

Corporate Alert

December 1, 2015

If you read one thing...

- ISS and Glass Lewis have released their updated proxy voting guidelines for the 2016 proxy season.
- These guidelines outline how they will make recommendations to shareholders on how they should vote on governance, compensation, and other matters, including proxy access and director overboarding.
- Companies should consider these revised ISS and Glass Lewis guidelines and anticipate any likely voting recommendations as they prepare for the 2016 proxy season.



ISS and Glass Lewis Update their Proxy Voting Guidelines for 2016 Proxy Season

Proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis each have released updates to their policies that outline how they will form recommendations to shareholders on how they should vote on governance, compensation and other matters for the 2016 proxy season. The ISS update can be found [here](#), and the Glass Lewis update [here](#). Companies should consider these revised ISS and Glass Lewis guidelines and anticipate any likely voting recommendations as they prepare for the 2016 proxy season.

We summarize the most notable updates to these guidelines below.

Proxy Access

ISS did not change its fundamental approach to management and shareholder proxy access proposals but noted that it will issue an FAQ in December 2015 to provide more information on which proxy access provisions ISS considers overly restrictive. The FAQ also will clarify the analytical framework that ISS will use to analyze proxy access nominations, which is conceptually similar to the analytic framework it uses in analyzing proxy contests.

Glass Lewis did not provide any updated guidance on proxy access, and will continue to use its [previously announced analysis](#) for evaluating the terms of proxy access shareholder proposals.

Director Overboarding

The new guidelines update the historical views of each of ISS and Glass Lewis regarding when they believe a board member serves on too many public company boards. As explained below, however, 2016 will serve as a transitional year.

For CEOs of public companies, ISS departed from its policy draft and decided against making changes to the threshold at which a public company CEO will be considered overboarded. For the near term, ISS will retain its existing policy of recommending against the CEO's outside directorships if he or she sits on the boards of more than two public companies besides his or her own.

For directors who are not CEOs, ISS will consider the director overboarded if he or she sits on more than five, down from six, public company boards (including their own). However, to allow impacted directors to reduce their board commitments in an orderly fashion, ISS will not recommend withhold votes against such directors under this new policy for the 2016 proxy season, but instead will include only cautionary language in their research report. Starting on or after February 1, 2017, negative recommendations will be made for directors sitting on more than five public company boards.

Beginning in 2017, Glass Lewis will recommend voting against directors who serve on more than five public company boards and directors who are executive officers and serve on more than one other board. In 2016, Glass Lewis "may note as a concern" these directors, thus providing a transition period similar to ISS.

Unilateral Board Action – Charter and Bylaw Changes

Current ISS policy provides for adverse vote recommendations on individual directors, committees or the full board at the next annual meeting when a unilateral board amendment of the articles or bylaws materially diminishes shareholders' rights. Recognizing that investors may have different expectations for established public companies as compared to newly public companies, ISS established two distinct policy responses.

For established public companies, the updated policy recommends that shareholders vote against or withhold from directors individually, committee members, or the entire board (except new nominees, who should be considered case-by-case) if the directors:

- classified the board
- adopted supermajority vote requirements to amend the bylaws or charter
- eliminated shareholders' ability to amend bylaws.

In subsequent years, ISS will consider on a case-by-case basis whether to continue recommending against boards unless the amendment is reversed or submitted to a binding shareholder vote.

For IPO companies, if the pre-IPO board amends the company's bylaws or charter prior to or in connection with the IPO to diminish shareholder rights, ISS will evaluate whether to issue adverse recommendations for directors at the meeting following the IPO based on the following:

- the level of impairment of shareholders' rights caused by the provision
- the company's or the board's rationale for adopting the provision

- the provision's impact on the ability to change the governance structure in the future (e.g., limitations on shareholder right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter)
- the ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure
- a public commitment to put the provision to a shareholder vote within three years of the date of the initial public offering.

In subsequent years, ISS will consider issuing adverse recommendations against directors on a case-by-case basis unless the amendment is reversed or submitted to a binding shareholder vote. Significant weight will be given to whether shareholders have the ability to amend the provisions by majority action and whether the company holds annual director elections, and ISS will consider as a mitigating factor a company's commitment to submit the provision to a shareholder vote within three years of the IPO.

Conflicting Shareholder Proposals

In October 2015, the SEC staff issued [Staff Legal Bulletin No. 14H](#), which addresses whether a company can exclude a shareholder proposal from the company's proxy materials based on the view that it competes with another similar proposal. SLB 14H increased the burden on companies to prove to the SEC staff that conflict exists, providing that a company may exclude only shareholder proposals that directly conflict with a management proposal.

Glass Lewis revised its guidelines to outline the factors that it will consider in making its recommendation on conflicting management and shareholder proposals, in anticipation that during the 2016 proxy season some companies may be forced (or choose) to include shareholder proposals and management proposals on the same topic in the company's proxy materials. These factors include:

- the nature of the underlying issue
- the benefit to shareholders
- the materiality of the differences in provisions between the management and shareholder proposals
- the appropriateness of the provisions
- the company's governance profile and responsiveness to shareholders (as evidenced by the company's response to previous shareholder proposals and its adoption of progressive shareholder rights provisions).

Shareholder Proposals on Equity Holding Periods for Executives

ISS has streamlined its policy with respect to shareholder proposals requiring executive officers to retain all or a significant portion of net shares acquired through compensation plans. Under the revised policy, ISS will recommend case-by-case on shareholder proposals seeking the adoption of share retention policies for executive officers, taking into account:

- the percentage/ratio of net shares required to be retained
- the time period required to retain the shares
- whether the company has equity retention, holding periods, or stock ownership requirements and the robustness of such requirements
- whether the company has any other compensation policies aimed at mitigating executive risk taking
- executives' actual stock ownership and the degree it meets or exceeds the thresholds in the proposal
- problematic pay practices, current and past, which may demonstrate a short-term versus long-term focus.

The changes are intended to eliminate the need for a separate policy tied to specified retention ratios (e.g., 75 percent of net shares) and make the policy easier to understand.

Exclusive Forum Provisions (IPO Companies Only)

Glass Lewis no longer will recommend voting against the chairperson of the nominating and corporate governance committee solely based on an exclusive forum bylaw being adopted in connection with an initial public offering. Instead, Glass Lewis will weigh the forum bylaw against other provisions that limit shareholder rights, such as supermajority vote requirements, classified boards and fee-shifting bylaws.

Glass Lewis will continue to recommend voting against the nominating and corporate governance committee chairperson when an exclusive forum bylaw is adopted without shareholder approval outside of a spin-off, merger or IPO.

ISS, on the other hand, does not recommend voting against directors based on the unilateral adoption of an exclusive forum bylaw provision and reviews exclusive forum bylaws on a case-by-case basis.

Compensation Practices for Externally Managed Issuers (EMIs)

ISS will deem an EMI's failure to provide sufficient disclosure for shareholders to reasonably assess named executive officer compensation to be a problematic pay practice, and generally warrant a recommendation against the EMI's say-on-pay proposal.

Nominating Committee Performance – Board Composition

Glass Lewis may consider recommending against the chairperson of the nominating and corporate governance committee where a failure to ensure that the board has directors with relevant experience, either through director assessment or board refreshment, has contributed to a company's poor performance. Glass Lewis has not specified how it will assess whether directors have relevant experience, how that lack of relevant experience contributed to a company's poor performance or when performance will be considered poor. The new guidelines note that Glass Lewis will consider a company's periodic director assessment process and the steps the company has taken to refresh the members of the board.

Environmental and Social Risk Oversight

Glass Lewis codified its position on the responsibility of directors for oversight of environmental and social issues, stating that it expects to recommend against directors responsible for risk oversight where the board or management failed to sufficiently identify and manage a material social or environmental risk that did (or could) negatively affect shareholder value.

Contact Information

If you have any questions regarding this alert, please contact:

Andrew J. Brady

abrady@akingump.com

202.887.4170

Washington, D.C.

Kerry E. Berchem

kberchem@akingump.com

212.872.1095

New York

Christine B. LaFollette

clafollette@akingump.com

713.220.5896

Houston

Garrett A. DeVries

gdevries@akingump.com

214.969.2891

Dallas