

October 26, 2018

Glass Lewis 2019 Proxy Voting Guidelines

U.S. Policy Update

On October 24, 2018, Glass, Lewis & Co., LLC ("Glass Lewis") released its 2019 Proxy Voting Policy Guidelines for the U.S. market as part of its annual policy update process. These guidelines will be effective for shareholder meetings held on or after January 1, 2019 unless otherwise noted.

The proxy advisor has introduced major updates on its policy changes in five existing categories: (i) board gender diversity, (ii) conflicting and excluded proposals, (iii) environmental and social risk oversight, (iv) virtual shareholder meetings, and (v) ratification of auditor. Minor clarifications and amendments were also made for executive compensation and other governance matters.

Notably for the first time, Glass Lewis is publicly seeking [ongoing comments](#) to its guidelines from all market participants as part of its increasingly transparent policy formulation process.

General Governance

Board Gender Diversity

As previously announced about a year ago, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members at meetings after January 1, 2019. Glass Lewis will also take other factors into consideration which could lead to against recommendations on other nominating committee members, such as the size of the company, the industry in which the company operates, the state in which the company is headquartered, and the governance profile of the company.

Finally, Glass Lewis will review a company's disclosure of its diversity considerations and may refrain from recommending shareholders vote against directors of companies outside the Russell 3000 Index or when boards have provided a sufficient rationale for not having any female board members. Such rationale may include, but is not limited to, a disclosed timetable for addressing the lack of diversity on the board or any notable restrictions in place regarding the board's composition such as director nomination agreements with significant investors.

Kingsdale Commentary: It appears that the initial policy application will apply mostly to Russell 3000 Index issuers in 2019. The primary screen Glass Lewis applies will be whether the board has at least one female director. Influenced by California's State Senate Bill 826, Glass Lewis will generally recommend voting against the governance committee chair if a company headquartered in California has no female directors unless the company has disclosed a definite plan to increase women representation on board by the end of 2019.

Conflicting and Excluded Proposals

Regarding conflicting special shareholder meeting resolutions, Glass Lewis has now codified the following:

- In instances where companies place on the ballot both a management and shareholder proposal requesting different thresholds for the right to call a special meeting, Glass Lewis will generally recommend voting for the lower threshold (in most instances, the shareholder proposal) and recommend voting against the higher threshold.
- In instances where there are conflicting management and shareholder special meeting proposals and the company does not currently maintain a special meeting right, Glass Lewis may consider recommending that shareholders vote in favor of the shareholder proposal and abstain from voting on management's proposal.
- In instances where companies have excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis will typically recommend against the ratification proposal as well as members of the nominating and governance committee.

Glass Lewis will also be making note of instances where the SEC has allowed companies to exclude shareholder proposals, which may result in recommendations against members of the governance committee. If Glass Lewis believes that the exclusion of a shareholder proposal was detrimental to shareholders, they may, in very limited circumstances, recommend against the members of the governance committee.

Kingsdale Commentary: SEC Rule 14a-8(i)(9) allows companies to exclude shareholder proposals "if the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting". The codified Glass Lewis policy provides a relatively clear-cut approach upon evaluating conflicting special shareholder meeting resolutions based on the principle that companies should not limit investors' ability to vote on shareholder proposals that advance certain rights or promote beneficial disclosure.

Environmental and Social ("E&S") Risk Oversight

For large cap companies and in instances where Glass Lewis identifies material oversight issues, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of E&S issues. Glass Lewis will also note instances where such oversight has not been clearly defined by companies in their governance documents. Further, in instances where it is clear that companies have not properly managed or mitigated E&S risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, Glass Lewis may consider recommending that shareholders vote against members of the board who are responsible for oversight of E&S risks. In the absence of explicit board oversight of environmental and social issues, Glass Lewis may recommend that shareholders vote against members of the audit committee.

Kingsdale Commentary: It appears that this policy mainly applies to large cap companies which Glass Lewis has not explicitly defined in its policy. Glass Lewis will first examine whether the board has delegated E&S risk oversight to certain directors or board-level committees and clearly defined the oversight structure in their governance documents. Subsequently, under circumstances where significant failures of E&S risk oversight occur, Glass Lewis will hold corresponding directors or committees responsible.

Virtual-Only Shareholder Meetings

Starting in 2019, companies that choose to hold their annual shareholder meeting by virtual means, and without the option of attending the meeting in person, may be subject to against recommendations. Specifically, Glass Lewis will examine a company's disclosure of its virtual meeting procedures and could

recommend voting against members of the governance committee if the company does not provide disclosure assuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

Glass Lewis will be looking for examples of effective disclosure including:

- (i) shareholder questions, rules around what types of questions are allowed, and rules for how questions and comments will be recognized and disclosed to meeting participants;
- (ii) procedures, if any, for posting appropriate questions received during the meeting, and the company's addressing the ability of shareholders to ask questions during the meeting, including time guidelines for answers, on the investor page of their website as soon as is practical after the meeting;
- (iii) addressing technical and logistical issues related to accessing the virtual meeting platform; and
- (iv) procedures for accessing technical support to assist in the event of any difficulties accessing the virtual meeting.

Kingsdale Commentary: Beginning in 2019, Glass Lewis will make voting recommendations on virtual-only shareholder meetings, with a focus on appropriate disclosures in a company's circular that ensures fairness to shareholders' rights. In its update, Glass Lewis has provided several examples of disclosure that companies may consider using when holding virtual-only shareholder meetings.

Ratification of Auditor: Additional Considerations

When reviewing an auditor vote, Glass Lewis will consider an auditor's tenure, a pattern of inaccurate audits, and any ongoing litigation or significant controversies which call into question an auditor's effectiveness. In limited cases, these factors may contribute to a recommendation against auditor ratification.

Executive Compensation

Added Excise Tax Gross-Ups

Glass Lewis will now consider the inclusion of new excise tax gross-up provisions as an additional factor that may contribute to a negative voting recommendation. When new excise tax gross-ups are provided in executive employment agreements, Glass Lewis will consider recommending against members of the compensation committee, particularly in situations where a company previously committed not to provide any such entitlements.

Kingsdale Commentary: It is not surprising that Glass Lewis has decided to formalize tax gross-up provisions in the policy as an additional factor to vote against compensation committee members. Tax gross-ups are generally disliked by shareholders as they provide no incentive to executives and are typically deemed an unnecessary cost to companies.

Contractual Payments and Arrangements

Glass Lewis has extended its policy regarding contractual payments and arrangements and has clarified the terms that may contribute to a negative vote recommendation on a say-on-pay proposal. When evaluating severance and sign-on arrangements, Glass Lewis considers general U.S. market practice, as well as the size and design of entitlements.

Kingsdale Commentary: Certain contractual payments and arrangements, such as excessive severance and generous sign-on bonuses are contrary to the pay-for-performance principle and can prove costly for

companies given shareholders' inability to predict whether the paid executives can deliver value or not. Companies should avoid such problematic pay practices when hiring new executives.

Executive Compensation Disclosure for Smaller Reporting Companies

When analyzing the performance of a board's compensation committee, Glass Lewis will consider the impact of materially decreased CD&A disclosure when formulating recommendations and may consider recommending against members of the committee where a reduction in disclosure substantially impacts shareholders' ability to make an informed assessment of the company's executive pay practices. A "smaller reporting company" ("SRC") is defined as companies with less than \$250 million of public float, or less than \$100 million in annual revenues and either no public float or a public float of less than \$700 million.

Kingsdale Commentary: *Glass Lewis now provides a clear approach when analyzing SRCs in terms of executive compensation disclosure largely as the result of the SEC's adopted amendments to raise the thresholds in the definition of SRCs in June 2018. Companies classified as SRCs should be aware of these developments.*

Grants of Front-Loaded Awards

When evaluating such awards, Glass Lewis takes quantum, design, and the company's rationale for granting awards under this structure into consideration. Glass Lewis believes that there are certain risks associated with the use of this structure.

Kingsdale Commentary: *It is expected that Glass Lewis wants any front-loaded awards to include a firm commitment not to grant additional awards for a defined period. While it may be understandable that the use of front-loaded awards is intended to lock-in executive service and incentives, companies should be wary of such an approach.*

Recoupment Provisions ("Clawbacks")

Glass Lewis will increasingly focus its attention on the specific terms of recoupment policies beyond whether a company maintains a "clawback" that simply satisfies the minimum legal requirements.

Kingsdale Commentary: *Section 954 of the Dodd-Frank Act mandates the SEC to require listed companies to adopt policies for recouping certain compensation during a three-year look-back period. In other words, Glass Lewis would like to see companies adopt detailed bonus recoupment policies that go beyond Section 304 of the Sarbanes-Oxley Act to prevent executives from retaining performance-based awards that were not truly earned.*

Other Executive Compensation Clarifications

Glass Lewis has updated its language in the discussion of how peer groups contribute to recommendations, revising the description of its pay-for-performance model, and adding discussion on the consideration of discretion in incentive plans. Glass Lewis has also added an explanation of the structure and disclosure ratings in its Proxy Papers and addressed certain recent developments in its discussion of director compensation and bonus plans.

Clarifying Amendments

Audited Ratification Proposals at Business Development Companies ("BDCS")

Glass Lewis has clarified that it does not recommend voting against members of the audit committees of BDCS for failing to include auditor ratification on the ballot alongside a proposal to issue shares below a company's net asset value (NAV).

Kingsdale Commentary: *Because any broker non-votes counted toward quorum will automatically be registered as “against” votes for purposes of such a proposal, the unintended result could be a case where the issuance proposal is not approved, despite sufficient voting shares being cast in favor. Glass Lewis’ approach is reasonable as shareholders’ ability to weigh-in on the selection of auditor should outweigh the consequences of failing to approve an issuance proposal due to such technicality.*

Director Recommendations on the Basis of Company Performance

In addition to the company’s stock price performance, Glass Lewis will consider the company’s overall corporate governance, pay-for-performance alignment, and responsiveness to shareholders. Importantly, its recommendation is not based solely on stock price performance of the bottom quartile of the company’s sector.

Kingsdale Commentary: *Glass Lewis’ more holistic approach, which relies on more than just stock performance to determine a director recommendation, makes this revised policy fairer and more reasonable.*

Director and Officer Indemnification

While Glass Lewis strongly believes that directors and officers should be held to the highest standards when carrying out their duties to shareholders, some protection from liability is reasonable to protect against certain lawsuits and to ensure that officers feel comfortable taking measured risks that may benefit shareholders. As such, Glass Lewis finds it appropriate for a company to provide indemnification and/or enroll in liability insurance to cover its directors and officers so long as the terms of such agreements are reasonable.

Kingsdale Commentary: *This is good news for issuers and should help increase the talent pool of potential director/executive candidates who may have hesitated to get involved due to concerns about indemnification.*

Net Operating Losses (NOL) Protective Amendments

Previously, when companies proposed the adoption of a NOL Poison Pill in addition to a separate proposal seeking approval of “protective amendments” to restrict certain share transfers, Glass Lewis would generally support adoption of the NOL Pill while opposing the protective amendment, on the grounds that the pill itself would be sufficiently restrictive to protect the company’s deferred tax assets. Given that it is common practice in the U.S. to seek approval of both proposals simultaneously, Glass Lewis has now clarified that in cases where companies propose adoption of both a NOL Poison Pill and an additional by-law amendment restricting certain share transfers, Glass Lewis may support both as long as the terms are reasonable.

Kingsdale Commentary: *The proposed changes make sense as it is logical for companies to propose the adoption of by-law amendments specifically restricting certain share transfers, in addition to proposing the adoption of a NOL pill. However, keep in mind that Glass Lewis will still evaluate NOL pills on a case-by-case basis taking into consideration a number of factors including the value of the NOLs to the company, the likelihood of a change of ownership based on the size of the holding and the nature of the larger shareholders, the trigger threshold, whether the term of the plan is limited in duration (i.e., whether it contains a reasonable “sunset” provision), and whether the NOL is subject to periodic board review and/or shareholder ratification.*

OTC-Listed Companies

In analyzing OTC-listed companies, Glass Lewis has clarified that, in cases where shareholders are not provided with information regarding the composition of the board, its key committees, or other basic governance practices, Glass Lewis will generally hold the chair of the board’s governance committee responsible. In cases where no governance committee is disclosed, Glass Lewis will generally hold the chair of the board responsible.

Kingsdale Commentary: OTC-listed companies should be aware of the implications of a lack of basic disclosure on board composition and governance practices.

Quorum Requirements

Glass Lewis generally believes that a majority of outstanding shares entitled to vote is an appropriate quorum for the transaction of business at shareholder meetings. However, should a company seek shareholder approval for a lower quorum requirement, Glass Lewis will generally support a reduced quorum of at least one-third of shares entitled to vote, either in person or by proxy. When evaluating such proposals, Glass Lewis also considers the specific facts and circumstances of the company, such as size and shareholder base.

Kingsdale Commentary: Delaware law, requires companies to provide for a quorum of no less than one-third of outstanding shares. Glass Lewis provides a more flexible approach on quorum requirements if the company has a compelling rationale for a reduced quorum.

Shareholder Initiatives Policy Updates

Glass Lewis has introduced significant policy changes in a total of six categories within the Shareholder Initiatives space dealing with various types of shareholder proposals, including: (i) Diversity Reporting, (ii) Materiality Considerations, and (iii) Written Consent.

Additional commentary on (i) Conflicting and Excluded Proposals, (ii) Environmental and Social Risk Oversight, and (iii) Recoupment Provisions are addressed in the general 2019 U.S. Policy Guidelines.

Diversity Reporting

In 2019, Glass Lewis will generally recommend that shareholders vote in favor of shareholder proposals requesting additional reporting regarding a company's diversity initiatives. Specifically, Glass Lewis will support proposals targeting disclosures of workforce diversity including tangible details concerning the methodology of promoting further diversity. When applying these recommendations to specific shareholder proposals, Glass Lewis will consider the following four mitigating factors: (i) the industry in which the company operates and the nature of its operations, (ii) the company's current level of disclosure regarding workplace diversity, (iii) the level of disclosure at the company's peers and (iv) any lawsuits or accusations of discrimination within the company.

Kingsdale Commentary: Despite increasing support for the continued evolution in the workplace diversity space, and Glass Lewis' endorsement for diversity initiatives in general, the proxy advisor has defined certain instances where the application of increased disclosure may be reconsidered. Regardless, clients are still advised to adopt general diversity policies as a minimum best practice. This is particularly important when there is a lack of diversity on the board or at the management level.

Materiality Considerations

In conjunction with further developments in the E&S space, Glass Lewis has formalized the concept of materiality when providing recommendations for these types of shareholder proposals. It is Glass Lewis' belief that E&S risks will be differentiated on a company-by-company basis, taking into account differences in a variety of factors including operations, workforce, structure, and geography. Given these implicit differences in the application of risk, Glass Lewis will place ultimate emphasis on the financial implications for a company implementing any proposed shareholder resolution. Glass Lewis will consider the standards developed by the Sustainability Accounting Standards Board ("SASB") as a resource to assist in determinations of financial materiality.

Kingsdale Commentary: *Given the continued interest and development of E&S issues, Glass Lewis is now placing greater emphasis on the financial implication of E&S proposals. By formalizing an approach to assessing the case-by-case financial impacts of adopting such shareholder proposals, Glass Lewis' E&S framework continues to evolve.*

Written Consent

Despite general support for the right of shareholders to act by written consent, Glass Lewis has added a mediating note regarding proxy access and special meeting rights. Specifically, Glass Lewis will generally recommend against shareholder proposals to modify by-laws to facilitate the right to act by written consent in instances where a company has previously adopted a special meeting right of 15%, or below, alongside reasonable proxy access provisions. In keeping with this guideline, Glass Lewis maintains its position that special meetings are preferable to action by written consent, given the greater degree of minority shareholder protection and capability for management response at a special meeting.

Kingsdale Commentary: *It appears that Glass Lewis has a preference for special meetings over action by written consent. This indicates that if the company already has a special meeting right of 15% or reasonable proxy access provisions in place, Glass Lewis will generally not support the shareholder proposals for the adoption of action by written consent.*

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