THE ADVISOR

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2021 PROXY ADVISOR POLICY UPDATES
By Shirley Westcott

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Overview

Institutional Shareholder Services (ISS) and Glass Lewis have released their updated voting guidelines, which take effect for annual meetings on or after Jan. 1, 2021 (Glass Lewis) and annual meetings on or after Feb. 1, 2021 (ISS).[1]

The most consequential changes, which will impact recommendations on nominating and governance committee chairs, are being phased in and do not take effect until 2022. These include new thresholds for board gender and racial/ethnic diversity and requirements for board refreshment and board oversight of environmental and social (E&S) issues.

ISS and Glass Lewis have also outlined their disclosure expectations regarding director skills and diversity, virtual-only shareholder meetings and COVID-19-related changes to executive compensation programs. Other updates are clarifications to current policies or formalize the proxy advisors' approach to shareholder proposals on climate change, workplace diversity, gender pay gaps, mandatory arbitration and sexual misconduct.

Separately, ISS announced that beginning Jan. 1, 2021, it will no longer provide draft reviews for S&P 500 companies. ISS stated that the process is not being used as intended—namely, for companies to identify factual errors in its reports. Instead, many companies lobby ISS to change vote recommendations. For this reason, many of ISS's institutional clients do not want subject companies involved in the research process or to see ISS's research and recommendations ahead of clients. Companies will still be able to access free copies of the final ISS report.

The proxy advisors' key policy revisions are discussed in more detail below.

Board-Related

Board Gender Diversity (ISS and Glass Lewis)

In 2020, ISS began recommending against nominating committee chairs at S&P 1500 and Russell 3000 firms if there were no women on the board. However, ISS gave companies a one-year exemption if they committed to appointing a female director within a year. Because the transition period has passed, ISS has eliminated that carveout. Going forward, ISS will only make exceptions for boards that have temporarily lost their gender representation—i.e., if there was a woman on the board at the last annual meeting and the company commits to restoring gender diversity by the next annual meeting.

Glass Lewis is upgrading its board gender diversity policy whereby in 2022 it will recommend against the nominating chair of Russell 3000 firms that do not have at least *two* women on the board—up from its current requirement of one. Glass Lewis will make exceptions if the board size is six or fewer or if the company provides a sufficient rationale or a plan to address the limited degree of board gender diversity. 2021 will be a transitional year whereby Glass Lewis will flag in its reports any boards that do not have a minimum of two women.

In addition to its standard policy, Glass Lewis's recommendations on board diversity will conform to state law mandates on board composition as they come into effect. Companies that fail to meet these requirements within the specified timeframes will face negative recommendations on their nominating committee chairs unless they disclose a clear plan for addressing the matter.

At present, the policy will apply to companies headquartered in California which are subject to various

[1] See ISS's policy revisions for 2021 at https://www.issgovernance.com/file/policy/latest/updates/Americas-Policy-Updates.pdf. See Glass Lewis's 2021 U.S. voting policies and ESG initiatives at https://www.glasslewis.com/voting-policies-upcoming/.

board diversity quotas. Under Senate Bill (SB) 826, California companies were required to have at least one female director by the end of 2019 and, depending on board size, two to three female directors by the end of 2021. Under Assembly Bill (AB) 979, which was enacted in September 2020, California companies must have at least one director from an underrepresented group—which includes various racial and ethnic categories as well as sexual orientation—by the end of 2021. Depending on board size, the quota will scale up to two to three diverse directors by the end of 2022.[2] Therefore, in 2022 Glass Lewis may recommend against the nominating committee chairs of California companies that do not have the requisite number of female directors and at least one director from an underrepresented community.

Discussion: Glass Lewis's higher threshold for female directors will have a significant impact on Russell 3000 firms, one-third of which have only one woman on their boards (25%) or no women on their boards (7%), according to Activist Insight.[3] The policy also goes beyond the guidelines of most major investors which expect some degree of board diversity but in most cases stop short of advocating specific quotas aside from one female director. One exception is BlackRock which encourages companies to have two women on the board.

Glass Lewis's policy regarding California's mandate appears unduly harsh. It will disproportionately affect small- and mid-cap companies which may opt to incur the financial penalty for non-compliance rather than bear the significant costs of adding new directors (e.g., compensation, insurance and training). According to an October 2020 progress report by the California Partners Project, 71.8% of California companies still need to appoint one or more women to their boards to meet the year-end 2021 requirement.[4]

The state-specific policy may also be premature in view of the ongoing legal challenges to California's law. Other states are avoiding that prospect by taking alternative approaches to promoting board diversity, such as disclosure requirements.[5]

Of note, Glass Lewis's policy explicitly cites California's legislation but does not mention Washington, which in March 2020 became the second state to enact a gender diversity quota for corporate boards. With some exceptions, companies subject to the Washington Business Corporation Act (WBCA) must have a gender diverse board by Jan. 1, 2022 or comply with new board diversity reporting requirements.[6] A board will be considered gender diverse if, for at least 270 days of the fiscal year preceding the company's annual meeting, 25% of directors self-identify as women. Glass Lewis's 2022 policy updates will likely reflect this development and any similar measures adopted in the interim by other states.[7]

Board Racial/Ethnic Diversity (ISS)

Beginning in 2021, ISS will flag in its reports S&P 1500 and Russell 3000 boards that have no apparent racial or ethnic diversity. Beginning in 2022, ISS will recommend against the nominating committee chair of such boards absent mitigating factors. These include the presence of a racial/ethnic minority on the board at the preceding annual meeting and a commitment to appoint at least one racially/ethnically diverse director.

[2] See the text of California's SB 826 and AB 979 at https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB826 and https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB979, respectively.

[3] See Activist Insight's data at https://www.proxyinsight.com/wp-content/uploads/dlm_uploads/2020/12/Proxy-Monthly-November-2020.pdf. Only 5% of S&P 500 firms fail to meet Glass Lewis's higher gender diversity standard.

[4] See the California Partners Project report at https://www.calpartnersproject.org/claimyourseat.

[5] Illinois, Maryland and New York have enacted board diversity reporting requirements. Colorado, Ohio and Pennsylvania have adopted or are considering resolutions to encourage greater gender diversity on boards.

[6] See Washington's Senate Bill 6037 at http://lawfilesext.leg.wa.gov/biennium/2019-20/Pdf/Bills/Session%20Laws/Senate/6037-S.SL.pdf#page=1. The legislation does not apply to unlisted companies, emerging growth or smaller reporting companies, controlled companies, companies with voting groups designating directors or companies that are not required to hole an annual shareholder meeting.

[7] Hawaii, Illinois, Massachusetts, Michigan and New Jersey have introduced legislation with board gender composition requirements.

Regarding disclosures, ISS will consider aggregate board diversity statistics to be acceptable if gender diversity is separated out from racial and ethnic diversity rather than being presented together as a single percentage or number of "diverse" directors.[8]

Discussion: According to ISS, as of Sep. 21, 2020, 17 S&P 500 firms (3.4%), 492 S&P 1500 firms (33%) and 1,260 Russell 3000 firms (42%) had no apparent minority ethnic and/or racial board representation. However, the figures may be more reflective of a lack of disclosure rather than a lack of diversity. This summer, ISS reached out to U.S. companies to voluntarily disclose the self-identified race/ethnicity of their directors and named executive officers (NEOs).[9]

Investor groups have similarly ramped up their calls for greater racial/ethnic diversity on boards in response to the Black Lives Matter movement. ISS's recent policy survey showed that 56% of investor respondents would consider voting against nominating committee members where board racial/ethnic diversity is lacking. In late October, a coalition of 22 investor organizations wrote to Russell 3000 firms, requesting that they voluntarily disclose their boards' gender, racial and ethnic composition in their 2021 proxy statements. To spur action, a number of the investor signatories indicated that they have or are considering policies to vote against nominating committees at companies with no reported racial/ethnic diversity.[10]

Like ISS, it appears that some investors will give companies a one-year grace period before penalizing nominating committees. For example, Legal & General Investment Management (LGIM) announced in early October that beginning in 2022, it will vote against the nominating committee chair or board chair of FTSE 100 and S&P 500 firms if they do not have at least one black, Asian or other ethnic minority on their boards.

Disclosure of Director Diversity and Skills (Glass Lewis)

Starting in 2021, Glass Lewis's reports on S&P 500 companies will include an assessment of their proxy statement disclosures of board diversity, director skills and the director nomination process. This will include:

- The current percentage of racially/ethnically diverse directors,
- Whether the board's definition of diversity explicitly includes gender and/or race/ethnicity,
- Whether the board has adopted a "Rooney Rule" policy to include women and minorities in the initial pool of director candidates, and
- Board skills disclosure.

Glass Lewis will not be making voting recommendations based on this assessment. However, it may help inform its evaluation of a company's overall governance and be a contributing factor in its recommendations on other board-related concerns.

Discussion: Under SEC rules, companies are required to disclose their directors' experience, qualifications, attributes and skills. These are typically presented in director biographies, though there is a growing trend towards using a matrix format. According to a 2020 survey by Shearman & Sterling, 74% of the 100 largest U.S. companies provide a board skills matrix in their proxy statement.[11] An increasing number also provide board diversity information: 93% disclose gender data, up from 75% in 2019, and 89% disclose racial/ethnic

[8] According to the EY Center for Board Matters, in 2019 36% of S&P 100 firms disclosed the aggregate diversity of their boards, combining diversity across gender, race, ethnicity and sometimes other identity categories to provide an overall percentage of "diverse" directors. See https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-cbm-2019-proxy-season-preview.pdf.

[9] See https://connect.societycorpgov.org/blogs/randi-morrison/2020/07/16/iss-seeks-board-and-neos-race-ethnicity-data.

[10] For more information on the coalition's campaign, press release and a sample letter, see https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/october2020_russell3000.pdf, https://www.illinoistreasurer.gov/Financial_Institutions/Equity,_Diversity__Inclusion/Russell_3000_Board_Diversity_Disclosure_Initiative and https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/letter%20to%20walmart%20—%20racial%20disclosure%20of%20board%20directors%20(10.28.2020).pdf.

[11] See Shearman & Sterling's Corporate Governance & Executive Compensation Survey 2020 at http://digital.shearman.com/i/1293427-2020-corporate-governance-and-executive-compensation/55.

data, up from 56% in 2019. Far fewer (28%) disclose a Rooney Rule policy to always consider diverse candidates in their director searches.

Companies listed on Nasdaq may eventually face board diversity disclosure and quota requirements if the SEC approves a listing rule change proposed in early December.[12] Within one year of approval, listed companies would be required to annually disclose board diversity data in a prescribed matrix format in their proxy statement or on their website. Within two years of approval, listed companies must have one diverse director—namely, one who identifies as female, an underrepresented minority (as categorized by the Equal Employment Opportunity Commission) or LGBTQ. Within four to five years of approval, depending on listing tier, companies must have two diverse directors. Companies that do not meet the board composition quotas within the specified timeframes must publicly explain why they are not in compliance.

Board Refreshment (ISS and Glass Lewis)

In recent years, there has been growing shareholder attention to board refreshment, particularly to promote diversity in the director ranks. Both ISS and Glass Lewis believe that board turnover is best achieved through routine director evaluations rather than through arbitrary age restrictions and poorly designed term or tenure limits. Nevertheless, they recognize that in rare circumstances a lack of refreshment can contribute to poor board responsiveness or company performance.

Currently, ISS opposes management and shareholder proposals to limit director tenure through term limits or a mandatory retirement age. Going forward, ISS will take a case-by-case approach towards the adoption of term limits. In the case of management proposals, ISS will take into account the following:

- The rationale for the term limit,
- The robustness of the company's board evaluation process,
- Whether the limit is long enough to allow for a broad range of director tenures,
- Whether the limit would disadvantage independent directors compared to insiders, and
- Whether the board will impose the limit evenly and not waive it in a discriminatory manner.

In the case of shareholder resolutions, ISS will take into account the scope of the proposal and concerns that are exacerbated by a lack of board turnover.

ISS will continue to oppose management and shareholder proposals calling for mandatory age limits for directors, and it will recommend in favor of resolutions to repeal such provisions.

Glass Lewis's policy update calls for a negative recommendation on the nominating committee chair if, alongside other governance or performance concerns, the average tenure of non-executive directors is 10 years or more and no new independent directors have joined the board in the past five years. In 2021, Glass Lewis will flag such companies in its reports rather than issuing adverse voting recommendations.

Glass Lewis will continue to recommend against the nominating/governance committee members if the board waives its age/term limits without sufficient explanation, such as consummation of a merger.

Discussion: Investors and issuers alike generally disfavor artificial director term limits. According to Spencer Stuart's 2019 Board Index, only 27 S&P 500 boards (5%) have set explicit term limits for non-executive directors with terms ranging from 10 to 20 years.[13] Within ISS's Governance QualityScore universe, only 66 out of 3,050 companies (2.2%) have director term limits, which can be waived in all cases. On the few occasions where term limits have been proposed in shareholder resolutions over the past 10

[12] See Nasdaq's proposed listing rule changes and FAQs at https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081.pdf and https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf.

[13] See the Spencer Stuart 2019 Board Index at https://www.spencerstuart.com/-/media/2019/ssbi-2019/us_board_index_2019.pdf.

years, support has never exceeded 20% and typically was in the single digits.

More often, investors will take into account the length of tenure when a director stands for reelection. For example, BlackRock may vote against the board's longest tenured directors where there is a lack of board responsiveness to shareholder concerns, evidence of board entrenchment, insufficient attention to board diversity or a failure to promote adequate board succession planning. State Street Global Advisors (SSGA) may vote against the chair or members of the nominating/governance committee and/or against long-serving directors if the company's average board tenure is excessive compared to the market-level average.

Governance

Virtual Shareholder Meetings (VSMs) (ISS and Glass Lewis)

ISS is establishing a formal policy regarding the format of annual meetings. ISS will generally support management proposals to amend the governing documents to permit shareholder participation in annual meetings by remote communications as long as the intention—in the absence of health or safety concerns—is not to supplant in-person meetings with virtual-only meetings.

In line with its COVID-19 guidance issued in April, ISS is encouraging companies to disclose the circumstances under which they will hold VSMs and to accord shareholders comparable rights and opportunities to participate electronically as they would have at a physical meeting.[14]

ISS will recommend case by case on shareholder proposals concerning VSMs, taking into account the scope and rational of the proposal and any concerns with prior meeting practices.

Glass Lewis has clarified that it has reinstated its standard policy on VSMs, which it had temporarily suspended during the COVID-19 pandemic.[15] Glass Lewis will generally recommend against the governance committee members if the company holds a VSM and does not provide robust proxy statement disclosure that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting. This includes disclosure of shareholders' ability to ask questions at the meeting, procedures for posting Q&A on the company's website, and logistical details for accessing the meeting and receiving technical support.

Discussion: In 2020, many U.S. companies had to quickly pivot to VSMs due to pandemic-related shutdowns, which could continue into 2021. According to ISS's 2020 post-season report, 2,663 out of 4,377 U.S. annual meetings (61%) held through July 31 were conducted in a virtual format. Only a handful of the companies sought shareholder approval of bylaw amendments to permit online meetings, all of which were supported by both investors and the proxy advisors.

Similarly, over the past seven years, shareholders have filed only about a dozen proposals dealing with VSMs—essentially asking companies that had switched to VSMs to reinstate in-person annual meetings. In all cases, the resolutions were either withdrawn or omitted, primarily as ordinary business.

Companies that conducted VSMs for the first time in 2020 now have the opportunity to refine their practices in advance of the 2021 annual meeting season. In keeping with the recommendations of proxy advisors and investor groups, they should address shortcomings pertaining to meeting access, presenting shareholder proposals at the meeting and asking questions on a live basis.

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[14] See ISS's COVID-19 guidance on VSMs at https://www.issgovernance.com/file/policy/active/americas/ISS-Policy-Guidance-for-Impacts-of-the-Coronavirus-Pandemic.pdf.

[15] See Glass Lewis's COVID-19 guidance on VSMs at https://www.glasslewis.com/immediate-glass-lewis-guidelines-update-on-virtual-only-meetings-due-to-covid-19-coronavirus/.

Shareholder Litigation Rights (ISS)

ISS has updated its policy on exclusive forum provisions to support such measures in certain circumstances. It is also differentiating between provisions for federal securities law claims and state law claims.

Federal Forum Provisions (FFPs)

ISS will generally support FFPs that specify the district courts of the U.S. as the exclusive forum for federal securities law matters.

ISS will generally oppose provisions that restrict the forum to a *particular* federal district court. ISS believes that shareholders should have flexibility in choosing a court with a location that is convenient to them. Unilateral adoption of such a provision will be considered a one-time failure under ISS's Unilateral Bylaw/Charter Amendments policy, prompting a vote against individual directors, committee members or the full board.

State Forum Provisions

ISS will generally support charter/bylaw provisions that specify Delaware or the Delaware Court of Chancery as the exclusive forum for state corporate law matters for Delaware-incorporated companies. ISS is carving out Delaware because its court system specializes in corporate law with a robust set of case precedents and the likelihood of judicial efficiency.

ISS will recommend case-by-case on forum selection provisions in other states, taking into account the company's rationale for the provision and the type of claims covered.

ISS will generally oppose provisions that specify a state other than the state of incorporation as the exclusive forum for corporate law matters or that specify a particular local court within the state. Unilateral adoption of such a provision will be considered a one-time failure under ISS's Unilateral Bylaw/Charter Amendments policy, prompting a vote against individual directors, committee members or the full board.

Discussion: ISS's policy change was prompted by a March 2020 Delaware Supreme Court decision—*Salzberg v. Sciabacucchi*—which upheld FFPs after they were previously deemed impermissible by the Delaware Chancery Court. Since then, 126 companies have added an FFP, according to Deal Point Data. Only six of the firms put the matter to a vote, which was approved in all cases.[16] ISS supported almost all of the proposals, while Glass Lewis recommended against each of them.

In prior years, ISS and Glass Lewis have rarely been supportive of any forum selection measures, though they almost always receive shareholder approval. ISS's more nuanced policy should result in fewer adverse recommendations on them.

Glass Lewis will additionally recommend against governance committee chairs if they unilaterally adopt an exclusive forum provision unless it is narrowly crafted to suit the unique circumstances facing the company. According to its 2020 post-season report, unilateral adoption of forum selection clauses was among the top five reasons Glass Lewis recommended against S&P 500 directors.[17]

Dead-Hand Poison Pills (ISS)

Currently, ISS recommends case by case on directors who adopt a short-term poison pill without shareholder approval. Going forward, ISS will recommend against the directors (excluding new nominees) if the pill contains a dead-hand or slow-hand provision which limits the ability of a future board to redeem the pill.

Discussion: The surge in pill adoptions during the 2020 pandemic saw the reemergence of aggressive features not seen in years. ISS identified four Maryland REITs that implemented one-year pills with slow-hand features. In all cases, they were adopted on or after the companies' 2020 annual meetings. ISS indicated that even if a pill expires between adoption and the next annual meeting, it will still recommend against the directors.

[16] See Deal Point Data's report at https://corpgov.law.harvard.edu/2020/11/11/companies-response-to-delaware-supreme-court-upholding-federal-forum-provisions/.
[17] To access Glass Lewis's 2020 post-season report, see https://www.glasslewis.com/proxy-season-reviews/.

Advance Notice Requirements (ISS)

In keeping with market practices, ISS will now recommend in favor of the adoption of advance notice provisions that require shareholder notice of a proposal/director nomination no earlier than 120 days prior to the meeting with a minimum 30-day submission window. This is more lenient than its current policy, which called for a deadline of no more than 60 days before the annual meeting.

ISS points out that the policy pertains to advance notice requirements in companies' governing documents and not to Rule 14a-8 shareholder proposals or proxy access director nominations.

Discussion: Advance notice bylaws are commonplace among U.S. public companies to allow for orderly shareholder meetings. Most are adopted through board action rather than being submitted for shareholder approval. A 2011 survey of Delaware companies' advance notice bylaws by Bass, Berry & Sims found that 80% had a window period of 30 days and, of these, 84% provided a notice period of 90-120 days prior to the annual meeting.[18]

ISS believes its update strikes a better balance between allowing shareholder submissions sufficiently close to the meeting date to account for new developments, while still allowing sufficient time for shareholders to evaluate and vote on all agenda items. In contrast, Glass Lewis opposes advance notice proposals in the belief that setting arbitrary notice deadlines limits the opportunity for shareholders to raise issues that may come up after the window closes.

Vote Results Disclosure (Glass Lewis)

In 2021, Glass Lewis will begin recommending against the governance committee chair when a detailed record of proxy voting results from the last annual meeting has not been disclosed. Glass Lewis believes this disclosure is a basic shareholder right and should be provided within a reasonable timeframe following the meeting in all cases.

Discussion: The update will primarily affect companies incorporated in foreign jurisdictions where such disclosure may not be a legal requirement. U.S. reporting companies must file shareholder vote results on Form 8-K generally within four business days after the shareholder meeting.

Environmental & Social (E&S)

Board Oversight: Material E&S Risk (ISS and Glass Lewis)

ISS has clarified that material failures of risk oversight include demonstrably poor oversight of environmental and social (E&S) issues, such as climate change. Under extraordinary circumstances, this may prompt a negative ISS recommendation against individual directors, committee members or the entire board.

Glass Lewis currently has a policy to recommend against board members who are responsible for the oversight of E&S risks where it is clear that a company has not properly managed or mitigated such risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value. In 2021, it will note as a concern in its reports when S&P 500 companies do not clearly disclose the board's oversight role of E&S issues, which may be conducted by specific directors, a board committee or the entire board.[19] Beginning in 2022, Glass Lewis will generally recommend against the chair of the governance committee if this disclosure is lacking.

Discussion: Although ISS doesn't specify what would constitute poor risk management of E&S matters, several large investors have already been holding directors accountable for E&S risks, albeit sparingly. In 2020, BlackRock began voting against directors for insufficient progress on climate risk disclosure or management. In the first half of the year, this included voting against director-related items—election of

[18] See Bass, Berry & Sim's survey at https://www.bassberry.com/wp-content/uploads/AdvanceNoticeBylaws.pdf.

[19] According to Deloitte, 41% of S&P 500 companies assign ESG oversight to the nominating/governance committee, while 10% have a formal ESG/sustainability committee. Another 28% do not disclose how the board handles this responsibility. See https://higherlogicdownload.s3.amazonaws.com/GOVERNANCEPROFESSIONALS/a8892c7c-6297-4149-b9fc-378577d0b150/UploadedImages/Defining_the_role_of_the_audit_committee_in_overseeing_ESG.pdf.

directors or supervisors, board discharge proposals and election of board chairmen—55 times at 49 companies globally. It has put another 191 companies "on watch" for potential negative votes in 2021.[20]

SSGA similarly began taking voting action against board members at S&P 500 firms that underperformed their peers based on its proprietary R-Factor ESG scoring system. During the second quarter of 2020, SSGA voted against directors at nine of the 14 laggard companies, five of which were in the U.S. and four of which were in the U.K. SSGA plans to expand its screen in 2022 to include other companies that have been underperforming on their R-Factor scores for multiple years.[21]

Management-Proposed E&S Resolutions (Glass Lewis)

Glass Lewis has codified its case-by-case approach to management-sponsored proposals that deal with E&S issues. Factors it will consider include:

- The nature of the request and whether it would materially impact shareholders,
- Whether there is a competing or corresponding shareholder proposal on the ballot,
- The company's general responsiveness to shareholders and to emerging E&S issues,
- Whether the proposal is binding or advisory, and
- Management's recommendation on how shareholders should vote on the proposal.

Discussion: Management-sponsored proposals on E&S issues are highly unusual but may start gathering steam in some markets. In 2020, Barclays asked shareholders to vote on its climate policy, countering a more aggressive resolution from ShareAction. The company proposal included an ambition to become a net-zero bank in Scope 1, 2 and 3 emissions by 2050 and a commitment to align all of its financing activities with the goals and timeline of the Paris climate accord. The shareholder proposal called for more detailed targets for phasing out the financing of the most carbon-intensive industries. ISS and Glass Lewis backed the management proposal, which passed, and opposed the shareholder resolution, which received 24% support.

BP also plans to present a resolution on its climate goals in 2021. The company will jointly draft the measure with Dutch activist group Follow This, which agreed to withdraw a 2020 shareholder proposal.

Climate Change Shareholder Proposals (Glass Lewis)

Currently, Glass Lewis generally supports shareholder resolutions requesting that companies in certain extractive or energy-intensive industries provide enhanced disclosure on climate-related issues, such as undertaking a climate change scenario analysis or issuing a report aligned with the Task Force on Climate-Related Financial Disclosures (TCFD) framework. Because climate change can have extensive and wide-ranging impacts, Glass Lewis believes it should be addressed by companies in every industry. It is therefore eliminating the company's industry as a factor for consideration.

Glass Lewis also codified its approach to shareholder proposals on climate-related lobbying. While it generally favors enhanced disclosure in this regard, it will take into account the company's industry, its current level of lobbying disclosure and any significant controversies related to its management of climate change or its trade association memberships. Glass Lewis will generally oppose any proposals that would require the company to suspend any of its trade association memberships or would limit the company's ability to participate fully in trade associations in which it is a member.

Discussion: Glass Lewis's revision on climate change proposals reflects a trend among investors and shareholder proponents to expand their climate-related engagements and resolutions beyond carbon-intensive industries. Notably, in 2020 a resolution on carbon transition planning won 73.5% support at discount retailer Dollar Tree.

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[20] See BlackRock's September 2020 Investment Stewardship Annual Report at https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2020.pdf.

[21] See SSGA's Q2 2020 Proxy Season Review at https://www.ssga.com/library-content/products/esg/asset-stewardship-report-q2-2020.pdf.

Shareholder activists are also stepping up their campaigns on corporate lobbying beyond disclosure requests to pressing companies to proactively lobby for climate action. In 2020, a coalition of investors sponsored a new proposal at Chevron, Exxon Mobil, Delta Air Lines and United Continental Holdings to report on how their lobbying activities align with the Paris Agreement goal of net-zero emissions by 2050.[22] ISS and Glass Lewis backed the resolutions, which received 43.6% average support and a majority vote at Chevron. At least 10 more of these proposals are in the pipeline for 2021.

Trade association affiliations are also coming under fire. This fall, members of the Interfaith Center on Corporate Responsibility (ICCR) urged 25 companies in various sectors—energy, power, transportation, food and beverage, financial services and technology—to drop their memberships in trade associations that continue to lobby against the Paris Accord.[23] So far, only one shareholder resolution along these lines has materialized—at Australian mining company BHP—which was rejected by ISS and Glass Lewis, as well as investors (27.1% support at the Australia annual meeting and 22.16% support at the U.K. annual meeting).

Gender Pay Gap Shareholder Proposals (ISS)

Currently, ISS takes a case-by-case approach to shareholder proposals to report on whether a gender, racial or ethnic pay gap exists and the measures being taken to reduce the gap. ISS is adding language to codify its view that a global race/ethnicity statistic may not be meaningful or possible to provide.

Discussion: In recent years, Arjuna Capital—the primary sponsor of these proposals—has called for reports on global median gender pay gaps. Beginning in 2020, the requests shifted to global median *gender/racial* pay gaps. While ISS supported the earlier resolutions, it considers the new version to be problematic because categories of race and ethnicity differ from country to country and even collecting such data may be illegal in some countries.

Glass Lewis has largely opposed both proposal variations because, unlike adjusted (equal pay for equal work) metrics, median pay gap data could provide potentially misleading information. A median pay gap could be influenced by the proportion of a particular gender or a particular racial/ethnic group in a specific type of role.

Mandatory Arbitration and Workplace Sexual Harassment Shareholder Proposals (ISS)

ISS is adding policies to codify its position on several employment-related shareholder proposals as follows:

- ISS will recommend case by case on proposals to report on the company's use of mandatory arbitration of employment-related claims.

- ISS will recommend case by case on proposals to report on company actions to strengthen policies and oversight to prevent workplace sexual harassment or to report on risks posed by a company's failure to prevent workplace sexual harassment.

Discussion: ISS has generally been supportive of these proposals since their emergence in the past two years. In contrast, Glass Lewis, which does not have a written policy on these topics, has opposed at least as many of the proposals as it has supported.

[22] For more on the investor coalition's campaign, see its press release, sample letter and focus list companies at https://www.ceres.org/news-center/press-releases/200-investors-call-us-companies-align-climate-lobbying-paris-agreement, https://www.ceres.org/sites/default/files/Final%20Generic%20SIGN-ON%20PACKET%20Investor%20Expectations%20on%20Climate%20Lobbying%20sign-on%20packet%20September%202019.pdf, and https://www.ceres.org/sites/default/files/US%20Companies%20receiving%20the%20Investor%20Letter%20on%20Corporate%20Lobbying%20on%20Climate%20Change%209.19.pdf. See the Investor Expectations on Corporate Lobbying on Climate Change at https://www.ceres.org/sites/default/files/INVESTOR%20EXPECTATIONS%20ON%20CORPORATE%20LOBBYING%20ON%20CLIMATE%20CHANGE%209.19.pdf.

[23] See ICCR's press release and engagement letter at https://www.iccr.org/business-support-science-based-climate-policy-seen-critical-rein-climate-change-say-investors and https://www.iccr.org/sites/default/files/resources_attachments/climatelobbyingiinitialengagementletter11.16.20.pdf.

Investors are taking a closer look at these types of workplace issues within the broader context of human capital management (HCM). Mandatory arbitration proposals averaged 31.3% in 2020—up from 23.1% in 2019—and included one majority vote. Proposals on sexual harassment policies averaged 19.5% in 2020, up from 14.4% in 2019.

Workplace Diversity Reporting Shareholder Proposals (Glass Lewis)

Glass Lewis has refined its guidelines on shareholder requests for workforce diversity reporting. Since 2019, Glass Lewis has generally supported shareholder proposals seeking disclosure of workplace diversity, as well as proposals asking for details on how companies are promoting diversity in their workforce. Its 2021 policy will also include proposals that specifically ask for the disclosure of EEO-1 reports, which break down the race and gender of company employees across 10 job categories.

In making its recommendations, Glass Lewis will take into account whether the requested disclosure would meaningfully benefit shareholders' understanding of the company's diversity considerations, the company's current level of disclosure relative to peers, and any lawsuits or accusations of discrimination within the company. Because human capital is of material importance to all companies, Glass Lewis is eliminating the company's industry and the nature of its operations as factors in its evaluation.

Discussion: Glass Lewis's policy update essentially reflects its recommendation practices of the last two years of backing calls for EEO-1 data. ISS has also supported most all workplace diversity reporting proposals since their emergence in 2016.

HCM and racial equality are expected to be top issues in 2021. Investor interest in these topics was evident in the 2020 proxy season when two workplace diversity proposals—at Fastenal and Fortinet— received substantial majority support. Since then, a number of investors—including SSGA, the New York City Retirement System and Calvert Research and Management—have been vigorously pressing companies to publish their EEO-1 reports in order to establish benchmarks and measure progress. Just Capital reports that only 32 companies in the Russell 1000 index (3.2%) make their EEO-1 data public.

Compensation

In view of compensation adjustments made during the COVID-19 pandemic, Glass Lewis has codified additional factors it will consider when assessing companies' annual/short-term (AIP) and long-term (LTIP) incentive plans. ISS also released a preliminary frequently asked questions (FAQ) document in mid-October, which provides general guidance on how it will approach COVID-related pay decisions in the context of its pay-for-performance (PFP) qualitative evaluations.[24] As in the past, ISS will conduct an in-depth qualitative review of a company's pay when there is an elevated concern from the quantitative screen.

AIPs (Glass Lewis)

Glass Lewis expects clearly disclosed justifications for any significant changes to the plan structure, as well as instances in which performance goals were lowered from the previous year. It has also expanded its description of situations where a company has applied upward discretion to include retroactively pro-rating performance periods.

LTIPs (Glass Lewis)

Glass Lewis has stipulated that any decision to roll back performance-based awards or to eliminate them from the LTIP may lead to a recommendation against the plan, outside of exceptional circumstances. Glass Lewis also wants clearly disclosed explanations of equity grant practices, significant structural changes to the program, and any use of upward discretion.

COVID-Related Compensation Decisions (ISS)

ISS will carefully scrutinize pandemic-related changes to bonus/AIPs and LTIPs bearing in mind that companies have faced extraordinary circumstances. ISS may consider modifications to executive pay programs to be acceptable as long as the rationale is

[24] See ISS's preliminary FAQs at https://www.issgovernance.com/file/policy/active/americas/US-Preliminary-Compensation-Policies-FAQ-regarding-COVID.pdf.

clearly disclosed and the resulting outcomes appear reasonable. The FAQ lays out key disclosure items.

- Bonus/AIPs: Under normal conditions, ISS considers adjustments to AIPs—such as changes to metrics, performance targets or measurement periods—or the suspension of bonus programs in favor of one-time discretionary awards to be problematic pay practices. ISS may support such actions if the company explains how specific challenges from the pandemic rendered the original performance targets impossible to achieve, why it favored its approach over other alternatives, and how the payouts appropriately reflect executive and company performance compared to what would have been paid under the original program design. Any discretionary awards should have a performance-based element. If the company is altering its bonus program design for 2021, it should discuss any positive changes, which could be a mitigating factor in ISS's qualitative evaluation.

- LTIPs: Changes to in-flight long-term incentive awards that cover multi-year performance periods will generally be viewed negatively by ISS. However, modest alterations for long-term incentive cycles that began in 2020—such as transitioning to relative or qualitative metrics—may be viewed as reasonable.

- Retention/one-time/replacement awards: ISS will continue to assess these awards with skepticism. One-time awards should be reasonable in size and isolated in practice and include performance-based, long-term vesting conditions and shareholder-friendly "guardrails" to avoid windfall scenarios. Companies that grant one-time awards for forfeited performance awards should explain how they do not simply insulate executives from lower pay.

- ISS responsive policy: Companies will continue to be subject to ISS's responsiveness policy if the say-on-pay (SOP) vote is less than 70%. However, if a company cannot implement changes to pay programs in response to shareholder concerns, it should explain how the pandemic impeded a response.

Discussion: Based on company disclosures to date, the proxy advisors' compensation updates may affect only a limited number of companies. According to research by the Conference Board and Semler Brossy Consulting Group, 177 Russell 3000 companies announced structural changes to their in-flight (ongoing) and/or go-forward (recently started or upcoming) incentive plans between March and October 2020.[25] Of these, 76% disclosed changes to their AIPs and 51% disclosed changes to their LTIPs.

The most common STIP structural changes were a reduction in the target and/or maximum payout opportunity (37% of companies), the addition of new metrics (28% of companies) and modifications to the performance period (22% of companies). The most prevalent actions on LTIPs included granting special awards to one or more NEOs (23% of companies), canceling outstanding grants and/or suspending new grants (23% of companies), and reducing the performance stock unit (PSU) target and/or maximum payout opportunity (21% of companies). About 15% of companies shifted their long-term award mix towards more time-based vehicles.

Other Topics

Closed-End Funds (ISS)

ISS will recommend against directors at closed-end management investment companies (CEFs) that have not provided a compelling rationale for opting into a state control share acquisition statute without shareholder approval. Such statutes serve as takeover defenses by restricting the voting rights of any person who acquires more than a specified percentage of a company's stock unless approved by the disinterested shareholders.

Discussion: ISS's update is in response to a May 2020 decision by the SEC's Division of Investment Management to overturn its decade-old position prohibiting registered CEFs and business development companies from opting into control share acquisition

[25] See the Conference Board/Semler Brossy study at https://conferenceboard.esgauge.org/covid-19/compchanges.

statutes (the Boulder Letter).[26] As a result of the reversal, CEFs can now avail themselves of state control share statutes to protect against activist investors that often try to reap short-term gains by pushing funds to liquidate or convert to open-end funds.[27]

Although approximately half of the states have control share statutes, many CEFs are incorporated in Maryland where they can opt into the statute by a simple board resolution. Such action may result in CEF shareholders losing their voting rights and lead to board entrenchment by discouraging activist campaigns.

Special Purpose Acquisition Companies (SPACs) (Glass Lewis)

Glass Lewis has added a new section to its policies detailing its approach to common issues associated with SPACs. Also known as "blank check companies," SPACs are shell companies with no commercial operations that are formed solely to raise capital through an initial public offering (IPO) in order to acquire an existing private company.

SPACs have a relatively short timeframe—typically two years—to consummate a qualifying business combination or else dissolve and return the IPO proceeds to common shareholders. As a result, they sometimes hold special meetings to extend the deadline. Glass Lewis will support reasonable extension requests in the belief that management and the board are in the best position to determine if they are needed.

Separately, Glass Lewis will consider directors of the post-combination entity who previously served as executives of the SPAC to be independent, absent any employment relationship or continuing material financial interest in the combined entity. Unlike a typical operating company, the essential role of a SPAC executive is to identify and execute an acquisition.

Discussion: SPAC listings have reached a record high in 2020 due to high levels of liquidity and market volatility, making them more appealing to private companies than traditional IPOs which are riskier and more time consuming to complete. According to SPAC Insider, 214 global SPAC IPOs raised $73.3 billion through early December 2020, far surpassing the $13.6 billion raised in 59 deals in 2019.[28]

Extension requests have also proliferated. According to Sidley Austin, 28 extensions received shareholder approval through the end of May 2020, setting a new record from 26 in 2019.[29] Glass Lewis has historically supported most extension proposals, as has ISS, which has a case-by-case policy.

Policy Clarifications

Classification of Directors (ISS)

ISS is modifying its classification of directors to limit the "executive director" category to officers of the company. Non-officer employees who serve on the board will be categorized as "non-independent non-executive directors." Directors whose pay is comparable to that of the NEOs will also be categorized as "non-independent non-executive directors."

Board Responsiveness (Glass Lewis)

Glass Lewis has clarified its approach to board responsiveness to non-binding shareholder resolutions. Under its current policy, support of 20% or more (excluding abstentions and broker non-votes) would prompt an evaluation of whether or not a board response was warranted. Per its update, Glass Lewis will expect significant board action on a shareholder

[26] See the SEC's statement at https://www.sec.gov/investment/control-share-acquisition-statutes#_ftn14. In its 2010 no-action letter to the Boulder Total Return Fund, staff concluded that opting into a control share acquisition statute would be inconsistent with Section 18(i) of the Investment Company Act which requires that every share of stock issued by a fund be voting stock and have equal voting rights with every other outstanding voting stock.

[27] A report by the Investment Company Institute (ICI) observed that because of an escalation of activist activity, the number of traditional exchange-listed CEFs in operation had declined by 25% between 2007 and 2019. See https://us.eversheds-sutherland.com/portalresource/20_ltr_cef.pdf.

[28] See SPAC Insider's statistics on SPAC IPOs at https://spacinsider.com/stats/.

[29] See Sidley Austin's research on SPAC extensions at http://ipo-edge.com/2020/06/05/sidley-austin-attorneys-spac-extensions-hit-record-after-coronavirus-freeze/.

proposal only when it receives majority support (excluding abstentions and broker non-votes).

Post-IPO/Spinoff Governance (Glass Lewis)

Glass Lewis has refined its approach to director recommendations on the basis of post-IPO governance concerns. Generally, it will hold the governance committee members accountable for provisions that are adverse to shareholders. If there is no governance committee or none of its members are up for election due to a classified board, Glass Lewis will expand its negative recommendation to other director nominees.

Glass Lewis will take a stricter stance towards companies that go public with unequal voting stock or other anti-takeover mechanisms. It will generally recommend against all members of the board who served at the time of the IPO if the board did not commit to submitting the provisions to a shareholder vote at the first shareholder meeting after the IPO or did not provide for a reasonable sunset of the provisions—typically three to five years for a classified board or poison pill and seven years or less for a multi-class share structure. If a multi-class share structure is put to a shareholder vote, Glass Lewis will examine the outcome based on the level of approval or disapproval attributed to the unaffiliated shareholders.

Excise Tax Gross-Ups and Golden Parachutes (Glass Lewis)

Glass Lewis strongly opposes excise tax gross-ups and their expansion. In keeping with this, it has added language to its policy regarding new gross-up entitlements that are tied to a change-in-control transaction. In such cases, Glass Lewis will not only oppose the golden parachute proposal, but may subsequently recommend against the compensation committee members and the SOP proposal of any involved corporate parties.

Option Exchanges and Repricings (Glass Lewis)

Glass Lewis generally opposes stock option exchanges and repricings irrespective of how they are accomplished. However, it has clarified that it will make an exception for programs that exclude directors and officers and programs and that are value-neutral or value-creative to shareholders.

Peer Group Methodology (Glass Lewis)

Glass Lewis has clarified that it uses a proprietary methodology (announced in 2019) in determining the peer groups used in its A-F PFP letter grades. In forming the peer groups, it considers both country-based and sector-based peers, along with the company's network of self-disclosed peers. Each component is considered on a weighted basis and is subject to size-based ranking and screening. The peer groups used are provided by CGLytics based on Glass Lewis's methodology and CGLytics' data.

Looking Ahead

In the coming weeks, ISS plans to publish its final FAQ document as well as review new shareholder proposals filed for 2021 and update its policies accordingly. Companies should also anticipate revisions to investor voting guidelines being released as proxy season draws near. Alliance Advisors will keep issuers apprised of any significant developments that materialize as they prepare for their 2021 annual meetings.