December 7, 2020

Skadden

SEC Reporting & Compliance Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

One Manhattan West
New York, NY 10001
212.735.3000

ISS and Glass Lewis Release Updated Proxy Voting Guidelines

Proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis recently announced updates to their proxy voting guidelines for the 2021 proxy season.[1] These updates reflect institutional investors' increased focus on board diversity and refreshment, as well as environmental, social and governance matters. The key voting policy updates are summarized below.

Board Diversity. Institutional investors have become much more vocal in their calls for public company boards of directors to become more diverse.[2] Reflecting those efforts, both ISS and Glass Lewis have enhanced their policies relating to board diversity.[3]

ISS. For 2021, with respect to companies in either the Russell 3000 or S&P 1500 indices, ISS will flag in its reports those company boards with no apparent racial or ethnic diversity. When analyzing the diversity of company boards, ISS will consider aggregate diversity statistics only when limited to racial and ethnic diversity (*i.e.*, not when racial/ethnic diversity and gender diversity are provided as a combined statistic). Beginning with annual meetings held on or after February 1, 2022, for companies in these indices, ISS will recommend against nominating committee chairs (or other directors on a case-by-case basis) where the board has no apparent racially or ethnically diverse members (unless the board had a racially/ethnically diverse member at the previous annual meeting and makes a commitment to add a racially/ethnically diverse director within the next year).

With respect to gender diversity, for companies in either the Russell 3000 or S&P 1500 indices, ISS will continue its policy of recommending against nominating committee chairs (or other directors on a case-by-case basis) of all-male boards. ISS has phased out its grace period for all-male boards that committed to add a female director within a year (unless the board included a female member at the previous annual meeting and makes a commitment to add a female director within the next year).

[1] See ISS' "United States Proxy Voting Guidelines — Benchmark Policy Recommendations." For a summary of ISS' 2020 updates for the U.S., Canada and Latin America, see ISS' "Americas Proxy Voting Guidelines Updates for 2021." For an executive summary of all policy updates to ISS' global proxy voting guidelines, see ISS' "ISS Benchmark Policy Updates — Executive Summary."

See Glass Lewis' "2021 Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice — United States" and Glass Lewis' "2021 Guidelines: Environmental, Social & Governance ("ESG") Initiatives."

[2] See our December 1, 2020, client alert "Preparing for the Shareholder Proposal Season."

[3] For information on Nasdaq's rule proposal regarding disclosure of board diversity statistics, see our December 4, 2020, client alert "Nasdaq Proposes New Board Diversity Requirements."

Glass Lewis. For 2021, in addition to Glass Lewis' current policy of generally voting against nominating committee chairs of all-male boards, the firm will note as a concern boards having only one woman board member. Beginning in 2022, Glass Lewis generally will recommend against nominating committee chairs of boards with less than two female directors (on boards with seven or more total directors).

In addition, Glass Lewis generally will make voting recommendations in accordance with board diversity requirements under applicable state laws, such as the California statutes requiring companies headquartered in the state to have a specified number of female directors and a specified number of directors from underrepresented communities.[4]

Beginning in 2021, for companies in the S&P 500 index, Glass Lewis reports will include an assessment of the company's proxy disclosure relating to board diversity, director skills and the director nomination process. Specifically, Glass Lewis will consider:

- the current percentage of racially/ethnically diverse directors;
- whether the board's definition of diversity explicitly includes gender, race or ethnicity;
- whether the board has a "Rooney Rule" policy requiring diverse candidates to be included in the initial pool of candidates when selecting new directors; and
- board skills disclosure.

Although Glass Lewis will not make voting recommendations solely on the basis of this assessment in 2021, the assessment may be a contributing factor in recommendations when other board-related concerns have been identified.

Board Refreshment/Tenure. Although investor concerns regarding a lack of board refreshment relate to staleness of director skills and erosion of independence, investors also consider a lack of board refreshment an impediment to increasing board diversity. Beginning in 2021, Glass Lewis will note as a concern instances where the average tenure of nonexecutive directors is 10 years or more and no new independent directors have joined the board in the past five years. Although Glass Lewis will not make voting recommendations solely on this basis in 2021, insufficient board refreshment may be a contributing factor in recommendations when other board-related concerns have been identified.

ISS has changed its policy from generally voting against shareholder proposals calling for director term limits to considering such proposals on a case-by-case basis, taking into account the scope of the proposal and the evidence of problems at the company combined with, or exacerbated by, a lack of board refreshment.

Environmental and Social Risk Oversight. Glass Lewis believes that companies and boards are best positioned to determine the appropriate board oversight structure for environmental and social risks at their particular companies — *e.g.*, oversight by the full board, an existing board committee or a new board committee – but that there should be transparency as to where at the board level the environmental and social risk oversight occurs. Beginning in 2021, for companies in the S&P 500 index, Glass Lewis will note as a concern the absence of clear disclosure concerning board-level oversight for environmental and social issues. Beginning in 2022, for S&P 500 companies, Glass Lewis generally will recommend against governance committee chairs for the failure to provide this disclosure.

Existing ISS policy calls for negative recommendations against directors in the event of material failures of governance, stewardship or risk oversight. ISS updated its list of examples of risk oversight failures to include "demonstrably poor risk oversight of environmental and social issues, including climate change."

Virtual Shareholder Meetings. The number of companies holding virtual shareholder meetings grew exponentially as a result of the COVID-19 pandemic.[5] Although — during the early days of the pandemic — Glass Lewis had suspended its policy relating to virtual shareholder meetings, the firm's standard policy is again in effect. For companies holding virtual shareholder meetings, Glass Lewis expects "robust" disclosure in the company's proxy statement addressing the ability of shareholders to participate in the meetings. This includes disclosure relating to shareholders' ability to ask questions at the meeting; procedures, if any, for posting appropriate questions received during the meeting and company responses on the company's website; and logistical details for meeting access and technical support.

For 2021, ISS has adopted a new policy of voting case-by-case on shareholder proposals concerning virtual-only shareholder meetings that considers the scope of the proposal and any concerns identified with the company's prior virtual meeting practices.

[4] See our client alerts from October 1, 2018, "California to Require Inclusion of Female Directors at Public Corporations Based in the State" and October 2, 2020, "New California Law Becomes First in Nation To Require Diversity on Boards of Public Companies."

[5] See our September 30, 2020, client alert "Planning Ahead: Virtual Shareholder Meetings in the 2021 Proxy Season."

Exclusive Forum Provisions. ISS will continue its policy of reviewing exclusive forum provisions for state law matters on a case-by-case basis, although under its updated policy the firm will generally vote in favor of Delaware exclusive forum provisions for Delaware corporations. Unilateral board adoption of an exclusive forum provision specifying a state other than the company's state of incorporation, or of a particular local court within the state, will be viewed as a one-time governance failure, which could result in a recommendation against directors.

In light of the March 2020 Delaware Supreme Court decision permitting Delaware corporations to include federal forum provisions in their governing documents, ISS will generally recommend voting for federal forum selection provisions that specify the district courts of the U.S. as the exclusive forum for federal securities law matters, but will recommend voting against provisions that restrict the forum to a particular federal district court.[6] Similarly, unilateral board adoption of a federal forum provision specifying a particular federal district court will be viewed as a one-time governance failure, which could result in a recommendation against directors.

Special Purpose Acquisition Companies (SPACs). Glass Lewis has adopted a new policy regarding its approach to SPACs. Where an executive of the pre-merger SPAC becomes a director of the post-merger company, Glass Lewis generally will not view the pre-merger SPAC role as an impediment to director independence unless there is evidence of an employment relationship or continuing material financial interest in the post-merger company.

Compensation. Glass Lewis' guidelines include the following compensation updates for 2021:

- **Disclose Short-Term Incentive Plan Changes.** Companies should disclose and justify any significant changes to their short-term incentive plan structures and instances in which target or maximum performance goals have been lowered compared with last year. Moreover, Glass Lewis will consider retroactively prorated performance periods to be an application of upward discretion, which should be disclosed.
- **Disclose Equity Granting Practices and Long-Term Incentive Plan Changes.** When evaluating long-term incentive plan structure, Glass Lewis will now consider whether equity granting practices are clearly disclosed. Significant structural program changes to long-term incentive equity compensation and any application of upward discretion also should be clearly disclosed and explained.
- **Retain Performance-Based Awards.** Glass Lewis explicitly stated that a shift away from performance-based award allocation or the elimination of performance-based awards from a company's long-term incentive plan will generally be viewed as a regression of best practices outside of exceptional circumstances and may give rise to a negative vote recommendation. Glass Lewis also highlighted its general preference for performance-based long-term incentive awards.
- **Tread Carefully on Option Exchange Programs and Repricing Proposals.** Glass Lewis emphasized that option exchange programs and repricing proposals should be value-neutral or value-creative and should exclude officers and board members, while generally retaining its opposition to option exchanges and repricing proposals.
- **Beware of Tax Gross-Ups.** Glass Lewis reinforced its opposition to excise tax gross-ups, noting that new excise tax gross-ups in connection with specific change-in-control transactions may trigger negative vote recommendations beyond the applicable golden parachute proposal. Accordingly, the firm may consider issuing negative vote recommendations against the compensation committee members and the next say-on-pay proposals of any involved corporate parties.
- **Understand the Peer Group.** Glass Lewis disclosed additional details regarding how it selects peer groups for its proprietary pay-for-performance analysis. Specifically, in determining such peer groups, the firm uses a proprietary methodology that considers country-based and sector-based peers, along with the applicable company's network of self-disclosed peers. Glass Lewis will use the peer group it identifies based on its independent methodology for its pay-for-performance analysis but also will present the company's self-selected peer group in the proxy paper research report for comparative purposes.

* * *

Companies should assess the potential impact of these voting recommendations on matters to be considered by their shareholders during the 2021 proxy season and determine whether any steps should be taken to address the impact.

[6] See our November 25, 2020, client alert "Within Three Months, a Second California State Court Enforces a Federal Forum Charter Provision for Securities Act Claims."

Contacts

Brian V. Breheny
Partner / Washington, D.C.
202.371.7180
brian.breheny@skadden.com

Marc S. Gerber
Partner / Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Richard J. Grossman
Partner / New York
212.735.2116
richard.grossman@skadden.com

Regina Olshan
Partner / New York
212.735.3963
regina.olshan@skadden.com

Stephanie Birndorf
Associate / Palo Alto
650.470.3117
stephanie.birndorf@skadden.com

Blake M. Grady
Associate / Washington, D.C.
202.371.7591
blake.grady@skadden.com