

Publications

Securities Alert: ISS and Glass Lewis Issue 2015 Corporate Governance Policy Updates

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Institutional Shareholder Services Inc. (ISS) and Glass Lewis & Co., LLC (Glass Lewis) recently released updates to their respective proxy voting guidelines for 2015 (2015 Updates). ISS's 2015 Updates will be effective for shareholder meetings held on or after February 1, 2015 and Glass Lewis's 2015 Updates will be effective for shareholder meetings held on or after January 1, 2015. The key highlights of the 2015 Updates are summarized below.

2015 Updates to ISS Proxy Voting Guidelines

Adoption of Bylaw or Charter Amendments without Shareholder Approval

ISS will now recommend that shareholders vote against or withhold votes from individual directors, committee members or the entire board if the board amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders. ISS will consider the following factors when evaluating such amendments:

- the board's rationale for adopting the amendment without shareholder approval;
- disclosure by the company of any significant engagement with shareholders regarding the amendment;
- the level of impairment of shareholders' rights caused by the board's unilateral adoption of the amendment;
- the board's track record with regard to unilateral board action on bylaw/charter amendments or other entrenchment provisions;
- the company's ownership structure and existing governance provisions;
- whether the amendment was made prior to or in connection with the company's IPO; and
- the timing of the board's amendment to the bylaws/charter in connection with a significant business development.

Independent Chair Shareholder Proposals

ISS has added new governance, board leadership and performance factors to its existing policy regarding shareholder proposals that seek an independent chair of the board. Under the updated policy, ISS will generally recommend that shareholders vote for independent chair proposals, subject to the following considerations:

- the scope of the proposal, including whether the proposal is precatory or binding and whether it seeks an immediate change in the chair role or could be implemented in connection with the appointment of the next CEO;
- the company's current board leadership structure and whether any of the following circumstances exist: (a) an executive or non-independent chair in addition to the CEO; (b) a recent combination of the role of CEO and chair; and (c) a departure from a structure with an independent chair;
- the impact any recent transitions in board leadership may have on independent board leadership; and
- the company's governance structure, practices and performance.

ISS expects to support more independent chair shareholder proposals under the updated policy than under its existing policy.

Shareholder Approval of Litigation-Related Bylaws

ISS will assess bylaw amendment proposals that impact the ability of shareholders to bring a suit against a company, including exclusive forum and fee-shifting provisions, on a case-by-case basis. ISS will consider the following factors in its assessment:

- the company's rationale for adopting such a provision;
- disclosure of past harm from shareholder lawsuits in which plaintiffs were unsuccessful or from shareholder lawsuits outside the jurisdiction of incorporation;
- the breadth of the application of the bylaw, including the types of lawsuits to which it applies and the definitions of key terms; and
- the governance features of the bylaw, including whether shareholders will have the ability to repeal the bylaw at a later date or hold directors accountable through annual director elections and a majority vote standard in uncontested elections.

Generally, ISS will recommend that shareholders vote against bylaws that mandate fee-shifting whenever plaintiffs are not completely successful on the merits.

Equity Plan Scorecard

ISS has adopted a new Equity Plan Scorecard model, or EPSC, to evaluate equity incentive plan proposals. The total EPSC score will generally determine whether ISS recommends voting for or against the proposal. The new scorecard system considers a range of positive and negative factors, which fall into three broad categories (the EPSC pillars):

- *Plan Cost.* The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers and considering both:
 - SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
 - SVT based only on new shares requested plus shares remaining for future grants.
- *Plan Features*
 - Automatic single-triggered award vesting upon a change in control;
 - discretionary vesting authority;
 - liberal share recycling on various award types; and
 - minimum vesting period for grants made under the plan.
- *Grant Practices*
 - The company's three year burn rate relative to its industry/market cap peers;
 - vesting requirements in most recent CEO equity grants (three year look-back);
 - the estimated duration of the plan based on the sum of shares remaining available and the new shares requested, divided by the average annual shares granted in the prior three years;
 - the proportion of the CEO's most recent equity grants/awards subject to performance conditions;
 - whether the company maintains a claw-back policy; and
 - whether the company has established post exercise/vesting share-holding requirements.

The weightings of the EPSC pillars will be keyed to each index. For S&P 500 and Russell 3000 companies, the EPSC pillars will be weighted as follows to calculate the total EPSC score: 45% plan cost, 35% grant practices and 20% plan features. ISS will then issue a recommendation based on the company's total EPSC score.

ISS will generally recommend that shareholders vote against a plan proposal if the combination of the factors above indicates that the plan is not in shareholders' interests, or if any of the following apply:

- awards may vest in connection with a liberal change-of-control definition;
- the plan would permit repricing or cash buyout of underwater options without shareholder approval;
- the plan is a vehicle for problematic pay practices or a pay-for-performance disconnect; or
- any other plan features are determined to have a significant negative impact on shareholder interests.

ISS expects to provide additional information regarding its EPSC model in December.

2015 Updates to Glass Lewis Proxy Voting Guidelines

Board Actions on Bylaws

Glass Lewis may recommend that shareholders vote against the chair of the governance committee, or the entire committee, if the board amends its bylaws for any of the following reasons:

- to eliminate the ability of shareholders to call a special meeting or to act by written consent;
- to increase the ownership threshold required for shareholders to call a special meeting;
- to increase the vote requirements for charter or bylaw amendments;
- to adopt provisions that require arbitration of shareholder claims or fee-shifting bylaws;
- to adopt a classified board; or
- to eliminate the ability of shareholders to remove a director without cause.

Material Transactions with Directors

Glass Lewis clarified that, with respect to its \$120,000 threshold for directors employed by a professional services firm where the company pays the firm, not the individual, for services, it may deem the transaction to be immaterial if the amount represents less than 1% of the firm's revenues and the board provides a compelling rationale regarding why the director's independence is not affected by the relationship.

Say-on-Pay

Glass Lewis has expanded its say-on-pay analysis to address additional "one-off" awards. Glass Lewis generally believes that companies should redesign their compensation programs rather than make additional awards if the existing incentive programs fail to provide adequate incentives to executives. However, Glass Lewis now acknowledges that additional incentives may be appropriate in certain circumstances. In such circumstances, companies should (a) provide a thorough description of the awards, including an explanation of their necessity and why existing awards do not provide sufficient motivation, (b) tie such awards to future service and performance whenever possible and (c) describe if and how the regular compensation arrangements will be affected by the additional awards. In reviewing a company's use of additional awards, Glass Lewis will review the terms and size of the grants in the context of the company's overall incentive strategy and granting practices, as well as the current operating environment.

Glass Lewis has also made a change to its pay-for-performance model in instances where a company receives a failing grade under Glass Lewis's pay-for-performance model. If a company receives a failing grade under its model, Glass Lewis is still likely to recommend that shareholders vote against the say-on-pay proposal. However, other qualitative factors, such as an effective overall incentive structure, the relevance of selected performance metrics, significant forthcoming enhancements or reasonable long-term payout levels, may lead Glass Lewis to issue a positive vote recommendation even when there is a disconnect between pay and performance.

Litigation-Related Bylaws

Glass Lewis will now recommend voting against or withholding votes from members of a company's governance committee if the company adopts a fee-shifting bylaw without shareholder approval. Glass Lewis also opposes mandatory arbitration bylaws.

Board Leadership Structure

Class Lewis will now recommend voting against or withholding votes from the chair of a company's governance committee if the company does not have an independent chair or an independent lead director.

