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Proxy Advisory Firms Issue Updates to Proxy Voting Guidelines for 2019

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In late 2018, Institutional Shareholder Services (ISS) and Glass Lewis & Co (Glass Lewis) each issued proxy voting guidelines for 2019. While policy changes announced by both firms were minimal, both ISS and Glass Lewis announced policy updates aimed at increasing female representation on boards of directors. This summary highlights some changes to ISS and Glass Lewis' policies for 2019 and is not intended to be all encompassing.

ISS Policy Updates

ISS did not make substantial changes to its policy for 2019. In fact, ISS postponed implementing a vote recommendation on excessive director pay that was to be introduced in 2019. After receiving investor feedback, ISS revised its methodology for identifying excessive director pay and will begin making vote recommendations in 2020. Under the new policy, ISS will recommend a vote "Against" Board members responsible for setting director pay if individual director pay is above the top two to three percent of a company's index and sector for two or more consecutive years (e.g., 2019 and 2020). ISS will consider mitigating factors, such as compression in pay within the index and sector, disclosure of a rationale for a director's pay positioning, and a larger equity grant at time of joining the board, in its vote recommendation.

In addition to the vote recommendation on director pay in 2020, ISS will recommend an "Against" vote for the Nominating Committee Chair if the Board does not have female representation. This will apply to companies in the Russell 3000 and S&P 1500 indices for meetings that occur after February 1, 2020.

Another policy change anticipated for 2019 was ISS replacing the metrics in the pay-for-performance assessment. However, ISS did not make any changes to their assessment from 2018. ISS considered using Economic Value Added (EVA) in lieu of the current GAAP measures (Return on Invested Capital, Return on Equity, Return on Assets, Earnings Before Interest, Taxes, Depreciation and Amortization growth and/or Cash Flow (from operations) growth). Instead, ISS will disclose a company's EVA performance as additional information within the research report and not in the Financial Performance Assessment (FPA). This is similar to the approach ISS used in 2017 for the FPA. ISS introduced the FPA as additional information in the research report in 2017 and, ultimately, incorporated it into the pay-for-performance assessment a year later. ISS may use a similar approach with EVA.

In addition to these policy updates, ISS provided clarification on its views on the use of TSR as an incentive metric, front-loaded awards and impact from regulatory updates, as well as updated its list of problematic pay practices as summarized in the below chart. For information on all ISS policy updates, please visit https://www.issgovernance.com/policy-gateway/latest-policies/

Other Select ISS Policy Updates
Front-loaded Awards Will likely recommend "Against" a company's say on pay (SOP) vote for large multi-year awards that are intended to cover more than four years.
Updated Problematic Pay Practices Added the definition of "Good Reason" whereby an executive could receive a windfall in the event of a corporate failure (such as bankruptcy or delisting). ISS will not consider the definition to be problematic if it is in connection with a constructive termination (e.g., material reduction in compensation, title or role, etc.).
Incentive Metrics Clarified that it does not advocate the use of any incentive metric over another (specifically TSR). ISS stated that the Board and Compensation Committee are best suited to determine the appropriate measures to incent executives to create long-term value for shareholders.
Updates due to Regulatory Changes Updated its policy to reflect recent regulatory changes: Elimination of 162(m) Tax Deductibility Exemptions: Will view pay programs negatively if a company shifts performance-based pay into fixed or discretionary forms of compensation. Smaller Reporting Companies: Will continue to review the completeness of the disclosure. ISS will likely recommend "Against" an SOP vote if it is difficult to assess the compensation philosophy and practices.

Glass Lewis Policy Updates

Similar to ISS, Glass Lewis did not make changes to its pay-for-performance assessment for 2019. The firm did, however, clarify that its letter rating system (i.e., A, B, C, D and F) is not equivalent to the typical school grading system. In the policy update, Glass Lewis notes that receiving a “C” means that pay is aligned with performance. An “A” or a “B” indicates that the pay percentile is less than the performance percentile, and a “D” or an “F” means that the pay percentile is higher than the performance percentile.

Glass Lewis noted three voting policy updates related to compensation and diversity:

1. If the Board does not have any female members, Glass Lewis will recommend a vote “Against” the Nominating Committee Chair and may extend the recommendation to other committee members, depending on factors including company size, state headquarters, and a company’s governance profile. Glass Lewis will take into consideration mitigating factors, such as a disclosed timetable for addressing female representation or an agreement with restrictions from a significant investor. The vote recommendation on Board diversity is in effect for 2019.

2. Glass Lewis will generally recommend a vote “For” shareholder proposals that request additional information regarding employee diversity or the process for promoting diversity within the workforce.

3. Glass Lewis will consider the addition of an excise tax gross-up, particularly if there is a prior commitment for no gross-up, as a factor that may influence a negative vote recommendation against the Compensation Committee.

In addition to these policy updates, Glass Lewis also noted that it will review the terms of a company’s recoupment or clawback policy. The mere presence of a policy that meets the legal minimum requirement will no longer suffice. Glass Lewis states that, at minimum, the recoupment should be triggered for a financial restatement. The lack of a comprehensive clawback policy may inform Glass Lewis’ overall opinion of a company’s compensation program.

Additionally, Glass Lewis provided insight on its views on front-loaded awards and contractual payments and arrangements, both summarized in the chart below. For all information related to Glass Lewis' 2019 voting policies visit http://www.glasslewis.com/guidelines/

Other Select Glass Lewis Policy Updates
Front-loaded Awards Will review a company’s rationale for a front-loaded grant and will expect a commitment to not grant additional awards during the defined period of the award.
Contractual Payments and Arrangements Will consider the amount of a “make whole” award as well as the process for determining the award size. Glass Lewis notes that the disclosure should include a meaningful rationale. To evaluate severance and sign-on awards, Glass Lewis will review the size of the payment in relation to the amount of target compensation, amounts paid to other executives (including an executive’s predecessor) and the design of the payment.