is considered a fundamental right,” ISS introduced a new policy indicating that it will recommend a vote against or withhold from members

[1] *See* Institutional Shareholder Services Inc., Americas Proxy Voting Guidelines Updates: 2017 Benchmark Policy Recommendations (Nov. 21, 2016); Glass Lewis & Co., 2017 Proxy Paper Guidelines: United States; Glass Lewis & Co., 2017 Proxy Paper Guidelines: Shareholder Initiatives.

of the governance committee, on an ongoing basis, if the company's charter "imposes undue restrictions on shareholders' ability to amend the bylaws." According to ISS, such restrictions include:

- outright prohibition on the submission of binding shareholder proposals; and
- share ownership requirements or time holding requirements in excess of Rule 14a-8 under the Securities Exchange Act of 1934.[2]

2. Unilateral Bylaw and Charter Amendments by IPO Companies

Under ISS's current policy, if, prior to or in connection with a company's initial public offering ("IPO"), a board adopts a bylaw or charter provision deemed to be "materially adverse to shareholder rights," ISS will generally recommend a vote against or withhold from individual directors, committee members, or the entire board, taking several enumerated factors into consideration. Among these factors is "[a] public commitment to put the provision to a shareholder vote within three years of the date" of the IPO. ISS takes a case-by-case approach with respect to director nominees in subsequent years, unless the provision is reversed or ratified by a shareholder vote.

This year, ISS adopted two key changes to its proxy voting policy on unilateral board actions. First, ISS will generally issue adverse vote recommendations against directors when a company completes its IPO "with a multi-class capital structure in which the classes do not have identical voting rights." Second, ISS will no longer consider whether shareholders will have the opportunity to vote on the provision within three years; rather, ISS will only consider whether the company has adopted a "reasonable sunset provision" with respect to the "adverse" governance provision or capital structure. ISS will continue to recommend a vote case-by-case on director nominees in subsequent years, "[u]nless the adverse provision and/or problematic capital structure is reversed or removed."

3. Director Overboarding

Last year, ISS revised its director overboarding policy to reduce the number of public company boards on which non-CEO directors may serve from a total of six to a total of five boards. ISS provided issuers a one-year transition period to permit affected directors to make any necessary changes. This transition period has come to an end; ISS will apply its revised director overboarding policy for meetings occurring on or after February 1, 2017.

[2] Rule 14a-8 provides that any shareholder that has continuously held at least $2,000 in market value, or 1%, of the company's securities for at least one year is eligible to submit a shareholder proposal.

B. Policy Updates Relating to Compensation

1. Equity-Based and Other Incentive Plans

ISS currently evaluates equity-based compensation plans using its "equity plan scorecard," which considers various factors categorized under three "pillars": plan cost, plan features, and grant practices. ISS has updated its policy to add another factor – dividends payable prior to award vesting – under the "plan features" pillar. Under its revised policy, ISS will award full points "if the equity plan expressly prohibits, for all award types, the payment of dividends before the vesting of the underlying award" (though accrual of dividends payable upon vesting is acceptable). ISS will not award any points "if this prohibition is absent or incomplete (i.e. not applicable to all award types)." Under ISS's updated policy, a company's general practice, not memorialized in the plan document, of not paying dividends until vesting will not be sufficient.

ISS has also modified the existing factor regarding the minimum vesting period for grants made under the plan. ISS has clarified that "an equity plan must specify a minimum vesting period of one year for all award types under the plan in order to receive full points for this factor." In addition, ISS will not award any points for this factor "if the plan allows for individual award agreements that reduce or eliminate the one-year vesting requirement."[3]

2. Amending Cash and Equity Plans

ISS has reorganized its existing policy on amending cash and equity plans to clarify its "approach for evaluating the different types of proposals involving amendments to cash and equity incentive plans." Most notably, ISS's revised policy clarifies that ISS will generally recommend a vote in favor of proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal "[s]eeks approval for Section 162(m) purposes only, and the plan administering committee consists entirely of independent outsiders, per ISS' Categorization of Directors." Conversely, ISS will generally recommend a vote against proposals to amend executive cash, stock, or cash and stock incentive plans if the proposal "[s]eeks approval for Section 162(m) purposes only, and the plan administering committee does not consist entirely of independent outsiders, per ISS' Categorization of Directors." ISS will recommend a vote case-by-case on all other proposals to amend cash incentive plans, including those "presented to shareholders for the first time after the company's IPO and/or proposals that bundle material amendment(s) other than those for Section 162(m) purposes." Finally, ISS will also take a case-by-case approach to all other proposals to amend equity incentive plans, taking several enumerated factors into account.

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[3] ISS has indicated that it plans to provide additional information regarding modifications to the equity plan scorecard policy in its FAQs to be updated next month.

3. Shareholder Ratification of Director Pay Programs

In response to recent lawsuits alleging that non-employee directors were excessively compensated and the attendant increase in management proposals seeking shareholder ratification of non-employee director pay programs, ISS has adopted a new policy, indicating that it will take a case-by-case approach to management proposals seeking the ratification of non-employee director compensation. If the equity plan under which non-employee director grants are made is on the ballot, ISS will consider whether or not the plan warrants support. In addition, ISS will take into account the following qualitative factors:

- the relative magnitude of director compensation as compared to companies of a similar profile;
- the presence of problematic pay practices relating to director compensation;
- director stock ownership guidelines and holding requirements;
- equity award vesting schedules;
- the mix of cash and equity-based compensation;
- meaningful limits on director compensation;
- the availability of retirement benefits or perquisites; and
- the quality of disclosure surrounding director compensation.

4. Equity Plans for Non-Employee Directors

Under its updated policy, ISS will continue to evaluate equity plans for non-employee directors on a case-by-case basis. ISS has clarified, however, that when assessing the reasonableness of equity plans for non-employee directors, it will consider, among other factors, "[t]he presence of any egregious plan features (such as an option repricing provision or liberal CIC vesting risk)." ISS has also updated the list of factors it will consider in cases where director stock plans exceed the plan cost or burn rate benchmarks when combined with employee or executive stock plans. In such cases, ISS will consider the same qualitative factors it will consider in its evaluation of proposals seeking shareholder ratification of non-employee director compensation plans (see "Shareholder Ratification of Director Pay Programs," above). In contrast to ISS's previous policy, under which ISS would recommend a vote in favor of the plan if all of several enumerated qualitative factors regarding the board's compensation were met and disclosed in the company's proxy statement, ISS will now look "holistically at all of the factors."

5. Executive Pay Assessments (Cross-Market Companies)[4]

   Companies listed in the U.S. but incorporated in a different country may be required to include, on the same ballot, several compensation proposals relating to the same pay program (e.g., a say-on-pay advisory vote required under U.S. and U.K. law and a forward-looking binding vote on remuneration policy, mandated only by U.K. law). Under ISS's current approach, "items that are on the ballot solely due to the requirements of another market (listing, incorporation, or national code) may be evaluated under the policy of the relevant market, regardless of the 'assigned' market coverage." ISS has now adopted a policy, applicable only to U.S. domestic issuers organized abroad, that provides that where such issuers have multiple compensation proposals on the ballot pertaining to the same program, ISS will base its recommendations for proposals required by foreign law on its U.S. policy for that program (e.g., ISS's U.S. say-on-pay policy for proposals relating to executive pay).

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

A. Director Overboarding

As Glass Lewis announced last year, beginning in 2017, the proxy advisory firm will generally recommend voting against "a director who serves as an executive officer of any public company while serving on more than two public company boards and any other director who serves on more than five public company boards." Glass Lewis will generally not recommend a vote against an overboarded director at the company where he or she also serves as an executive officer.

Glass Lewis's policy further specifies that, in its evaluation of directors' commitments, it "may consider relevant factors," including:

- "the size and location of the other companies where the director serves on the board;
- the director's board roles at the companies in question;
- whether the director serves on the board of any large privately-held companies;
- the director's tenure on the boards in question; and
- the director's attendance record at all companies."

Additionally, Glass Lewis may determine not to recommend a vote against an overboarded director if the company provides "sufficient rationale" for that director's continued board service. According to Glass Lewis,

[4] While a summary of this policy update has been included in a November 21st e-mail from ISS to its subscribers which outlined ISS's key policy changes for the 2017 proxy season, this policy does not seem to appear in ISS's Americas Proxy Voting Guidelines Updates: 2017 Benchmark Policy Recommendations or its Executive Summary: Proxy Voting Guidelines Updates and Process, both of which were published on the same date.

the company's rationale "should allow shareholders to evaluate the scope of the directors' other commitments, as well as their contributions to the board including specialized knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide, and other relevant factors."

Finally, under its revised policy, Glass Lewis will generally refrain from recommending that shareholders vote against "a director who serves on an excessive number of boards within a consolidated group of companies or a director that represents a firm whose sole purpose is to manage a portfolio of investments which include the company."

B. Governance Following an IPO or Spin-Off

Glass Lewis has adopted a new policy, providing that, where it believes that the board of a newly-public company approved "governing documents that significantly restrict the ability of shareholders to effect change," it may recommend a vote against governance committee members or directors who served at the time of the governing documents' adoption, "depending on the severity of the concern." In its evaluation, Glass Lewis will consider:

- the adoption of anti-takeover provisions, such as a poison pill or classified board;
- supermajority vote requirements to amend governing documents;
- the presence of exclusive forum or fee-shifting provisions;
- whether shareholders can call special meetings or act by written consent;
- the voting standard provided for the election of directors;
- the ability of shareholders to remove directors without cause; and
- the presence of evergreen provisions in the company's equity compensation arrangements.

Under the new policy, where the board adopts an anti-takeover provision prior to the IPO, Glass Lewis will consider recommending a vote against directors who served when the provision was adopted, if the board:

- did not commit to submitting the anti-takeover provision to a shareholder vote at the company's first post-IPO shareholder meeting; and
- "did not provide a sound rationale or sunset provision for adopting the anti-takeover provision in question."

C. Board Evaluation and Refreshment

Glass Lewis has revised its policy on board refreshment to clarify that it believes that "a robust board evaluation process – one focused on the assessment and alignment of director skills with company strategy –

is more effective than solely relying on age or tenure limits." While acknowledging that "age limits can aid board succession planning," Glass Lewis notes that "the long-term impact of age limits restricts experienced and potentially valuable board members from service through arbitrary means." Glass Lewis believes that shareholders are better served by "monitoring the board's overall composition, including its diversity of skill sets, the alignment of the board's areas of expertise with a company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules that don't necessarily correlate with returns or benefits for shareholders."

D. Shareholder Proposals Regarding Gender Pay Equity

Glass Lewis has codified its policy on shareholder proposals that request increased disclosure regarding the company's efforts to ensure gender pay equity. Glass Lewis will take a case-by-case approach to such proposals, taking into account:

- the company's industry;
- the company's current policies, efforts and disclosure with regard to gender pay equity;
- the practices and disclosure of peer companies; and
- any relevant legal and regulatory actions at the company.

Glass Lewis will "consider supporting well-crafted shareholder resolutions requesting more disclosure on the issue of gender pay equity in instances where the company has not adequately addressed the issue and there is credible evidence that such inattention presents a risk to the company's operations and/or shareholders."

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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