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ISS and Glass Lewis Announce 2017 Voting Policy Updates

Institutional Shareholder Services (ISS) and Glass Lewis recently published their 2017 updates to their proxy voting policies and guidelines. Updated policies regarding executive compensation matters are discussed in a separate memo. Along with the updated policies, ISS also launched ISS QualityScore, an updated version of ISS' governance scoring system. ISS' 2017 policies will take effect for shareholder meetings that are held on or after February 1, 2017 and Glass Lewis' 2017 policies will apply to meetings that are held on or after January 1, 2017.

As previewed in ISS' draft policy updates discussed in a prior memo, the updated 2017 U.S. proxy voting policies include:

- **Restrictions on Binding Shareholder Proposals:** Under the new policy, ISS will generally recommend voting against or withholding votes from members of the governance committee if the company's charter imposes "undue restrictions" on the ability of shareholders to amend the bylaws, such as outright prohibitions on binding shareholder proposals or limitations on the ability to make proposals based on share ownership or holding periods in excess of those required under Rule 14a-8.

- **Multi-Class Capital Structure at IPO:** If a company completes a public offering with charter or bylaw provisions that are "materially adverse to shareholder rights," including a multi-class capital structure in which the classes have different voting rights, ISS will generally recommend voting against or withholding votes from incumbent directors and will evaluate new nominees on a case-by-case basis. Before issuing an adverse recommendation, ISS will consider potentially mitigating factors, such as a sunset provision (instead of merely a commitment to submit the charter or bylaw provisions to a shareholder vote within three years). While this standard reflects ISS' continuing effort to compel companies to conform to its perceived "best governance practices" it is worth noting that a number of companies have completed public offerings with multi-class capital structures in order to preserve their "startup culture" and have enjoyed immense success with such strategies.

The ISS QualityScore incorporates adjustments to the previous "QuickScore" scoring methodology. It adds several new governance factors in each of the "four pillars," including:

- **Board Structure:** What proportion of non-executive directors has been on the board fewer than 6 years? Does the board have any mechanisms to encourage director refreshment? Has the board adequately responded to low support for a management proposal?

- **Shareholder Rights:** Does the company have an exclusive venue/forum provision? Can the board materially modify the company's capital structure without shareholder approval? Does the company have a representative claim limitation or other significant litigation rights limitations? What is the ownership threshold and duration requirement for proxy access? What is the cap on shareholder nominees to fill seats from proxy access? What is the aggregation limit on shareholders forming a nominating group for proxy access?

- **Compensation:** Does the company employ at least one compensation metric that compares its performance to a benchmark or peer group?

- **Audit and Risk Oversight:** What is the tenure of the company's external auditor?

Although ISS strongly advocates for transparency in companies' approaches to governance and executive compensation, the QualityScore discussion does not provide disclosure regarding the specific weighing and balancing among the various factors, both new and old, in the scoring model. And QualityScore continues the same structural flaw that existed in QuickScore and prior iterations, namely that relatively minor deviations in substance can lead to large variations in ranking. In our view, QualityScore is not a substitute for the informed business judgment of a well-advised board as to the appropriate corporate governance practices and compensation policies for their companies.

Notable updates in the Glass Lewis 2017 U.S. proxy guidelines include:

- **Governance Following IPO or Spin-Off:** While Glass Lewis will generally refrain from making voting recommendations based on a company's governance structure during the year following its public offering, Glass Lewis will review the terms of the company's charter and bylaws for any severe restrictions of shareholder rights, including the adoption of poison pills, supermajority vote requirements to amend organizational documents or a classified board. Glass Lewis may recommend voting against individual directors who served on the board when such provisions were adopted if (i) the company did not commit to submit such provisions to a shareholder vote at the first shareholder meeting following the IPO or (ii) the provisions were not accompanied by a reasonable sunset provision or sound rationale for adoption.

- **Overboarded Directors:** Glass Lewis will generally recommend voting against individual directors who serve on a total of more than five public company boards, if the director is not an active executive officer of any public company, or on more than two public company boards if the director is an active executive officer. However, Glass Lewis will refrain from issuing an adverse recommendation on a director who fails these tests if the company provides sufficient rationale for the director's continued service that allows shareholders to evaluate the scope of the director's competing commitments and contribution to the company.

- **Board Refreshment:** Generally, Glass Lewis prefers a robust board evaluation process to reliance on age or tenure limits. However, if a board adopts age or tenure limits and waives such limits without sufficient explanation, Glass Lewis will continue to issue adverse recommendations against the members of the nominating and/or governance committees of the board. Additionally, Glass Lewis may consider issuing an adverse recommendation against the chair of the nominating committee where a failure to ensure that the board has directors with relevant experience, either through director assessment or board refreshment, has contributed to the company's poor performance.

Next month, ISS will release the full and summary forms of its complete 2017 proxy voting policies along with an updated Frequently Asked Questions guidance for certain U.S. policies. In January 2017, ISS will update its U.S. Summary Proxy Voting Guidelines after a review of anticipated U.S. shareholder proposals.

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As companies and boards look ahead to the 2017 proxy season, they should keep these updates in mind as they prepare for upcoming annual meetings and engage with various stakeholders, but should not substitute such guidelines and policies for what the board determines is in the best interest of the company.

Andrew R. Brownstein
Steven A. Rosenblum
David A. Katz
Trevor S. Norwitz
Sabastian V. Niles
Jenny Y. Lin