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EXEQUITY

Independent Board and Management Advisors

Client Alert

Glass Lewis' and ISS' 2020 Policy Updates

Recently, both Glass, Lewis & Co. (Glass Lewis)[1] and Institutional Shareholder Services Inc. (ISS)[2] issued their U.S. policy updates for the 2020 proxy season. None of the updates are significant in and of themselves but are likely to impact a select group of companies that have not yet acted with respect to adopting current corporate governance best practices.

Glass Lewis' 2020 Policy Updates

Glass Lewis' policy updates generally clarify and codify positions Glass Lewis has in respect to compensation matters:

- Glass Lewis will generally recommend against all members of the compensation committee when the board adopts a frequency for its advisory vote on executive compensation other than the frequency approved by a plurality of shareholders.
- In assessing say-on-pay proposals, Glass Lewis will review significant changes and modifications, including post-fiscal year-end changes and one-time awards, especially when the changes touch on issues that are material to Glass Lewis recommendations.
- Glass Lewis clarified that inappropriate or insufficient response to low shareholder support for a say-on-pay proposal may cause it to recommend against the next say-on-pay proposal. In general, Glass Lewis' expectations with respect to the appropriate level of responsiveness will correspond with the level of shareholder opposition, as expressed both through the magnitude of opposition in a single year, and through the persistence of shareholder discontent over time.
- Where a company applies upward discretion, which includes lowering goals mid-year or increasing payout, Glass Lewis expects a robust discussion of why the decision was necessary.
- For contractual payments and arrangements, Glass Lewis is generally wary of terms that are excessively restrictive in favor of the executive, or that could potentially incentivize behaviors that are not in a company's best interests. Glass Lewis indicates that in addition to the quantum of pay, it will also consider the design

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[1] Glass Lewis issued its 2020 Policy Guideline Updates—U.S., U.K., Canada, Europe, China, and more, on November 5, 2019, available at: https://www.glasslewis.com/2020-policy-guideline-updates-u-s-u-k-canada-europe-china-and-more.

[2] ISS announced its 2020 Benchmark Policy Updates on November 12, 2019, available at: https://www.issgovernance.com/iss-announces-2020-benchmark-policy-updates.

with certain provisions making it more likely that Glass Lewis will issue a negative vote recommendation, including: excessively broad change-in-control triggers, inappropriate severance entitlements, inadequately explained or excessive sign-on arrangements, guaranteed bonuses (especially as a multi-year occurrence), and failure to address any problematic pay practices in amended employment agreements, which include excessive change-in- control entitlements; modified single-trigger, change-in-control entitlements; excise tax gross-ups; and multi-year guaranteed awards.

- Glass Lewis also clarified its views with respect to change in control, including a section in its policy guidelines that clearly articulates its stance with respect to the following change-in-control items:
  - Inclusion of long-term incentives in cash severance calculations is particularly inappropriate;
  - Change-in-control arrangements should require a double trigger (require both a change in control and termination or constructive termination); and
  - Definitions of change in control should not be excessively broad, as they could lead to situations where executives receive additional compensation where no meaningful change in status or duties has occurred.

Glass Lewis also addressed shareholder proposals given recent SEC guidance on how it will take a more "hands off" approach, which could lead to companies excluding shareholder proposals without the SEC agreeing with such action. In such cases, when a company fails to submit the proposal to shareholder vote, Glass Lewis will generally recommend against members of the governance committee.

Glass Lewis' 2020 policy updates will apply to shareholder meetings on and after January 1, 2020.

ISS' 2020 Policy Updates

ISS' 2020 Policy Updates apply to shareholder meetings on and after February 1, 2020. ISS only included one compensation-related policy change for U.S. public companies. ISS will recommend against any equity plan that includes an evergreen feature that automatically adds shares to the plan without further shareholder action.

Comment*: As a practical matter, this change is unlikely to impact many companies. Most companies have moved away from using evergreen provisions, as they are not viewed as a best practice. Additionally, the method by which ISS analyzed such features (basically, the evergreen percent increase times the common shares outstanding multiplied by the term of the plan) meant that most plans with such features failed the old ISS ISSue Compass model quantitative modeling and the new Equity Plan Scorecard model.*

We also note that 2020 will be the second year of ISS' excessive director pay policy but the first year it will actually be applied, because ISS delayed the effectiveness of this policy until the 2020 proxy season. ISS could issue adverse voting recommendations for board members responsible for approving/setting non-employee director pay if there has been a "recurring pattern of excessive pay magnitude without a compelling rationale" for two or more years. Regarding this policy, we note that it has the same shortcomings as ISS' say-on-pay policy with respect to compensation design changes, i.e., if a company did not get flagged for having excessive non-employee director pay at its 2019 annual meeting (based on 2018 pay), it could be flagged for that at its 2020 annual meeting for its 2019 director pay, and in many cases would be unable to revise its pay program for 2020 director pay as that is typically addressed annually, well before the annual meeting.

However, in the press release announcing the release of its 2020 Policy Updates, ISS indicated that for 2020 Economic Value Added (EVA) metrics would be incorporated into its pay-for-performance (P4P) quantitative assessment as part of the Financial Performance Assessment (FPA). But since ISS views this change to the quantitative P4P test as not a policy change, the full details of this change were not disclosed in ISS' 2020 Policy Updates.

Comment*: See the discussion below concerning the preliminary compensation FAQs ISS released on November 21, 2019[3] which address how EVA will be incorporated into FPA.*

Additionally, ISS made its policy with respect to Board Gender Diversity final. Starting February 1, 2020, ISS will generally vote against or withhold from the chair of the nominating committee at Russell 3000 and S&P 1500 companies if they do not have at least one woman on their boards. ISS then identified several mitigating factors:

- Until February 1, 2021, the company makes a firm commitment to appoint at least one woman to the board within a year;
- A woman was on the board at the preceding annual meeting and the company makes a firm commitment to appoint at least one woman to the board within a year; and
- Other relevant factors.

Comment*: If a Russell 3000 or S&P 1500 company does not have or expect to have at least one woman on its board at its next shareholder meeting in 2020, it should review the mitigating factors and see whether it could comply with ISS' requirements in order to avoid ISS issuing against vote recommendations for the chair of its nominating committee.*

Finally, the new ISS policies target problematic governance structures of newly public companies. Specifically, if before going public a company adopts supermajority vote requirements to amend the bylaws or charter, adopts a classified board structure, or any other egregious provisions without a reasonable sunset provision, ISS will generally vote against or withhold from directors individually, committee members, or the entire board. ISS will vote on a case-by-case basis on directors in subsequent years if the adverse provision is not reversed or removed.

Additionally, if before going public a company adopts a multi-class capital structure in which the classes have unequal voting rights without a reasonable sunset provision (any period greater than seven years ISS will not consider reasonable), ISS will generally vote against or withhold from the entire board. In subsequent years, ISS will continue to vote against or withhold from incumbent directors unless the problematic capital structure is reversed or removed.

Comment: *As a practical matter, if a company does implement a multi-class capital structure with unequal voting rights, the impact of an ISS against or withhold recommendation is likely to be negligible.*

[3] ISS United States Compensation Policies for 2020 Preliminary Frequently Asked Quested, November 21, 2019, available at: https://www.issgovernance.com/file/policy/latest/americas/US-Preliminary-Compensation-FAQ.pdf.

ISS' Preliminary Compensation FAQs

On November 21, 2019, ISS released a set of preliminary compensation FAQs. The FAQs indicate that for meetings on and after February 1, 2020, ISS will determine FPA only using its EVA metrics, but will still disclose GAAP metrics in its proxy reports.

The FAQs also indicate that ISS will decrease the quantitative thresholds for both the Relative Degree of Alignment (RDA) and Pay-TSR Alignment (PTA) as follows:

2019 vs. 2020 Quantitative Thresholds: All Us Companies				
Measure	**Policy Year**	**Eligible for FPA Adjustment**	**Medium Concern**	**High Concern**
RDA	2019	-28	-40	-50
	2020	**-38**	**-50**	**-60**
PTA	2019	-13%	-20%	-35%
	2020	**-22%**	**-30%**	**-45%**

Comment*: These changes effectively require worse scores in 2020, which may make it less likely for companies to fall into higher levels of concern under these ISS quantitative P4P tests.*

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