

M O R R O W S O D A L I

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PROXY UPDATE

GLASS LEWIS PROXY VOTING GUIDELINES: 2019 UPDATES

Glass Lewis has released 2019 updates to its Proxy Paper Guidelines, which will go into effect for meetings on or after January 1, 2019. Glass Lewis has added several new guidelines and updated or codified others. Of note, in 2019 Glass Lewis' board gender diversity policy will go into effect and Glass Lewis will generally recommend Against directors at companies that do not have at least one female director. Glass Lewis has also added guidelines on several executive compensation issues that could impact the firm's recommendations on say-on-pay and compensation committee members.

Overall, these policy updates increase the focus on ESG, diversity and compensation matters; and it will be important that companies understand how these policy changes could impact voting in 2019. Below is a summary of the key policy changes and additions.

Board Gender Diversity

Glass Lewis ("GL") added a Board Gender Diversity policy (defined as having at least one female director on the board) in 2018. 2018 was a phase-in year in which GL was simply "noting" concern (rather than making a voting recommendation) in their Proxy Papers when a board lacked gender diversity.

In 2019, GL will begin to take action and will "generally" (read most likely) recommend Against the chair of the nominating committee, and possibly other committee members, if there are no female board members. In making its recommendation, GL may refrain from making Against recommendations on companies outside of the Russell 3000 index, or when the company has robust disclosure including a timetable for addressing the lack of diversity or where there are notable restrictions on board composition (such as agreements with significant shareholders).

GL also notes that California has passed a law that requires all companies headquartered in the state to have at least one female board member by the end of 2019. As a result, GL will recommend Against the chair of the nominating committee if a California-headquartered company does not have at least one female director by the end of 2019 or has not disclosed a clear plan for how the company will address the issue before the end of 2019.

Environmental and Social Risk Oversight

GL has codified and clarified its policy on environmental and social risk. GL clarified that for large-cap companies and where GL identifies “material oversight issues”, it will review the governance practices of the companies and identify directors and board-level committees charged with oversight of E&S issues. Where it is clear that a company has not properly managed or mitigated E&S risk that could impact shareholder value, GL may recommend a vote Against members of the board responsible for E&S oversight or, in the absence of disclosure of explicit board oversight on E&S issues, GL may recommend an Against vote on members of the audit committee.

Director Recommendations on the Basis of Company Performance

In its prior policy regarding Against recommendations on director nominees resulting from poor company performance, GL had a red line trigger to recommend Against a director who served on the board of a company that had performance in the bottom quartile of its sector for the last three years. That provision has been clarified to state that in addition to poor performance vs. peers, GL will also consider the company’s overall corporate governance, pay-for-performance and board responsiveness to shareholders.

Factors in Evaluating Say-on-Pay Proposals and Compensation Committee Members

In evaluating say-on-pay proposals and compensation committee members, GL will now consider additional factors:

NEW - Contractual Payments and Arrangements.

GL has added a new policy (almost a page in length) on contractual payments and arrangements and lists a variety of compensation practices that could cause an Against recommendation on say-on-pay. These include: sign-on arrangements and make-whole payments that are not clearly disclosed, multi-year bonus guarantees, severance that is above the upper limit of general market practice, poor design of key-man clauses and board continuity conditions, excessively broad change in control triggers, poor wording of employment agreements, and excise tax gross-ups on golden parachutes.

NEW - Grants of Front-Loaded Awards.

GL has added a new policy (half a page this time) on grants of front-loaded awards. Generally, GL states that it is “wary” of the practice of companies providing large grants (usually equity awards) that are intended to provide compensation for multiple years (a practice known as front-loading). GL notes that while front-loaded awards may lock-in the services of an executive, they risk tying the hands of the compensation committee. Also, GL notes that a front-loaded grant, as opposed to an annual grant, can preclude improvements or changes as circumstances change, and there is the potential for perverse incentives and unintended consequences. In making a determination on a company’s executive compensation program, GL would consider the company’s rationale for granting the award and expect a firm commitment that there would be no additional awards for a defined period. If a company were to break that commitment, the company can expect an Against recommendation on say-on-pay.

Excise Tax Gross-ups.

The inclusion of tax gross-up provisions has been added as an additional factor that GL will consider when reviewing a company’s compensation practices. The inclusion of gross-ups may contribute to an against recommendation on say-on-pay and could also lead to an against recommendation on members of the compensation committee, especially if the committee ignores a previous pledge to not provide tax gross-ups.

Recoupment Provisions (“Clawbacks”).

GL has clarified its policy on clawbacks, noting that it is looking to see if the terms of a company’s clawback policy go beyond just the current legal requirements. The absence of more expansive recoupment tools could result in an Against recommendation on say-on-pay.

Smaller Reporting Company (SRC) Disclosure.

For 2019, the SEC has provided that SRCs can reduce their compensation disclosure requirements and only disclose 2 years of summary compensation for the top 3 executives. In addition, SRCs are not required to provide a CD&A discussion. GL has indicated that if a company fails to provide sufficient disclosure of its compensation policies (what GL refers to as “incomplete or absent discussion on compensation”) GL may recommend Against on say-on-pay and the compensation committee solely on that basis.

Conflicting and Excluded Proposals

GL has significantly expanded this policy by now also addressing excluded proposals. The 2018 policy only addressed conflicting proposals. GL states clearly that they believe the exclusion of shareholder proposals because of conflicting management proposals is “especially problematic”. GL will “make note” of instances where a company has excluded a shareholder proposal based on no-action relief from the SEC; but may recommend Against members of the governance committee if GL believes the exclusion is detrimental to shareholders.

GL also addresses proposals that seek to allow shareholders to call a special meeting. GL says they generally favor a 10-15% right. In the event there are conflicting management and shareholder proposals on the right for shareholders to call a special meeting on the agenda, GL will generally recommend for the lower threshold.

In the event that a company excludes a shareholder proposal seeking a reduced special meeting right by means of ratifying a management proposal that is “materially different” from the shareholder proposal, GL will generally recommend Against the chair of the governance committee.

Virtual-Only Shareholder Meetings

The GL policy on virtual-only shareholder meetings which was announced in November 2017, will go in to effect on January 1, 2019. While GL believes virtual meeting technology can complement a traditional, in-person meeting by increasing participation, it is concerned that a virtual-only meeting could stifle meaningful communication with management and the board. Therefore, for companies that hold a virtual-only meeting, GL will look for “robust” disclosure in the proxy to assure shareholders will have the same “rights and opportunities to participate” as they would at an in-person meeting.

In this year’s policy GL lists examples of “effective” disclosure, including: the ability of shareholders to ask questions during the meeting and procedures for asking questions (including time guidelines, types of questions allowed, how questions will be recognized and disclosed to meeting participants), procedures, if any, for posting questions on the investor page of the company’s website during and after the meeting, and procedures for accessing technical help during the virtual meeting.

In the absence of such disclosure GL will “generally” recommend against members of the governance committee.

NOL Protective Amendment

In the past, while GL would generally recommend For a proposal to adopt an NOL pill, it would generally vote against a separate proposal, which often accompanies the NOL pill proposal, seeking “protective amendments” such as restricting certain share transfers. GL has changed its policy and will now support the separate amendment proposal (as well as the NOL pill) if it deems the terms to be reasonable.

Auditor Ratification

GL has added additional factors that it will consider in deciding on how to recommend on the ratification of auditors. These factors, which may call into question the auditor’s effectiveness and whether shareholders would benefit from rotating the company’s auditors, include auditor tenure, a pattern of inaccurate audits and any on-going litigation or significant controversies.

NEW - Director and Officer Indemnification

In the Governance Structure section of its guidelines, GL has added a section on director and officer indemnification. GL states that while directors and officers should be held to the highest standards when carrying out their duties, some reasonable protection from liability against certain law suits is appropriate so that officers feel comfortable in taking some reasonable risks that may benefit shareholders

NEW - Quorum Requirements

GL has added a policy on quorums for shareholder meetings and will support proposals seeking to lower quorum to at least one-third of the shares entitled to vote.

We will monitor how the new GL guidelines impact voting in 2019 and update our clients to any significant developments.

In the meantime, please contact your Morrow Sodali representative if you have any questions.