

# C-SUITE

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## The AI Evolution

Why all boards should  
be thinking about  
artificial intelligence  
in 2018



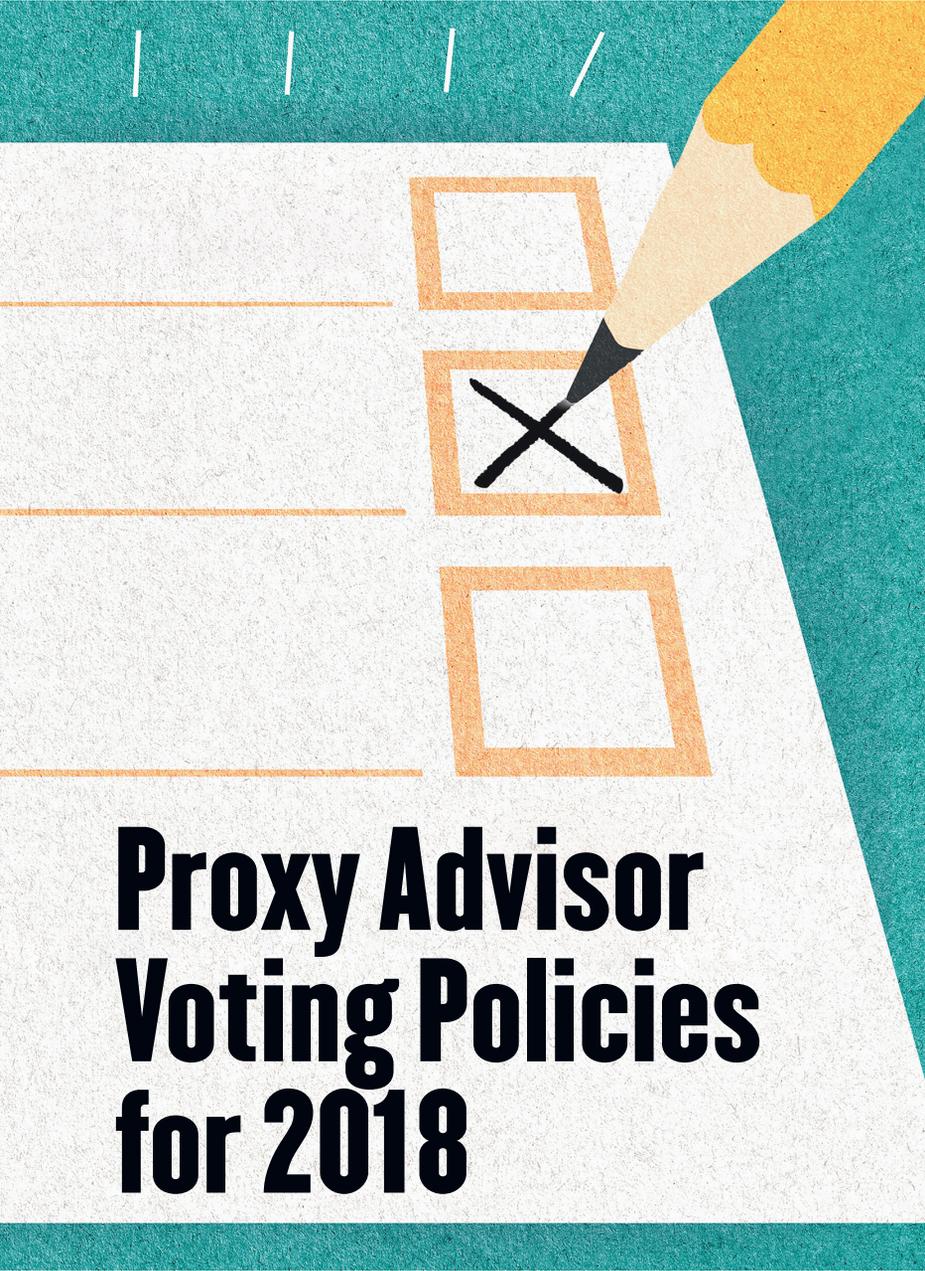
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A roller coaster year for corporate governance  
Protecting the board against shareholder scrutiny  
Hot-button boardroom issues for 2018

Creating diverse board committees

Interviews with Betsy Atkins, CEO and Founder of  
Baja Corporation and multi-boarded director, and  
James Lam, board member at E\*TRADE Financial





# Proxy Advisor Voting Policies for 2018

What board members and management should know about Glass Lewis and ISS updates

By Alex Bahn

HOGAN LOVELLS

**I**n November 2017, proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis released annual updates to their U.S. voting policies. These updates take effect in 2018 and touch on a range of governance topics to which institutional shareholders are paying increasingly close attention.

In light of ISS' and Glass Lewis' updated voting policies, actions that public companies and boards should consider taking include the following:

- Review existing corporate governance policies and practices in the areas addressed by the updates effective for 2018 and consider whether action is advisable, in particular on topics of frequent shareholder proposals.
- Assess the existing level of disclosure in the proxy statement concerning board skills, qualifications and diversity, as well as the company's shareholder outreach program.

## ISS Policy Updates (Effective for shareholder meetings on or after February 1, 2018)

### Corporate governance matters

- **Gender diversity.** ISS will highlight companies whose boards have no women directors. However, ISS will make no negative voting recommendations on this basis in 2018.
- **Classified boards.** ISS has codified its existing practice and will recommend against all board nominees at companies that have opted into, or failed to opt out of, state laws requiring classified boards absent shareholder approval (except new nominees, who will be evaluated on a case-by-case basis).
- **Shareholder rights plans.** ISS has modified its policies relating to voting recommendations at companies with shareholder rights plans (poison pills) that have not been approved by shareholders. Key changes include:
  - **Long-term poison pills** (over 12 months in duration): (1) ISS will no longer view a commitment to present a long-term poison pill for shareholder approval as a mitigating factor and (2) poison pills adopted in 2009 or earlier will no longer be grandfathered.
  - **Short-term poison pills** (12 or fewer months in duration): ISS will continue to evaluate these companies on a case-by-case basis, but will now focus on the board's rationale for the poison pill rather than the company's governance and accountability track record. ISS also will consider other factors, including a commitment to put any renewal of the poison pill to a shareholder vote.

### Executive compensation

- **CEO pay ratio.** ISS will include companies' pay ratios in its reports, but the ratios will not impact its voting recommendations. However, given the anticipated investor interest in these disclosures, one can imagine that ISS may

consider future changes to its voting policies to take pay ratio disclosures into account.

- **Board responsiveness to Say on Pay and say-on-frequency proposals.** ISS will continue to determine whether to issue adverse recommendations on compensation committee members (or the full board, in exceptional cases) on a case-by-case basis following a year where a Say on Pay proposal receives less than 70% support. ISS has revised the factors it will consider in this determination, including:

- Timing and frequency of engagement with major institutional investors regarding the issues that contributed to the low level of support
- Whether the company's independent directors participate in such engagement
- Disclosure of specific concerns raised by shareholders that led to their dissent
- Specific, meaningful actions to address shareholder concerns

ISS will apply the same factors in determining its recommendation on a Say on Pay proposal following a prior Say on Pay proposal that received less than 70% support.

- **Pay for performance.** ISS has updated the Peer Group Alignment analysis, an existing component of its annual quantitative pay for performance evaluation, to take into account rankings of a company's CEO total compensation and company financial performance within a peer group, each measured over a three-year period.

#### Shareholder proposals

- **Gender pay equality.** ISS will evaluate proposals requesting information on pay data or company policies on a case-by-case basis, and will consider a variety of factors, including current policies and disclosures, the company's use of fair and equitable practices and whether reporting on gender pay equality policies lags the company's peers.
- **Climate change.** ISS has expanded its existing policy to provide that, going forward, it generally will support shareholder proposals seeking disclosure of how companies identify, measure and manage climate risks.

### Glass Lewis Policy Updates (Effective for shareholder meetings on or after January 1, 2018)

#### Corporate governance matters

- **Dual-class share structures.** Glass Lewis believes



Alex Bahn is a Partner with Hogan Lovells. He can be reached at [alex.bahn@hoganlovells.com](mailto:alex.bahn@hoganlovells.com). Partners Alan Dye and Martha Steinman also contributed to this article.

that dual-class structures typically are not in the best interest of shareholders and that economic ownership should match voting power. Glass Lewis typically recommends in favor of proposals to eliminate dual-class share structures and will now generally recommend against proposals to adopt a new class of common stock with unequal voting power. Glass Lewis generally refrains from making recommendations on the basis of governance standards for one year following a company's IPO or spin-off. However, where Glass Lewis believes that governing documents "severely" restrict shareholder rights "indefinitely," it may recommend against directors on a case-by-case basis during this one-year period and will now include dual-class share structures with disparate voting rights as a factor in its evaluation.

- **Board responsiveness.** If 20% (previously 25%) or more of votes are against, or withheld from, a nominee or a

management-sponsored proposal (including Say on Pay), Glass Lewis will not automatically recommend a negative vote on a future proposal, but the low level of support may contribute to a negative recommendation if Glass Lewis determines the board has not responded "appropriately." Glass Lewis will take the same approach if 20% or more of votes are in favor of a shareholder proposal. For companies with dual-class structures, Glass Lewis will look to how many unaffiliated shareholders supported a shareholder proposal (or opposed a management proposal) to determine if a board response is warranted.

#### Executive compensation

- **CEO pay ratio.** Like ISS, Glass Lewis will present companies' CEO pay ratios in its reports, but the ratio will not be a determinative factor in its voting recommendations.
- **Pay for performance.** Glass Lewis has also clarified the "grades" it gives companies on executive compensation as part of its pay for performance analysis. A grade of "C" denotes a company that neither overpays nor underpays relative to peers, while grades of "A" or "B" represent lower pay and greater performance relative to peers, and "D" or "F" represent higher pay levels and lower performance.

#### Shareholder proposals

- **Climate change.** Glass Lewis will generally support shareholder proposals seeking disclosure of climate change scenarios at companies in extractive or energy-intensive industries. It will evaluate on a case-by-case basis requests that companies report in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures.
- **Proxy access.** Glass Lewis will evaluate on a case-by-case basis shareholder proposals seeking to amend existing proxy access bylaws. Glass Lewis will generally recommend against a "fix-it" proposal if the company has already implemented proxy access in a manner reasonably conforming to broad market practice, but may support the proposal where a company has "unnecessarily restrictive" proxy access provisions.
- **Dual-class share structures.** Consistent with its views on dual-class governance, Glass Lewis will generally support shareholder proposals that seek to eliminate a two-class structure. **CS**