PJT Camberview

Glass Lewis Releases 2019 Policy Guidelines

Heightened Focus on E&S Issues and Materiality; Board Diversity and Virtual Meeting Policies go into Effect; Conflicting Proposals get Greater Clarity

On Wednesday, October 24, Glass Lewis released its 2019 Policy and Shareholder Resolutions Guidelines for U.S.-based companies and shareholder initiatives. The policy updates this year are extensive with 17 named policy changes highlighted at the top of the updated U.S. guidelines and six changes highlighted regarding shareholder proposal-specific changes (with some overlap between the two updates). However, rather than transforming existing approaches, these changes primarily provide greater clarity about existing policies or practices, including oversight of environmental and social risk.

Updated Policies Reflect Investors' Evolving Views

Glass Lewis updated several governance and shareholder proposal policies for the 2019 proxy season to reflect developing investor sentiment, including:

- E&S Risk Oversight – Glass Lewis enhanced the language around how it evaluates board oversight (including outlining directors' responsibilities) of environmental and social risk with a focus on materiality. The proxy advisor clarified that it may recommend against directors responsible for environmental and social risk oversight in instances where it believes that companies have not properly managed or mitigated those risks to the detriment of shareholder value. If this oversight responsibility is not explicitly assigned, Glass Lewis may recommend against members of the audit committee
- Excluding Proposals – Glass Lewis will recommend against members of the governance committee in very limited circumstances where it determines that the exclusion of a shareholder proposal was "detrimental to shareholders"
- Materiality – Glass Lewis formalized its consideration of materiality when reviewing and making voting recommendations on shareholder resolutions, highlighting that it will evaluate the company-specific financial implications of adopting or not adopting a shareholder resolution and consider the industry-specific standards developed by the Sustainability Accounting Standards Board (SASB)
- Written Consent – Glass Lewis adjusted its approach to written consent shareholder proposals in instances where companies have implemented both proxy access and a special meeting right with a threshold of 15% or lower. In those instances, it will generally recommend against shareholder proposals that request companies adopt a shareholder right to action by written consent
- Diversity Reporting – Glass Lewis will generally vote in favor of shareholder proposals requesting additional disclosure on employee diversity and steps companies are taking to promote diversity within their ranks

Glass Lewis updated a number of compensation-related policies, including:

- Excise Tax Gross-Ups – When new excise tax gross-ups are provided for in executive employment agreements, Glass Lewis will consider recommending against members of the compensation committee, particularly in situations where a company previously committed not to provide any such entitlements in the future
- Front-Loaded Awards – Glass Lewis will apply particular scrutiny to front-loaded awards, noting the risk implications of such grants, and may recommend against say on pay if a company breaks its commitment not to grant further awards for a defined period absent a convincing rationale
- Clawbacks – If a company maintains only a "bare-minimum" clawback provision, the absence of more expansive recoupment tools may "inform our overall view of the compensation program"

- **Non-Formulaic Bonus Plans** – If a company has chosen to rely primarily on a subjective assessment or the board's discretion in determining short-term bonuses, in conjunction with other significant issues in a program's design or operation, the use of a non-formulaic bonus may cause Glass Lewis to recommend against say on pay
- **CD&A Disclosure** – Glass Lewis will now consider recommending against members of the compensation committee where a material reduction in CD&A disclosure substantially impacts shareholders' ability to make an informed assessment of the company's executive pay practices. This change was driven by a June 2018 amendment to the SEC's definition of a "smaller reporting company" that expanded the scope of companies that can provide reduced disclosures
- **Contractual/Severance Arrangements** – Glass Lewis significantly increased its discussion of contractual and severance arrangements. It notes that while guaranteed bonuses are not exceedingly problematic in the short term, multi-year guarantees may on their own cause them to recommend against say on pay

Codification and Clarification of Existing Practices, Including Special Meeting Shareholder Resolutions

Several changes outlined in Glass Lewis's Policy Guidelines are codifications or clarifications of existing policies and practices. A notable change in 2019 is the codification of a policy on special meeting shareholder resolutions. Last year, Glass Lewis recommended against all special meeting ratification proposals and most nominating and governance committee chairs at six companies that put forth management proposals to ratify existing special meeting rights after being granted no-action relief by the SEC to exclude shareholder proposals to reduce the special meeting threshold. This year, that voting determination has been codified into policy.

Glass Lewis writes:

- In instances where companies place on the ballot both a management and shareholder proposal requesting different thresholds for the right to call a special meeting, Glass Lewis will generally recommend voting for the lower threshold (in most instances the shareholder proposal) and recommend voting against the higher threshold
- In instances where there are conflicting management and shareholder special meeting proposals and the company does not currently maintain a special meeting right, Glass Lewis may consider recommending that shareholders vote in favor of the shareholder proposal and recommending that shareholders abstain from voting on management's proposal
- In instances where companies have excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis will typically recommend against the ratification proposal as well as members of the nominating and governance committee

Additionally, Glass Lewis codified the factors that may contribute to a recommendation against auditor ratification, including auditor tenure, a pattern of inaccurate audits and ongoing litigation or significant controversies that call into question the auditor's effectiveness.

Board Diversity and Virtual Meetings Policies Take Effect in 2019

Last year, Glass Lewis announced two new policies – board gender diversity and virtual shareholder meetings – that will take effect for meetings held on or after January 1, 2019. The delayed effective date for these new policies was intended to provide companies with an opportunity to adjust their practices or disclosure before facing negative recommendations.

- Under the updated board gender diversity policy, Glass Lewis will generally recommend against the nominating/governance committee chair of a board with no female members and, depending on other factors, may extend this recommendation to vote against other nominating committee members. This recommendation will be made after close examination of disclosure on board diversity considerations and other relevant factors.

- For companies that hold virtual meetings without an option of in-person attendance, Glass Lewis will "recommend voting against members of the governance committee if the company does not provide disclosure assuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting"

Takeaways for Issuers

Directionally, Glass Lewis's policy and shareholder proposal updates are reflective of institutional investors' heightened focus on board oversight of environmental and social topics and continued scrutiny of compensation matters. The 2019 updates, codifications and clarifications should lead to more consistent application of existing approaches. In particular, the new policies on board gender diversity, virtual meetings and exclusion of shareholder proposals have the potential to generate more votes against directors. Companies should consider whether any of the new policies and changes necessitate a review of disclosure or potential changes to documentation of oversight responsibilities to avoid unwarranted scrutiny.

The months ahead are shaping up to be a critical time period for proxy advisors. In September, the SEC rescinded a pair of 14-year-old no-action letters which had provided assurances that investment advisors could rely on proxy advisor recommendations for their annual votes at public companies. The move came in preparation for a fall Proxy Process roundtable set to be hosted by the SEC later this month which is expected to cover a number of issues including proxy advisors, shareholder proposals and proxy plumbing. These actions come on the heels of several Congressional initiatives seeking to examine and regulate proxy advisors. Taken together, it is clear that there will be a continued focus across the market on the policies, practices and transparency of proxy advisors for the foreseeable future.

Authors

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About PJT Camberview

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