2020 Proxy Advisor Voting Guidelines: What to Watch For

November 19, 2019

Earlier this month, Institutional Shareholder Services and Glass Lewis each released updates to their proxy voting guidelines for the United States, which will be applicable to shareholder meetings during the 2020 proxy season. Below, we highlight four key policy updates relating to:

- "abusive" share repurchase programs;
- "problematic" multi-class capital structures;
- the exclusion of shareholder proposals; and
- the evaluation of board committee performance.

The full text of the 2020 United States policy updates published by ISS and Glass Lewis are available here and here, respectively.

"Abusive" Share Repurchase Programs (ISS). In furtherance of its position that shareholders generally support the use of share buyback programs as a source of liquidity, ISS typically votes in favor of management proposals to institute open-market share repurchase plans in which all shareholders may participate on equal terms. Recognizing the possibility of potential abusive practices, however, ISS codified in its updated guidelines the following concerns which could warrant a vote against such proposals for U.S. companies or foreign companies that are U.S. domestic issuers listed solely in the United States:

- the use of buybacks as greenmail or to reward company insiders by purchasing their shares at a price higher than they could receive in an open-market sale;
- the use of buybacks to boost earnings per share or other compensation metrics to increase payouts to executives or other insiders; and
- repurchases that threaten a company's long-term viability.

Absent these "abusive" practices, ISS generally will continue to vote in favor of management proposals to institute share repurchase programs. Notably, this policy update will not affect most U.S. public companies, which implement share repurchase programs by means of board approval without a shareholder vote.

This policy update follows recent public scrutiny of share repurchase programs. Over the past year, potential legislation that would impose limitations on corporate share buybacks has received high-profile congressional support, including from U.S. Senators Tammy Baldwin, Marco Rubio, Bernie Sanders, Chuck Schumer and Chris Van Hollen. In June 2019, a group of petitioners including the AFL-CIO called upon the SEC to revise Exchange Act Rule 10b-18, which provides a safe harbor for companies to undertake share repurchase programs, claiming that buybacks improperly benefit corporate insiders without creating any real value to the company or its shareholders. Among other concerns, the petition cited the strong financial incentive of executives to use share repurchases to meet earnings targets and increase their own compensation—a concern echoed by ISS in its policy update.

"Problematic" Multi-Class Capital Structures (ISS). In its evaluation of newly public companies' governance structures, ISS generally votes against or withholds votes from individual directors, committee members or the full board of newly public companies that adopt certain bylaw or charter provisions ISS considers to be materially adverse to shareholder rights, including a classified board structure and supermajority vote requirements to amend the bylaws or charter. Under its new policy, ISS will now also separately evaluate whether newly public companies have problematic, multi-class capital structures with unequal voting rights and no reasonable time-based sunset provision. In assessing the reasonableness of the sunset, ISS will take into account factors such as the company's life span, its post-IPO ownership structure and the board's disclosed rationale for the sunset period selected. No sunset period longer than seven years will be considered reasonable.

While ISS reported that investor sentiment is varied regarding the use and sunset of multi-class capital structures, these structures have been widely criticized by large institutional investors, such as BlackRock, Vanguard and CalSTRS, who have adopted voting policies that favor "one-share, one-vote" structures. Despite this criticism, multi-class capital structures continue to be used by newly public companies, particularly technology companies. WeWork recently sought to go public with a triple-class stock structure with a 10-to-1 voting ratio, and, according to the Council of Institutional Investors, 26% of newly public companies that went public on U.S. stock exchanges in the first half of 2019 employed multi-class voting structures.

Under its new policy, ISS will continue to vote against or withhold votes from incumbent directors in subsequent years unless the problematic multi-class capital structure is reversed or removed.

Exclusion of Shareholder Proposals (Glass Lewis). A company that seeks to exclude a shareholder proposal from its proxy materials is required to file its reasoning with the SEC under Exchange Act Rule 14a-8. In response, the SEC historically provided no-action guidance in writing by concurring with the purported reasoning, disagreeing or declining to state a view. In September 2019, the SEC Division of Corporation Finance announced a new policy that it may respond orally to no-action requests instead of in writing. Further, where the Division declines to take a view on an excluded proposal, the announcement notes that the company and the shareholder proponent should not interpret that as indicating the company must include the shareholder proposal in its proxy statement.

Despite this statement from the SEC, under its updated guidelines, Glass Lewis will now consider recommending that shareholders vote against all members of the Nominating and Governance Committee if a company excludes a shareholder proposal when the SEC declines to state a view. In addition, if the SEC verbally concurs with the company's rationale for excluding a shareholder proposal and there is no written record provided by the SEC about such determination, Glass Lewis now expects companies to disclose the no-action relief. In the absence of such disclosure, Glass Lewis will consider recommending an adverse vote against members of the Nominating and Governance Committee if the company excludes the shareholder proposal.

Evaluation of Board Committee Performance (Glass Lewis). A number of Glass Lewis's policy updates codify additional factors that it will consider when evaluating the performance of board committees and, in turn, whether it will recommend a vote for or against the chair of a board committee or the entire committee. These factors include, among others:

- for the Audit Committee, whether fees paid to the company's external auditor for audit-related and non-audit-related services are disclosed;

- for the Nominating and Governance Committee, whether director attendance records are disclosed and, if so, whether those records include sufficient detail to ascertain which directors failed to attend meetings; and

- for the Compensation Committee, whether the board adopts a frequency for its advisory vote on executive compensation matters ("say-on-pay") that is different than what was approved by the shareholders.

Disclosure on auditor fees and director attendance are already required by SEC disclosure rules (Item 9 of Schedule 14A and Item 407(b) of Regulation S-K, respectively), so these policy updates may have limited effect in practice.

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The ISS and Glass Lewis 2020 proxy voting guidelines contain additional substantive and technical updates that may be of interest to public companies as they prepare for the upcoming proxy season. Please do not hesitate to contact us with any questions.

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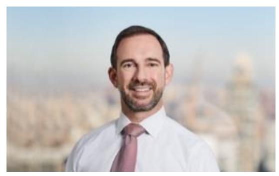

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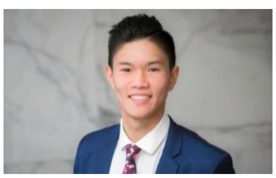

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