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Heads Up for the 2017 Proxy Season:

ISS and Glass Lewis Update Their Voting Policies

Glass Lewis Opens Enrollment for Issuer Data Report Service

By Lyuba Goltser and Megan Pendleton

ISS and Glass Lewis have released updates to their proxy voting policies for the 2017 proxy season, which are available here and here. While this year's updates seem less far-reaching than we have seen in previous years, companies should familiarize themselves with the new policies, some of which could affect director elections and proposals relating to executive and director compensation. The policy updates will apply to annual meetings held on or after February 1, 2017. In this Alert we provide guidance for U.S. public companies on addressing these developments and practical tips for "***What to do Now?***" on page 6.

In addition, Glass Lewis has opened enrollment for its 2017 Issuer Data Report (IDR) program through January 6, 2017. Participation in this program is available on a first-come, first-served basis.

Key Developments

Overlapping ISS and Glass Lewis Developments

- Director "Overboarding"
- Governance at Newly Public Companies

ISS Developments

- Restrictions on Shareholder Right to Amend Bylaws
- Stock Distributions: Stock Splits and Dividends
- Equity Plan Scorecard: Dividends on Unvested Awards and Minimum Vesting
- Cash and Equity Plan Amendments, Including Section 162(m) Approval
- Shareholder Ratification of Non-Employee Director Pay Program
- Equity Plans for Non-Employee Directors

Glass Lewis Developments

- Board Self-Assessment and Refreshment

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ISS and Glass Lewis Put Spotlight on Overboarding

From meetings held beginning in February 2017, ISS and Glass Lewis will implement their previously announced policies on director overboarding. Our Alert discussing these policy changes is available here.

ISS Policy. ISS will recommend against a director who (i) is the company's CEO and serves on the board of more than 2 public companies (*besides* his or her own), and (ii) any other director who serves on more than 5 public company boards in total.

Glass Lewis Policy. Glass Lewis will recommend against a director who (i) is an executive officer of the company and serves on the board of a total of 2 public companies (*including* his or her own), and (ii) any other director who serves on more than 5 public company boards in total. Glass Lewis's policy also provides guidance on factors it will consider in applying its overboarding policy, including situations where it may not recommend against certain overboarded directors. Companies should review this guidance, which could inform the drafting of proxy statement disclosure to address these considerations. *See* "***What to do Now?***" below.

Overview of ISS Policy Changes

1. Restrictions on Shareholder Right to Amend Bylaws – *NEW*

Under a new ISS policy, ISS will recommend against members of the governance committee if the company's charter contains provisions that "unduly" restrict shareholders' ability to amend the company's bylaws. "Undue" restrictions include (i) an outright prohibition on the submission of binding shareholder proposals, or (ii) share ownership requirements or time holding requirements in excess of SEC Rule 14a-8 (*i.e.*, $2,000 or 1% for at least 1 year). ISS will continue to issue the negative recommendation until such restrictions are removed. In adopting this policy, ISS noted that some states allow companies to restrict in their charters the right of shareholders to amend a company's bylaws, a right which ISS views as a fundamental right of shareholders.

Spotlight on Maryland REITS

Maryland law, in particular, enables boards to provide that only the directors, and not shareholders, have the right to amend the company's bylaws. In its annual survey results, ISS highlighted that over two-thirds of Maryland REITs have conferred the power to amend the bylaws exclusively on the board. While ISS's new policy does not specifically target REITs, it appears as though such companies may be particularly implicated.

2. IPO Companies with Dual Classes of Stock with Unequal Voting Rights – *REVISED*

Last year, ISS amended its policy for evaluating certain bylaw or charter amendments adopted by the board prior to or in connection with a company's IPO. For a summary of last year's changes, see our Alert here. Citing an increase in the number of companies completing IPOs with multi-class structures, ISS has further amended its policy relating to IPO-companies for the 2017 proxy season.

ISS will issue a negative recommendation against directors, committee members, or the entire board (except new nominees, who will be considered case-by-case) at companies that, prior to or in connection with an IPO,

(i) adopt bylaw or charter provisions that ISS views as materially adverse to shareholder rights, or (ii) implement a multi-class capital structure affording unequal voting rights.

Under the revised policy, in making its voting recommendation, ISS will no longer take into account the company's commitment to submit the problematic provision to a binding shareholder vote within three years of the IPO, but will consider any reasonable sunset provision. ISS will vote case-by-case on director nominees in subsequent years until the adverse provision or problematic capital structure is reversed or removed.

3. Stock Distributions: Stock Splits & Dividends – *REVISED*

ISS has clarified its policy on stock splits and dividends in connection with stock distributions. ISS will generally vote in favor of management proposals to increase stock authorizations for stock splits and stock dividends so long as the "effective increase" (current policy uses only "increase") in authorized shares is equal to or less than the allowable increase calculated in accordance with ISS's common stock authorization policy. ISS notes that a clarification is appropriate because proposals to increase the authorization of common stock may be tied to the implementation of a planned stock split or stock dividend.

4. Equity Plan Scorecard: Dividends on Unvested Awards and Minimum Vesting – *REVISED*

ISS has added a new scored factor to its "equity plan scorecard" (EPSC), which assesses plan costs, plan features and grant practices. Under the revised policy, ISS will consider whether dividends are paid on unvested awards. ISS's view is that, from an incentive and retention perspective, dividends on unvested awards should be paid only after the underlying awards have been earned and not during the performance/severance period. ISS will award full points if an equity plan expressly prohibits, for *all* award types, the payment of dividends before the vesting of the underlying award (however, accrual of dividends payable upon vesting is acceptable). No points will be awarded if the prohibition does not apply to all award types. A company's general practice (not enumerated in the plan document) of not paying dividends until vesting will not suffice.

ISS also modified the minimum vesting factor under the EPSC's "plan features" category. It will only give point credit if the plan contains a *one year* minimum vesting requirement for all award types that cannot be overridden by individual award agreements, except for up to 5% of the shares issuable under the plan. As before, the plan administrator's ability to accelerate vesting will continue to be considered by ISS under a separate EPSC factor. Minor changes to various factor weightings were also made. ISS will provide additional information about updates to the EPSC policy in its Equity Compensation Plans FAQ document, which is expected to be released in December.

5. Cash and Equity Plan Amendments, Including Section 162(m) Approval – *REVISED*

ISS revised its policy to more clearly differentiate the evaluation framework applicable to amendments presented solely for the purposes of compliance with IRS Code Section 162(m), versus those involving multiple bundled amendments, sometimes with proposed amendments that increase the cost of the plan or that include an increase in the number of authorized shares under the plan. Under the updated policy, ISS generally recommends in favor of proposals relating to cash and/or equity incentive plans if the proposal (i) only seeks to amend administrative features of the plan, or (ii) only seeks approval for Section 162(m) purposes so long as the plan administering committee consists entirely of "*independent outside directors*" (as defined by ISS). If the proposal bundles an approval for 162(m) purposes with non-administrative amendments, the ISS will evaluate the proposal on case-by-case basis.

6. Shareholder Ratification of Director Pay Programs – *NEW*

In response to recent high-profile lawsuits regarding excessive non-employee director compensation, some companies have been submitting their non-employee director compensation programs for shareholder ratification at the annual meeting. Under a new policy, ISS has memorialized its framework for evaluating management proposals to ratify non-employee director compensation programs.

In assessing whether to recommend in favor of such programs, ISS will consider: (i) if the equity plan under which non-employee director grants are made is on the ballot, whether or not it warrants support, and (ii) the following *qualitative factors*:

- the relative magnitude of director compensation as compared to companies of a similar profile;
- the presence of problematic pay practices relating to director compensation;
- director stock ownership guidelines and holding requirements;
- equity award vesting schedules;
- the mix of cash and equity-based compensation;
- meaningful limits on director compensation;
- the availability of retirement benefits or perquisites; and
- the quality of disclosure surrounding director compensation.

7. Equity Plans for Non-Employee Directors – *REVISED*

ISS has updated its policy on reviewing equity plans for non-employee directors to provide that when the plan is determined to be relatively costly (e.g., exceeding the plan cost or burn rate benchmarks when combined with employee stock plans), ISS's vote recommendation will be case-by-case, looking holistically at the qualitative factors enumerated above, rather than requiring *all* the previously listed factors to be met. In addition, under ISS's revised policy, ISS will consider the presence of any egregious plan features (e.g., option repricing or liberal change in control vesting) when evaluating the reasonableness of non-employee director equity plans.

Overview of Glass Lewis Policy Changes

1. Governance at Newly Public Companies – *REVISED*

Newly-public companies have historically faced less scrutiny from ISS and Glass Lewis. Glass Lewis in particular generally refrains from making recommendations on the basis of governance standards during the one-year period following an IPO. However, like ISS, Glass Lewis has expanded its view on situations that may warrant shareholder action against the board of directors of a newly public company. Glass Lewis will evaluate whether a board of directors has approved highly restrictive governance provisions that result in shareholder rights being "severely restricted indefinitely." Under its revised policy, Glass Lewis may recommend a vote against the members of the governance committee or all of the directors that served at the time the provision was adopted, depending on the level of concern.

In evaluating whether shareholder rights are restricted, Glass Lewis will consider the existence of the following:

- the adoption of anti-takeover provisions such as a poison pill or classified board;
- supermajority vote requirements to amend governing documents;
- the presence of exclusive forum or fee-shifting provisions;
- whether shareholders can call special meetings or act by written consent;
- the voting standard provided for the election of directors;
- the ability of shareholders to remove directors without cause; and
- the presence of evergreen provisions in the company's equity compensation arrangements.

Unlike ISS, Glass Lewis will consider whether the board committed to submit the anti-takeover provision to a shareholder vote at the company's first annual meeting following the IPO. Glass Lewis will also take into account whether the board of directors provided a sound rationale and the existence of a sunset provision.

2. Board Self-Assessment and Refreshment -- *REVISED*

Glass Lewis has clarified its approach to board evaluation, succession planning and refreshment. As a general matter, Glass Lewis believes a robust board evaluation process — one focused on the assessment and alignment of director skills with company strategy — is more effective than relying solely on age or tenure limits. Further, Glass Lewis believes that shareholders are better suited to monitor the board's overall composition, including its diversity of skill sets, the alignment of the board's areas of expertise with a company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules that do not necessarily correlate with returns or benefits for shareholders. Glass Lewis has not changed its policy to consider recommending against the nominating / governance committee where such committee waives previously adopted term or age limits.

Glass Lewis Opens Enrollment for Issuer Data Reports

Companies that wish to receive a free issuer data report (IDR) from Glass Lewis should sign up here as soon as possible. Glass Lewis only makes this service available to a limited number of companies "on a first-come, first-served basis". The enrollment period ends on January 6, 2017. Companies enrolled for this service will receive a response confirming participation, and will receive an IDR via email approximately three to four weeks prior to their shareholder meeting. Companies will generally have 48 hours to review their IDR and provide any suggested corrections to Glass Lewis. IDRs are only issued for companies that have released all proxy materials no less than 30 days before the shareholder meeting date. Unlike ISS's draft voting recommendation preview available to S&P 500 companies, Glass Lewis's IDR only presents data points about the company, and not the draft voting recommendations.

What To Do Now?

- **Evaluate Number of Directorships.** Evaluate whether your company's directors, including the company's CEO or other executive officers, could be at risk under the newly applicable ISS and Glass Lewis overboarding policies. Ensure that directors and executive officers update their annual questionnaires to provide current biographies, including all other boards on which they serve (both public and private). Companies should have a policy requiring prompt notice of changes in employment or directorships, and directors and executive officers should be periodically refreshed about this policy. Directors and executive officers should be mindful of potential overboarding that may arise from board service on private companies that anticipate an IPO.
- **Review and Enhance Disclosure – Eye on Overboarding.** Review last year's proxy statement compensation and governance disclosure and consider any investor feedback with an eye toward further improvements. Clear, complete and concise proxy statement disclosure that highlights developments and explains the board's rationale can be a company's best tool for making its case to the proxy advisors and shareholders generally. In particular, Glass Lewis indicated that it may not recommend against certain overboarded directors if the company provides adequate rationale for the directors' continued board service and provides enough information to enable shareholders to evaluate the scope of the directors' other commitments and their contributions to the company (e.g., specialized knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide). Glass Lewis also provided additional guidance on factors it will consider when applying its overboarding policy, including the size and location of the other companies where the director serves on the board, the director's board duties at the companies in question, whether the director serves on the board of any large privately-held companies, the director's tenure on the boards in question, and the director's attendance record at all companies.
- **Consider Governance Provisions at Newly Public Companies.** Companies preparing for an IPO or spin-off should carefully consider any charter or bylaw provisions that ISS may view as adversely impacting shareholders, as well as multi-class structures with unequal rights. Newly public companies preparing for their first annual meeting should familiarize themselves with ISS and Glass Lewis policies and, if necessary, prepare their boards for potential negative voting recommendations on their election.
- **Enroll for Glass Lewis IDR and Register for ISS Voting Recommendation Preview.** Companies that wish to receive a free IDR from Glass Lewis should enroll as soon as possible because availability is limited. S&P 500 companies should also register for ISS's draft voting recommendation review process by using the form available here. S&P 500 companies that have registered with ISS will receive a draft report reflecting ISS's voting recommendations in advance of the annual meeting. They will then have a very narrow time window (48 hours) in which to respond to ISS with any updates, or engage with ISS if possible.
- **Review and Verify QualityScore Report.** Carefully review and verify your updated QualityScore reports, which became available on November 21, 2016. Companies may generally verify data verification points at any time, except between the company's proxy filing and shareholder meeting.
- **Register with ISS for Equity Compensation Scorecard.** Companies planning to seek shareholder approval of an equity compensation plan at the next annual meeting should register to gain access to the ISS Equity Plan Data Verification Portal and review the data points about the company that ISS will consider as part of its scorecard approach.

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