Benesch

# Corporate Governance Trends and Best Practices Among Middle Market Public Companies

February 2020

**Welcome** to the second annual Benesch Corporate Governance Report, which focuses on trends and best practices at middle market public companies.

2019 saw a continued focus on corporate governance from a number of audiences and constituencies. Discussions around diversity and environmental, social, and governance (ESG) matters remained prevalent among public companies, investors, and regulators, with much of the discourse focused on the utility of varying ESG disclosures. Shareholders voiced their perspectives on corporate governance and ESG matters through shareholder proposals and various initiatives aimed at effecting change to current governance structures, such as multiple classes of equity, proxy access, and ESG disclosure. Additionally, corporate governance missteps by companies made big headlines in 2019. The conversations around corporate governance matters continue to evolve, as evidenced by the move away from the focus on proxy access to whether and how a public company describes its environmental initiatives. The vocal constituencies have expanded beyond a company's shareholders and regulators to also include its suppliers, customers, and the public at large.

Our Report is intended to capture how these trends are represented and addressed by middle market public companies. The universe of companies reviewed for this Report was, as in our 2019 Report, derived from an S&P index focused on smaller public companies, the S&P SmallCap 600® index. We selected companies with market caps ranging from $75 million to $2.5 billion, resulting in a list of 220 companies from across the United States, of which we ultimately evaluated 200 companies for the results included in this Report. The complete list of companies included in this Report is located in Appendix A.

Thank you to the team that helped us assemble this Report, including our associates, Sam Barbara and Brian Mielcusny, and our summer associates, Amanda Bulot, Vanessa Gomez, Kaitlyn Heintzelman, Nicholas Lacey, Patrick Lipaj, Megan MacCallum, Anisha Patel, Marissa Pursel, Julia Rolniak, and Jaquan Williams.

We would be happy to discuss our findings, discuss trends, and help you address any gaps in your company's governance structure. We also look forward to receiving any feedback, suggestions, or questions related to the results included in our Report.

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# General Corporate Governance

## Smaller Reporting Company Status

**In June 2018, the Securities and Exchange Commission (the SEC) amended the threshold to meet the definition of "smaller reporting company" (or SRC). Under Regulation S-K and Regulation S-X, companies that qualify as SRCs are permitted to take advantage of reduced disclosure requirements—for example, SRCs are not required to include a Compensation Disclosure and Analysis section in their proxy statements.**

Prior to the 2018 amendment, for a company to meet the definition of "smaller reporting company," a company was required to have a public float of less than $75 million. Under the amended definition, this threshold was raised to a public float of less than $250 million. Companies with less than $100 million in annual revenues and either no public float or a public float that is less than $700 million are also eligible to provide scaled-back disclosures.

According to the SEC's adopting release regarding this amendment, in 2016, 2,592 companies claimed SRC status, representing about **25%** of the total number of SEC registrants. This number had been steadily decreasing since 2013, when there were 3,380 smaller reporting companies (representing approximately 44% of registrants).[1]

The SEC estimated in its 2018 adopting release that 966 additional registrants would be eligible for SRC status in the first year following the adoption of the increased threshold, representing approximately 38.6% of all registrants.[2]

Our Report focuses on public companies identified on the S&P Small Cap 600® and, in particular, we limited our review to companies with market caps of approximately $75 million to $2.5 billion. In light of the SEC's amendment to the definition of SRC (and the likely resulting rise in public companies that qualified as SRCs), we looked at which of the companies reviewed were SRCs and whether that changed their approach to disclosures in their proxy statements.

Of the companies reviewed, **3%** (six companies) disclosed on the cover of their annual reports on Form 10-K that they qualified as SRCs. Surprisingly, of those companies, only two fully employed the scaled-back disclosure available to SRCs.

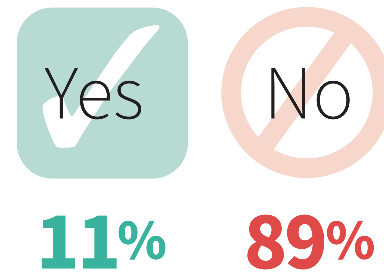
1 "Smaller Reporting Company Definition." *Code of Federal Regulations*, title 17 (2018): 210, 229, 230, 239, 240, 249. https://www.sec.gov/rules/final/2018/33-10513.pdf

2 *Id.*

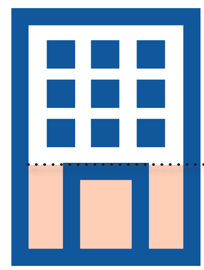
## Classes of Stock and Controlled Companies

Of the companies reviewed, 21 companies (or approximately **11%**) had multiple classes of stock. This number is comparable to the results of our Report last year, where **10%** of the companies reviewed had multiple classes of stock. Of the 21 companies with multiple classes of stock, 7 were controlled companies. Of all the companies reviewed, **10%** were controlled companies..

**Percent of Companies Reviewed with Multiple Classes of Stock**




According to a report by the Council of Institutional Investors, in the first half of 2019, 26% of the IPOs on a U.S. exchange had dual-class structures with unequal voting rights. Of these companies with a dual-class structure, only 20% had time-based sunset structures. While the number of companies with a dual-class IPO capital structure (either with or without time-based sunset) has increased in the past three years (2017 – 19%, 2018 – 11%, first half of 2019 – 26%), over the same time period, dual-class companies as a percentage of total market capitalization has decreased (2017 – 49%, 2018 – 17%, first half of 2019 – 15%).[3]



**Approximately 1/3 of companies with multiple classes of stock were controlled companies.**

Institutional Shareholder Services (ISS) has also noted the growth of multi-class capital structures in newly public companies over the past several years. ISS will generally recommend a vote against or withhold from an entire Board if, prior to or in connection with the company's public offering, the company/Board implements a multi-class capital structure with unequal voting rights, unless it is subject to a reasonable time-based sunset provision.

ISS is not the only institution opposed to multi-class capital structures; concerns over dual-class stock structures continue to be top of mind for certain institutional investors. The Council of Institutional Investors has started a campaign at the state level—in particular, Delaware—to amend the corporate code to require publicly traded companies with a multi-class structure to have such structure end no later than seven years after the company's IPO. This proposal cites recent academic evidence showing that, while dual-class voting structures may be beneficial in the short run, they are not advantageous in the long run and in fact "over time, and on average, the valuation of these firms tends to decline, as the 'wedge' between ownership and control widens."[4]

3 Council of Institutional Investors. "Dual Class IPO Snapshot: 2017-2019 Statistics." Council of Institutional Investors, n.d. https://www.cii.org/files/2019 Dual Class Update for Website FINAL(2).pdf.

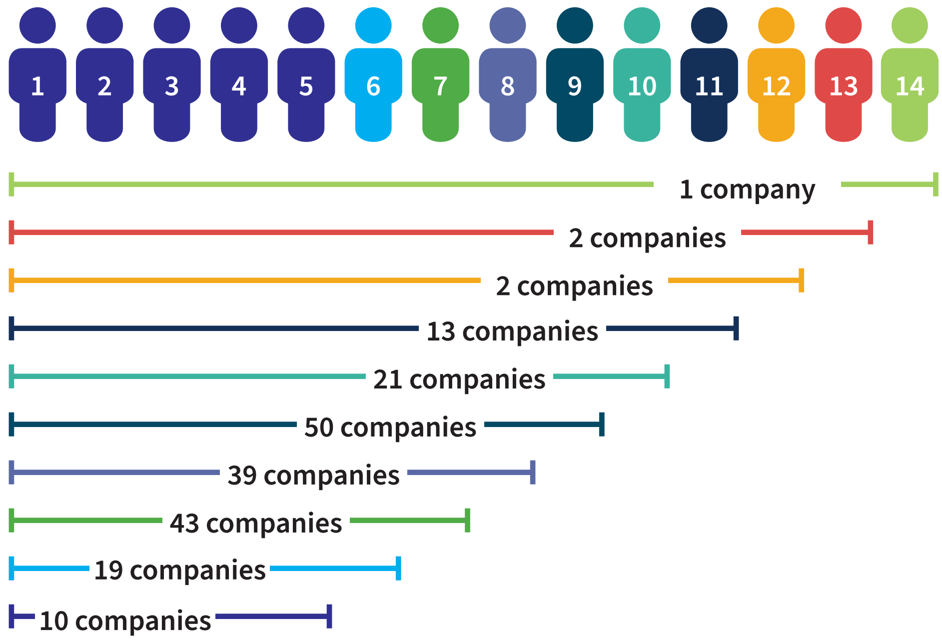
4 Council of Institutional Investors. "Email Correspondence." Council of Institutional Investors, September 13, 2019. https://www.cii.org/files/issues_and_advocacy/correspondence/2019/September 13 2019 Final DGCL letter.pdf.

# Composition of Board of Directors

## BOARD SIZE

Similar to the results of last year's Report, **85%** of the companies reviewed have a Board of Directors with **seven** or **more** directors on their Board, with **66%** of the companies reviewed having a Board of Directors with **seven** to **nine** directors.

**Total Number of Directors on a Company's Board**




## INDEPENDENCE

Approximately **90%** of the companies reviewed have a Board of Directors where **70%** or more of the directors are independent.

Independence at the committee level continued to be very common—virtually all of the companies reviewed had independent chairs of their Audit, Compensation, and Nominating/Corporate Governance committees.

63%

**have a Board of Directors that is somewhere between 80% and 90% independent**

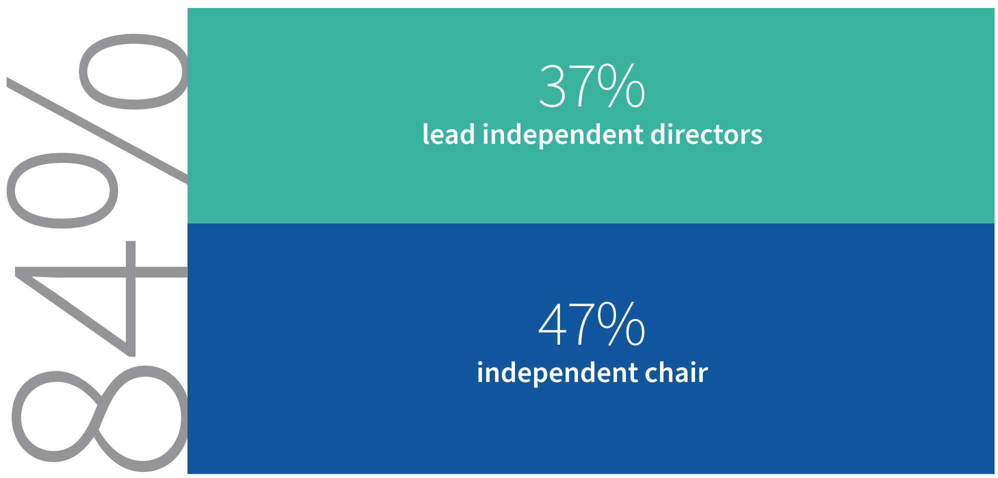
73.5%

**have a Board of Directors that is at least 80% independent.**

## BOARD LEADERSHIP

Consistent with the results of last year's Report, a strong majority of Boards (**84%**) have either an independent chair of the Board or a lead independent director. Of the companies reviewed, just under half (94 companies, or **47%**) have an independent chair, and **37%** have lead independent directors.

There continues to be a strong emphasis on Boards having an independent Board chair. ISS found that nearly two-thirds of investors it surveyed believe that ISS should recommend against the election or reelection of a Board chair if he or she is not independent.[5] This is something for Nominating/Governance Committees and Boards to monitor and consider, as independent Board chairs are not yet universal—as noted above, slightly more than half of the companies reviewed for this Report did not have an independent Board chair.




5 Hinks, Gavin. "Board Independence Revealed as Key Issue for Investors in 2020." Board Agenda, September 16, 2019. https://boardagenda.com/2019/09/16/board-independence-key-issue-investors-2020/.

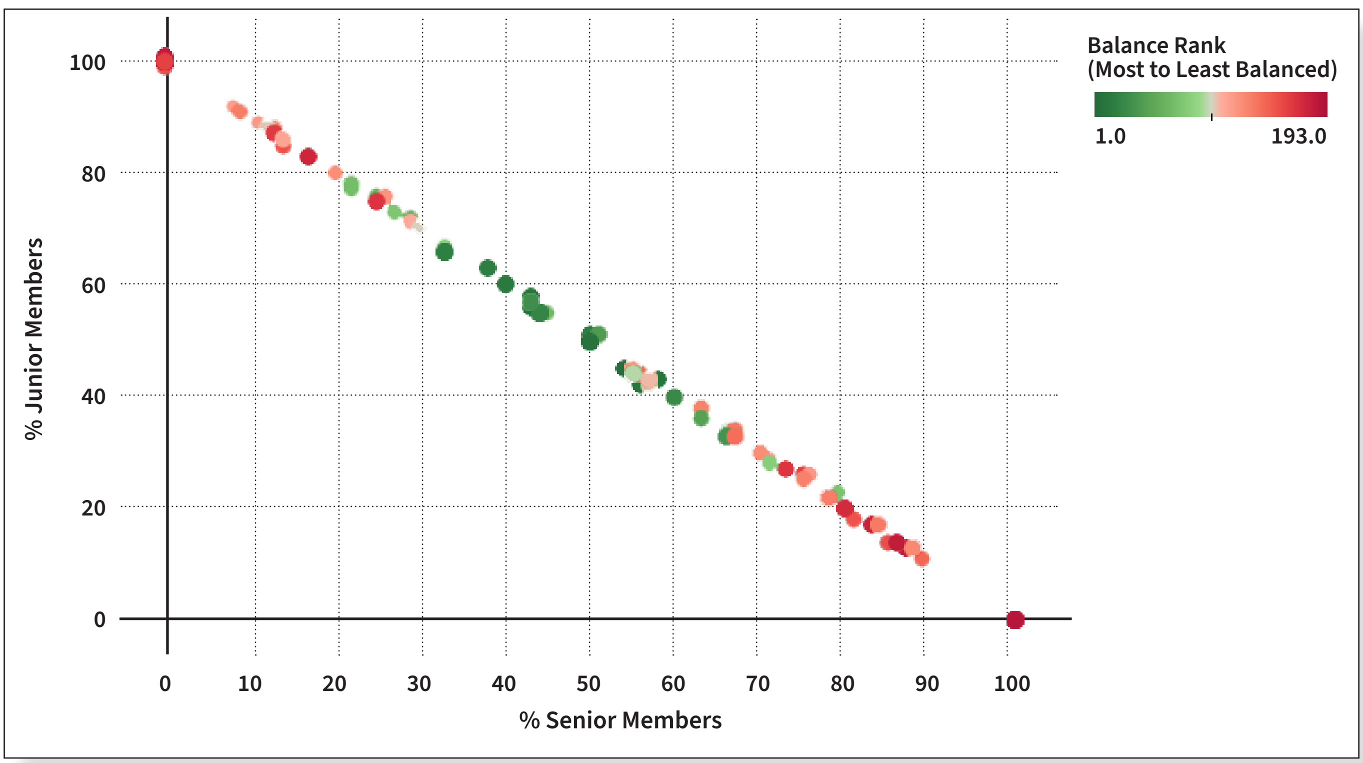
## LENGTH OF DIRECTOR SERVICE

In evaluating Board tenure, we looked at all directors of the companies reviewed and tracked whether they served fewer than 3 years, between 4 and 6 years, between 7 and 9 years and more than 10 years. For purposes of analyzing the results for this Report, we consider a "balanced" Board as one in which the distribution of individual directors' tenure was approximately equal across all four tenure categories. Moreover, we considered a Board with a larger percentage of directors falling into the junior (<3 years; 4-6 years) category as a highly "refreshed" Board.

The following chart shows the spread of balanced Boards, with the the darker green circles at the center representing the most-balanced Boards and the circles extending out representing the less-balanced Boards that fall in either the more-refreshed or longer-tenured ends of the spectrum. Looking at the 20 Boards that fell the furthest away from being deemed "balanced," **65%** of those Boards had more than 50% of their directors who had served for six or fewer years, while **35%** of those outlying Boards had more than 50% of their directors who had served for 7 years or more.

Of all the Boards reviewed, **55.2%** are considered balanced, with a split between refreshed directors and long-tenured directors equal to or less than 70/30. It should be noted that some of the Boards on the more refreshed end of the spectrum included Boards of companies that have become public in the last few years, and, accordingly, their directors have not had the opportunity to serve for a longer period of time. Nonetheless, it generally appears that Boards are leaning toward more refreshed Boards.

**Balanced Board Distribution**



## GENDER DIVERSITY ON BOARDS

The 2019 proxy season showed a continued focus on gender diversity on the Boards of Directors of public companies of all sizes. Gender diversity has been an area of scrutiny for several years, from a variety of fronts. Large institutional investors, such as BlackRock and State Street, have been advocating for more female representation on public company Boards of Directors. California enacted a law in 2018 that mandated that public companies with principal executive offices located in California have at least one female director on their Boards of Directors by December 31, 2019. Other states (New Jersey and Michigan) have followed suit, and introduced bills with similar mandates. Other states have adopted or introduced legislation encouraging diverse/gender representation on Boards (Pennsylvania) or calling for data collection/reporting on diverse/gender representation (Illinois, New York, and Maryland). In addition, ISS recently revised its policy regarding gender diversity. Under the revised policy, for companies in the Russell 3000 or S&P 1500 indices, ISS will generally recommend a vote against or withhold from the chair of the Nominating/Governance Committee at companies where there are no women on such company's Board, short of mitigating factors. Mitigating factors include (i) until February 1, 2021, a firm commitment (included in the company's proxy statement) to appoint at least one woman to the Board within a year or (ii) the presence of a woman on the Board at the prior annual meeting and a firm commitment to appoint at least one woman to the Board in the next year.

2019 saw changes in the gender composition of public company Boards of Directors. In July 2019, the Wall Street Journal reported that the last S&P 500 company that had an all-male Board appointed a woman to its Board of Directors, meaning all S&P 500 companies had at least one female director.[6]

Adding to the scrutiny of diversity of public company Boards, in January 2020, Goldman Sachs announced that, starting July 1, 2020, it would not take a company public unless the company had at least one diverse Board member, with a focus on women. The CEO of Goldman Sachs further indicated that number would increase to two diverse members in 2021.

Gender diversity continued to increase at middle market companies, as well. Of the companies reviewed, **87.5%** had female Board members (only 25 of the companies reviewed had no women on their Boards of Directors, versus over 30 companies reviewed in 2018 that had no women on their Boards of Directors).

**Generally, the companies that did not have any female representation on their Boards of Directors did not directly address or provide any explanation for this lack of gender diversity. However, several companies did provide disclosure surrounding their initiatives regarding gender and other diversity on their Boards of Directors:**

- Two companies noted their respective Boards were actively seeking qualified women and individuals from minority groups as director candidates.
- Three companies disclosed amendments to their respective corporate governance guidelines or the adoption of specific diversity policies to underscore their commitment to diversity by including diverse candidates in the pool of candidates considered for director roles.
- Two companies noted that when reviewing candidates for an open Board seat, their respective Nominating/Governance Committees would include in the list of candidates one or more qualified female and minority candidates.
- One company disclosed that its Nominating/Governance Committee would be meeting in 2019 to develop a plan to establish criteria to use when identifying director candidates, and seeking qualified female and other diverse candidates would be a point of emphasis in this process.

6 Fuhrmans, Vanessa. "The Last All-Male Board on the S&P 500 Is No Longer." The Wall Street Journal, July 24, 2019. https://www.wsj.com/articles/the-last-all-male-board-on-the-s-p-500-is-no-longer-11564003203.

## DIVERSITY REPRESENTATION ON BOARDS

In addition to disclosure around gender diversity on Boards of Directors, we analyzed how companies disclosed and discussed racial/ethnic diversity on their Boards, as public company disclosure around diversity representation (beyond gender diversity) on Boards of Directors also continues to be a hot topic in the news and for a number of investors. A June 2019 GAO report included an emphasis on improving the federal disclosure requirements for both gender and diversity disclosure.[7] The report cites the inconsistencies and variations in how diversity is disclosed in proxy statements, which is consistent with our review and the variation in disclosures we saw.

- Of the companies reviewed, **14%** specifically disclosed diversity representation on their Boards, which is an increase over the **10%** of companies reviewed last year that specifically disclosed diversity.
- Of these companies, 23 companies (approximately **79%** of that subset, and approximately **12%** overall) disclosed the specific percentage of the Board membership that it considered "diverse."

**A number of companies also provided commentary on how their Boards would work to increase Board diversity:**

- Making diversity a priority, setting a voluntary target, requiring a diverse slate of candidates, filling interim Board seats with diverse candidates, emphasizing the importance of diversity, and mentoring potential diverse Board candidates.
- Enlarging the pipeline of potential Board candidates.

## BOARD FINANCIAL EXPERTS

Audit Committees also include "Financial Experts" on their committees in accordance with the requirements under Item 407(d)(5)(ii) of Regulation S-K. The number of reported Financial Experts was concentrated between one and four Financial Experts:

**Number of Financial Experts Serving on the Audit Committee**

| 1 expert | 2 experts | 3 experts | 4 experts |
|---|---|---|---|
| 31% | 22% | 24% | 12% |

7 United States Government Accountability Office. Testimony of Chelsea Gurkin on Board Diversity: Strategies to Increase Representation of Women and Minorities (2019). https://www.gao.gov/assets/700/699874.pdf

# Board of Directors Elections

## FREQUENCY OF DIRECTOR ELECTIONS

63%
**have annual Board elections**

Annual director elections continue to be the majority approach to frequency of director elections. Approximately **63%** of companies reviewed hold director elections annually.

Of the approximately **37%** of the companies reviewed that do not conduct annual elections, the vast majority provide for classified Boards where directors are elected every three years.

ISS considers classified Boards as a "problematic" corporate governance practice, and while annual director elections have become more and more prevalent among S&P 1500 companies as a whole, a 2018 ISS study noted that adoption of annual elections by smaller public companies lagged behind larger companies. In particular, while 87% of S&P 500 companies had annual director elections in 2017, only 53% of S&P SmallCap 600® companies had adopted annual director elections.[8]

## VOTE STANDARDS IN UNCONTESTED ELECTIONS

Of the companies reviewed, **68%** had a "majority" vote standard for uncontested director elections. A majority vote standard requires that directors receive a majority of the shares voting or present at the applicable meeting in order to be elected. In contrast, under a plurality standard, the directors receiving the largest number of votes will be elected.

Similar to last year's Report, while a majority vote standard is clearly prevalent among the companies reviewed, this number continues to fall below that of larger public companies. According to ISS, 90% of S&P 500 companies maintain a majority vote standard for uncontested elections. However, the prevalence of the majority vote standard vs. a plurality vote standard in the companies reviewed is fairly consistent with the Russell 3000 as a whole, where 58% of companies maintain a majority vote standard.[9]

8 Papadopoulos, Kosmas, Robert Kalb, Angelica Valderrama, and Jared Sorhaindo. "U.S. Board Study: Board Accountability Practices Review." Institutional Shareholder Services, April 17, 2018. https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf.

9 Papadopoulos, Kosmas. "The CLS Blue Sky Blog." The CLS Blue Sky Blog (blog). Columbia Law School, July 17, 2019. http://clsbluesky.law.columbia.edu/2019/07/17/iss-offers-overview-of-vote-requirements-at-u-s-meetings/.

# Director Attendance and Evaluations

## BOARD MEETING ATTENDANCE

Similar to our findings last year, an overwhelming majority of directors attended at least 75% or more of their company's Board and applicable committee meetings. Of the companies reviewed, **95%** reported that all of their directors had met the 75% meeting threshold.

ISS and Glass Lewis & Co. (Glass Lewis) maintain policies for their voting recommendations in connection with directors' attendance at Board of Directors and committee meetings. ISS and Glass Lewis generally recommend a vote against or withhold from directors who attend fewer than 75% of the aggregate of the Board and committee meetings for the period for which they served, unless an acceptable reason for absences is disclosed. Acceptable reasons for absences generally include serious illnesses or similar extenuating circumstances, or where a director has been on the Board for less than one year.

Of the few companies who had directors who did not meet the 75% meeting attendance threshold, the following reasons were disclosed:

- Scheduling conflicts
- Director was newly appointed and did not make it to the few remaining meetings
- Health matters
- Travel/Flight issues that prevented attendance

In a few instances, no explanation was provided.

## PERFORMANCE REVIEWS

Approximately **58%** of the companies disclosed that their Boards of Directors conducted evaluations of Board performance. This is an increase compared to the results of last year's Report (where **49%** of companies disclosed Board evaluations).

Board performance and evaluation continues to be of interest to investors. According to an Ernst & Young report, 73% of Fortune 100 companies disclosed their Boards of Directors undertake evaluations of Board performance.[10] While the disclosure of Board evaluations for middle market companies is not as prevalent as it is for larger companies, it continues to be on the rise for both middle market and larger public companies.

10 Ernst and Young. "How Companies Are Evolving Board Evaluations and Disclosures." EY Center for Board Matters. Ernst and Young, 2019. https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-how-companies-are-evolving-board-evaluations-and-disclosures.pdf.

# Governance Guidelines and Restrictions

## BOARD GUIDELINES

In our review of companies' disclosure of Board governance guidelines, the results of our 2019 review were very similar to the prior year—**83%** of companies reviewed disclosed the presence of Board governance guidelines in the 2019 proxy season (as compared to **80%** in the prior year).

## STOCK OWNERSHIP GUIDELINES

Similar to practices at larger public companies (and similar to observations in last year's Report), a significant majority of companies subject directors to stock ownership guidelines. Such stock ownership guidelines require that directors maintain some level of ownership of shares of the company's stock. Of companies reviewed, **75%** (as compared to **71%** last year) disclosed the existence of stock ownership guidelines for directors.

## HEDGING AND PLEDGING

Consistent with last year's Report, approximately **77%** of companies prohibited hedging of company stock by company employees.

Additionally, only about **3%** of companies disclosed that their executives or directors pledged company shares.

2019 marked the last year of voluntary disclosure regarding most companies' policies regarding hedging policies. In 2018, the SEC adopted final rules regarding public companies' disclosure of hedging practices and policies. In particular, public companies will be required to describe any practices or policies they have adopted regarding the ability of employees (including officers) or directors to purchase securities or other financial instruments, or otherwise engage in transactions that hedge or offset, or are designed to hedge or offset, any decrease in the market value of equity securities granted as compensation, or held directly or indirectly by the employee or director. If the company does not have any such practices or policies, the rule will require the company to disclose that fact or state that hedging transactions are generally permitted. This disclosure is now required in proxy and information statements for the election of directors during fiscal years beginning on or after July 1, 2019. Companies that qualify as SRCs or "emerging growth companies" (each as defined in Securities Exchange Act Rule 12b-2) must comply with the new disclosure requirements in proxy and information statements for the election of directors during fiscal years beginning on or after July 1, 2020. Listed closed-end funds and foreign private issuers will not be subject to the new disclosure requirements.

While the SEC's final rules did not cover companies' policies regarding pledging of company shares, Regulation S-K requires disclosure of pledged shares by directors and executive officers in the "Certain Beneficial Ownership" table. Further, ISS maintains a voting policy to vote against members of the committee that oversees risk related to pledging, or the full Board, "where a significant level of pledged company stock by executives or directors raises concerns."[11]

11 Institutional Shareholder Services. "United States Proxy Voting Guidelines: Benchmark Policy Recommendations." ISS Governance, January 4, 2018. https://www.issgovernance.com/file/policy/2018-US-Voting-Guidelines.pdf.

# Over-boarding

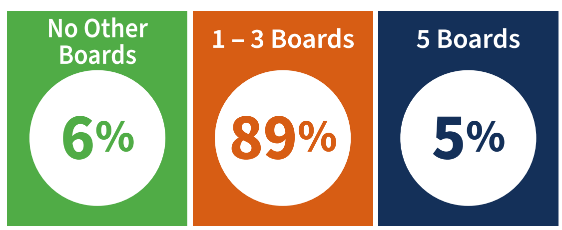
## DIRECTOR OVER-BOARDING

In 2019, as in recent years, investors have focused on whether a company's directors are "over-boarded." Acting as a public company director involves a significant amount of responsibilities and is a substantial time commitment. Accordingly, investors are increasingly monitoring the number of public company Boards on which a director sits.

ISS and Glass Lewis view an independent director as "over-boarded" if the director serves on more than five public company Boards (for Glass Lewis, this number drops to two if the director is also a named executive officer (or NEO) of a public company). However, a number of institutional investors have developed internal voting guidelines with varying positions for independent director "over-boarding" thresholds (some view the maximum number of public Board memberships at four, others at six, with further variances if an independent director is also an NEO of a public company).

Of the companies reviewed, a small number had either no directors serving on the Boards of other public companies or had directors serving on a total of five public company Boards (including the reviewed company). The vast majority of companies reported directors serving on between one and three other Boards in addition to the reviewed company's Board.

**Percent of Directors Serving on Other Public Company Boards**

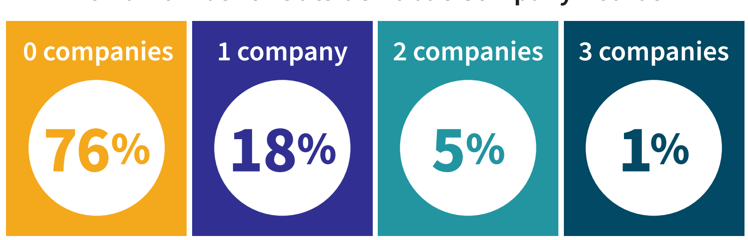



## CEO OVER-BOARDING

The concern about over-boarding can be particularly acute for public company CEOs. Both ISS and a number of institutional investors maintain voting policies related to the number of "other" public company Boards on which a public company CEO serves. ISS voting guidelines view a CEO as "over-boarded" if such CEO has three or more total public company Board memberships and provides for a "withhold" vote against a public company CEO who sits on the Boards of more than two public companies besides his or her own.

Similar to the results in last year's Report, very few of the CEOs of the companies we reviewed would be viewed as "over-boarded" under ISS standards. Of the companies reviewed, a strong majority (**76%**) of CEOs did not sit on any outside Boards. Of the CEOs included in our Report, **6%** would be deemed "over-boarded" by ISS standards.

**Percent of Companies Reviewed Where the CEO Sits on a Number of Outside Public Company Boards**



## Proxy Access

The era of proxy access by private ordering has resulted in proxy access becoming mainstream at S&P 500 companies, where over 70% of companies have adopted proxy access. As companies have increasingly adopted provisions in their governing documents allowing shareholders meeting certain ownership and other requirements to nominate director candidates to be included on the company's ballot, the number of shareholder proposals urging companies to adopt proxy access has lessened over the past few years.

Since 2011, when the U.S. Court of Appeals for the D.C. circuit invalidated the SEC's rule requiring public companies to adopt proxy access, certain institutional investors advocated for public companies to nevertheless adopt proxy access. In 2014, the New York City Comptroller and New York City pension funds launched the "Boardroom Accountability" project. One of its initial campaigns was to "give shareowners the right to nominate directors at U.S. companies using the corporate ballot, known as 'proxy access.'"[12] The proxy access initiative was "Boardroom Accountability Project 1.0." In September 2017 and October 2019, Boardroom Accountability Project 2.0 and Boardroom Accountability Project 3.0, respectively, were launched. These projects moved away from proxy access and instead focused on corporate Board diversity, independence, and climate responsibility.

However, proxy access has not yet become ubiquitous at middle market public companies. Of the companies we reviewed, **14%** granted proxy access to their shareholders. This number is in keeping with the Russell 3000 as a whole, where only 15.5% of companies have adopted proxy access.

The 2019 proxy season found fewer shareholder proposals regarding proxy access. In 2019, across public companies, there were 27 shareholder proposals relating to proxy access that were put to a shareholder vote, of which only 5 were proposals for companies to implement proxy access provisions (the remaining 22 were proposals to amend existing proxy access provisions).[13] This is a decline from the 37 proxy access-related proposals in 2018 (and a marked decline compared to the 63 proxy access proposals in 2016).[14]

The continued decrease in proxy access proposals by shareholders likely correlates to the fact that proxy access has been fairly widely adopted at S&P 500 companies. However, that the number of shareholder proposals has continued to decline may indicate that this wave of corporate governance shareholder activism will not become widespread at middle market and smaller public companies.

12 New York City Comptroller. "Boardroom Accountability Project 3.0." New York City Comptroller, 2019. https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview/.

13 Proxy Monitor. "Proxy Monitor." ProxyMonitor.org. Manhattan Institute, 2019. https://www.proxymonitor.org/ScoreCard2019.aspx.; Treviño, Marc. "Harvard Law School Forum on Corporate Governance." *Harvard Law School Forum on Corporate Governance* (blog), July 26, 2019. https://corpgov.law.harvard.edu/2019/07/26/2019-proxy-season-review-part-1-rule-14a-8-shareholder-proposals/.

14 Treviño, Marc. "Harvard Law School Forum on Corporate Governance." *Harvard Law School Forum on Corporate Governance* (blog), July 26, 2019.

## Related-Party Transactions

Companies are required to disclose certain transactions undertaken by a company and related persons, including directors and executive officers. In particular, when considering Board structure of public companies, ISS will look at, among other facts, whether a company's CEO has been involved in any material related-party transactions.

Similar to the results of last year's Report, only a minority (**13%**) of companies disclosed related-party transactions involving the company's CEO.

## CEO Pay Ratio

We observed reported CEO pay ratios ranging from 0 (where the CEO did not take any pay) to one company at 2,493 to 1.

Of the companies that reported a pay ratio, **75.5%** of the companies reviewed disclosed pay ratios of less than 100 to 1—further, those companies fell into the following bands of CEO pay ratios:

| | |
|---|---|
| 47 companies | < 20 to 1 |
| 31 companies | > 20 to 1, but < 40 to 1 |
| 26 companies | > 40 to 1, but < 60 to 1 |
| 20 companies | > 60 to 1, but < 80 to 1 |
| 14 companies | > 80 to 1, but < 100 to 1 |

Another **19** companies fell in the range of having a CEO ratio of greater than 100 to 1 but less than 200 to 1.

**Thirteen** companies fell on the higher end of the ranges we observed, with CEO pay ratios of over 400 to 1. Of those 13 companies, 9 are businesses in the retail or manufacturing sectors.

2019 marked the second year of proxy statement disclosure of the ratio of CEO compensation to a company's "median" employee. One question that faced companies going into the 2019 proxy season was whether to retain the same median employee as was disclosed in 2018 or select a new median employee.

According to the SEC in its adoption of this rule, a company is permitted to identify its median employee once every three years unless there has been a change in its employee population or employee compensation arrangements that it reasonably believes would result in a significant change to its pay ratio disclosure. Also, within those three years, if the median employee's compensation changes, the company may use another employee with substantially similar compensation as its median employee.

We observed that **24** companies disclosed that they had identified a new median employee. Their reasons for doing so ranged from the fact that the prior median employee departed from the company (the most common reason) to significant employee population change due to a divestiture, acquisition, relocation, and change in employee numbers to the company's variable pay practices.

It should be noted that SRCs are not required to disclose CEO pay ratio under their reduced disclosure requirements.

## Virtual Meetings

The holding of virtual annual meetings continues to be a minority practice among the companies reviewed.

The following shows the companies who held virtual annual meetings during the 2019 proxy season:

**Number of Companies Reviewed That Offer Virtual Stockholder Meetings**

Yes
15

No
185

**Number of Companies Reviewed With Virtual Stockholder Meetings That Were Virtual-Only Meetings**

Yes
11

No
4

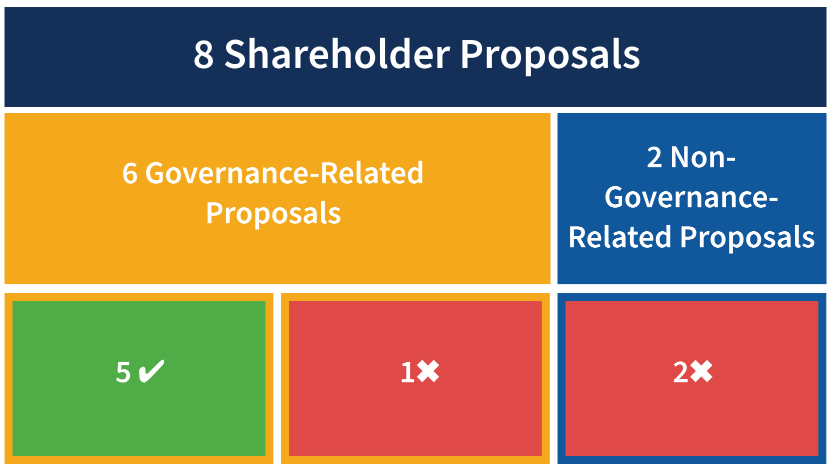
As noted in last year's Report, the practice of holding virtual-only annual meetings is not universally accepted. Certain institutional investors do not support or have spoken out against virtual-only annual meetings. Commencing with the 2019 proxy season, Glass Lewis generally took the position of recommending votes "against" Nominating/Governance Committee Board members of companies that intend to hold virtual-only stockholder meetings unless the company's proxy statement includes a "robust disclosure" assuring shareholders that they have the same rights and opportunities to participate in such annual meeting as they would at an in-person meeting.

Despite a certain level of opposition to virtual-only annual meetings, the percentage of public companies holding virtual-only annual meetings has been increasing slightly in the past few years. According to an ISS review, 7.7% of Russell 3000 companies held virtual-only meetings during the 2019 proxy season (vs. 6.8% in the year before)[15] and some larger companies (for example, General Motors and Microsoft) went to virtual-only meetings in 2019. In addition to potentially providing cost savings to the company, virtual meetings may provide greater access to shareholders who would not otherwise be able to attend an in-person annual meeting.

15 Buellingen, Marie Clara. "CLS Blue Sky Blog." CLS Blue Sky Blog (blog). Lexis Securities Mosaic Blogwatch, October 10, 2019. http://www.lexissecuritiesmosaic.com/net/Blogwatch/Blogwatch.aspx?ID=35382.

## Shareholder Proposals

During the 2019 proxy season, only **4%** of our companies (eight companies) included shareholder proposals in their respective proxy statements that were ultimately submitted to shareholders for approval. Following a general trend pertaining to proposals submitted to shareholders via proxy (discussed further below), six of the eight proposals noted during our review (**75%**) related to general corporate governance matters, including, for example, proposals requiring the election of directors by a majority vote (in both contested and uncontested director elections), providing for enhanced shareholder proxy access, and relating to the replacement of any "supermajority" approval requirements set forth in the bylaws of the company. Our review also revealed shareholder proposals relating to the issuance by a company of a report detailing potential risks associated with its current equal employment opportunity policy, as well as changes to equity compensation policies for equity awards to senior directors.




Of the eight shareholder proposals this proxy season, a majority were related to governance and were approved, with only one governance-related proposal not receiving approval. For the shareholder proposals that were non-governance related, the outcome was not good, with both being voted down.

The characteristics of the shareholder proposals seen in our review correspond generally to the trends noted among larger public companies. As was the case during the 2018 proxy season, in 2019, most shareholder proposals (approximately 64.4%) related to general corporate governance matters. In 2019, among larger public companies, common shareholder proposals include those relating to an independent Board chair, a required political contribution disclosure, and Board diversity. More specifically, shareholders of an increasing number of companies are passing proposals to eliminate supermajority approval requirements contained in applicable governing documents, such as bylaws. Among 2019 proxy statements of larger public companies, 16 included supermajority elimination proposals that were ultimately approved, an increase from 8 during the previous year.[16]

16 Park, Lyndon. "Harvard Law School Forum on Corporate Governance." Harvard Law School Forum on Corporate Governance (blog), September 17, 2019. https://corpgov.law.harvard.edu/2019/09/17/2019-proxy-season-recap-and-2020-trends-to-watch/.

# Environmental, Social, and Governance (ESG) Initiatives

A growing trend in recent years has been disclosure by public companies regarding their environmental, social, and governance (or ESG) initiatives.

As part of our review of proxy statements of middle market public companies, we analyzed how such companies are discussing their ESG initiatives. Disclosure in this area spanned a range of topics including corporate social responsibility (CSR), Board diversity, and refreshment, as well as general diversity, a number of which are addressed in more detail elsewhere in this Report.

33 companies

**referenced ESG initiatives in their proxy statements, and 9 (or approximately 27%) of those companies included more links to outside, in-depth reports on CSR and/or sustainability.**

6 companies

**(or approximately 18%) included links to their governance or sustainability guidelines, but not to in-depth reporting.**

The companies reviewed disclosed publishing CSR and/or sustainability reports at a lower rate than the Russell 1000, where 60% of companies published sustainability reports according to the U.S. Chamber of Commerce's Project GO Report. Project GO is an initiative that pairs business best practices with reasonable policy prescriptions to help address socioeconomic concerns. At the S&P 500 level, Project GO reports that 86% of companies publish sustainability reports.[17]

Looking more specifically at what CSR initiatives the reviewed companies are undertaking, we noted three categories of initiatives across industries: (1) philanthropy, (2) community involvement, and (3) internal and/or supply chain environmental impact. Many of the companies reviewed engage in a combination of these initiatives. Companies that discussed ESG matters without reporting specific work in any of these three categories tend to cite environmental commitment, recycling efforts, diversity, and employee well-being, without disclosing specific initiatives.

Of the 33 companies reviewed that disclosed ESG initiatives, we noted the following disclosures under the categories described above:

### Internal and/or Supply Chain Impact on the Environment and Human Rights

- 25 (or approximately **76%**) companies mentioned attention to their internal environmental impact (citing factors such as environmental concerns, and/or recycling efforts, and waste reduction). Of these companies, 4 specifically mentioned monitoring their carbon footprint.
- 8 (or approximately **24%**) companies monitored their environmental impact through scrutiny of their supply chains, and partnerships with customers. Of these companies, 3 also monitored human rights in their supply chains.

17 United States Chamber of Commerce. Remarks by Suzanne Clark on Project Go: Bringing Together Business Solutions and Practical Policies to Address Socioeconomic Challenges (October 22, 2019). https://www.uschamber.com/speech/project-go-bringing-together-business-solutions-and-practical-policies-address-socioeconomic.

### Philanthropy

- 14 companies (or approximately **42%**) referenced charitable giving, and 4 companies (or approximately **12%**) specifically reported the dollar amounts donated.
- Disclosure of charitable giving primarily included donations to local and national organizations directly or through employee fundraisers. Two tech-focused companies (financial services and computer services) reported partnerships where they provided their technology products and services to communities or organizations. One retail company (furniture) donated products to charity as well.

### Community Involvement

- 10 companies (or approximately **30%**) reported community involvement, generally, under their ESG initiatives, with 7 specifically describing those efforts. Community involvement included, primarily, charitable giving, community partnerships, and paid volunteer time.

Because ESG disclosures are voluntary, what companies provide for disclosures can vary significantly from company to company. As this area of disclosure grows, so has clamoring for the standardization of disclosure in this area. A survey published by McKinsey reported that 75% of the investors they surveyed agreed with the statement that there should be a single sustainability reporting standard.[18] In October 2018, a petition was submitted to the SEC calling for the SEC to, among other actions, start the process of developing a framework around ESG disclosure. This petition was signed by organizations representing over $5 trillion in assets under management, including CalPERs, the New York State Comptroller, and the State Treasurers of Illinois, Connecticut, and Oregon.[19]

However, the adoption of an ESG reporting standard is not universally supported. SEC Chairman Jay Clayton has remarked that "ESG" means "many different things to different constituencies," making it difficult to prescribe a single standard.[20] The U.S. Chamber of Commerce has also emphasized a tailored, rather than a one-size-fits-all approach, for ESG disclosure.

18 Bernow, Sara, Jonathan Godsall, Bryce Klempner, and Charlotte Merten. "More than Values: The Value-Based Sustainability Reporting That Investors Want." McKinsey & Company, August 2019. https://www.mckinsey.com/business-functions/sustainability/our-insights/more-than-values-the-value-based-sustainability-reporting-that-investors-want?cid=eml-web#.

19 Securities and Exchange Commission. "Letter to Secretary." Securities and Exchange Commission, October 1, 2018. https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

20 Tahmincioglu, Eve. "SEC Chief Takes on Short-Termism and ESG." Directors & Boards, n.d. https://www.directorsandboards.com/articles/singlesec-chief-takes-short-termism-and-esg.

## Companies Included in This Report

| Name of Company | Ticker Symbol |
|---|---|
| 8X8, Inc. | EGHT |
| ADTRAN, Inc. | ADTN |
| AeroVironment, Inc. | AVAV |
| Ambac Financial Group, Inc. | AMBC |
| American Woodmark Company | AMWD |
| American Equity Investment Life Holding Company | AEL |
| American Public Education, Inc. | APEI |
| AMN Healthcare Services, Inc. | AMN |
| Amphastar Pharmaceuticals, Inc. | AMPH |
| AngioDynamics, Inc. | ANGO |
| ANI Pharmaceuticals, Inc. | ANIP |
| Anika Therapeutics, Inc. | ANIK |
| Anixter International Inc. | AXE |
| Arcbest Corporation | ARCB |
| Arcosa, Inc. | ACA |
| Arlo Technologies, Inc. | ARLO |
| Armada Hoffler Properties, Inc. | AHH |
| Asbury Automotive Group, Inc. | ABG |
| Assertio Therapeutics, Inc. | ASRT |
| Astec Industries, Inc. | ASTE |
| ATN International, Inc. | ATNI |
| Avon Products, Inc. | AVP |
| B&G Foods, Inc. | BGS |
| Benchmark Electronics, Inc. | BHE |
| BJ's Restaurants, Inc. | BJRI |
| Blucora, Inc. | BCOR |
| Boise Cascade Company | BCC |
| Boot Barn Holdings, Inc. | BOOT |
| The Buckle, Inc. | BKE |
| Calamp Corp. | CAMP |
| California Water Service Group | CWT |
| Callaway Golf Company | ELY |

| Name of Company | Ticker Symbol |
|---|---|
| Cal-Maine Foods, Inc. | CALM |
| Cambrex Corporation | CBM |
| Cardtronics plc | CATM |
| Career Education Corporation | CECO |
| Century Aluminum Company | CENX |
| Century Communities, Inc. | CCS |
| CEVA,Inc. | CEVA |
| Chico's FAS, Inc. | CHS |
| The Children's Place, Inc. | PLCE |
| Circor International, Inc. | CIR |
| Community Health Systems, Inc. | CYH |
| Conn's, Inc. | CONN |
| CONSOL Energy Inc. | CEIX |
| Control4 Corporation | CTRL |
| Cooper-Standard Holdings, Inc. | CPS |
| Corcept Therapeutics Incorporated | CORT |
| Corvel Corporations | CRVL |
| Cray Inc. | CRAY |
| Cross Country Healthcare, Inc. | CCRN |
| Cubic Corporation | CUB |
| Cutera, Inc. | CUTR |
| Cytokinetics, Incorporated | CYTK |
| DSP Group, Inc. | DSPG |
| Dine Brands Global, Inc. | DIN |
| Diodes Incorporated. | DIOD |
| Diplomat Pharmacy, Inc. | DPLO |
| DMC Global, Inc. | BOOM |
| Donnelley Financial Solutions, Inc. | DFIN |
| Ebix, Inc. | EBIX |
| Electronics For Imaging, Inc. | EFII |
| Enanta Pharmaceuticals, Inc. | ENTA |
| Encore Wire Corporation | WIRE |
| Endo International plc | ENDP |

## Companies Included in This Report

| Name of Company | Ticker Symbol |
|---|---|
| Enova International, Inc. | ENVA |
| Era Group Inc. | ERA |
| Exlservice Holdings, Inc. | EXLS |
| Express, Inc. | EXPR |
| Fiesta Restaurant Group, Inc. | FRGI |
| Forward Air Corporation | FWRD |
| Fossil Group, Inc. | FOSL |
| Franklin Electric Co., Inc. | FELE |
| Frontier Communications Corporation | FTR |
| FutureFuel Corp. | FF |
| Gannett Co., Inc. | GCI |
| Garrett Motion, Inc. | GTX |
| Genesco Inc. | GCO |
| Getty Realty Corp. | GTY |
| Gibraltar Industries, Inc. | ROCK |
| G-III Apparel Group, Ltd. | GIII |
| GMS Inc. | GMS |
| Greenhill & Co., Inc. | GHL |
| Gulf Island Fabrications, Inc. | GIFI |
| H. B. Fuller Company | FUL |
| Hawaiian Holdings Inc. | HA |
| HealthStream, Inc. | HSTM |
| Heartland Express Inc. | HTLD |
| Heidrick & Struggles International, Inc. | HSII |
| Heska Corporation | HSKA |
| Innophos Holdings, Inc. | IPHS |
| Innospec Inc. | IOSP |
| Innoviva, Inc. | INVA |
| Insteel Industries, Inc. | IIIN |
| Interface Inc. | TILE |
| INTL FCStone Inc. | INTL |
| James River Group Holdings, Ltd. | JRVR |
| Kaman Corporation | KAMN |
| Kelly Services, Inc. | KELYA |

| Name of Company | Ticker Symbol |
|---|---|
| Kopin Corporation | KOPN |
| Koppers Holdings Inc. | KOP |
| Kulicke and Soffa Industries, Inc. | KLIC |
| Lantheus Holdings, Inc. | LNTH |
| LA-Z-Boy Incorporated | LZB |
| LCI Industries | LCII |
| LGI Homes, Inc. | LGIH |
| Liquidity Services, Inc. | LQDT |
| LSB Industries, Inc. | LXU |
| Magellan Health, Inc. | MGLN |
| Marcus & Millichap, Inc. | MMI |
| Materion Corporation | MTRN |
| Medpace Holdings, Inc. | MEDP |
| Mercer International Inc. | MERC |
| Meritage Homes Corporation | MTH |
| Methode Electronics, Inc. | MEI |
| Microstrategy Incorporated | MSTR |
| Mobile Mini, Inc. | MINI |
| Motorcar Parts of America, Inc. | MPAA |
| Mueller Industries Inc. | MLI |
| Myers Industries, Inc. | MYE |
| National Presto Industries, Inc. | NPK |
| Natus Medical Incorporated | BABY |
| Nautilus, Inc. | NLS |
| Navigant Consulting, Inc. | NCI |
| Newpark Resources, Inc. | NR |
| NIC Inc. | EGOV |
| Office Depot, Inc. | ODP |
| Office Properties Income Trust | OPI |
| Oil States International, Inc. | OIS |
| OneSpan, Inc. | OSPN |
| Onto Innovations Inc. | ONTO |
| Orasure Technologies, Inc. | OSUR |
| Orthofix Medical Inc. | OFIX |

## Companies Included in This Report

| Name of Company | Ticker Symbol |
|---|---|
| PDF Solutions, Inc. | PDFS |
| Perficient,Inc. | PRFT |
| Petmed Express, Inc. | PETS |
| Photronics, Inc. | PLAB |
| Piper Jaffray Companies | PJC |
| Pitney Bowes Inc. | PBI |
| Power Integrations, Inc. | POWI |
| Pro-Assurance Corporation | PRA |
| Progress Software Corporation | PRGS |
| The Providence Service Corporation | PRSC |
| Quanex Building Products Corporation | NX |
| Rambus Inc. | RMBS |
| Raven Industries, Inc. | RAVN |
| Red Robin Gourmet Burgers, Inc. | RRGB |
| REGENXBIO Inc. | RGNX |
| Regis Corporation | RGS |
| Renewable Energy Group, Inc. | REGI |
| Rex American Resources Corporation | REX |
| RH | RH |
| R.R. Donnelley & Sons Company | RRD |
| Ruth’s Hospitality Group, Inc. | RUTH |
| Safety Insurance Group, Inc. | SAFT |
| Saia, Inc. | SAIA |
| Sanmina Corporation | SANM |
| Scholastic Corporation | SCHL |
| Schweitzer-Mauduit Internationa, Inc. | SWM |
| SEACOR Holdings Inc. | CKH |
| Seneca Foods Corporation | SENEA |
| Shake Shack Inc. | SHAK |
| Shutterstock, Inc. | SSTK |
| Sonic Automotive, Inc. | SAH |
| SpartanNash Company | SPTN |
| SPX Corporation | SPXC |
| Stepan Company | SCL |

| Name of Company | Ticker Symbol |
|---|---|
| Stewart Information Services Corporation | STC |
| SunCoke Energy, Inc. | SXC |
| Superior Industries International, Inc. | SUP |
| Sykes Enterprises, Incorporated | SYKE |
| Tabula Rasa HealthCare, Inc. | TRHC |
| Tactile Systems Technology, Inc. | TCMD |
| Techtarget, Inc. | TTGT |
| Tennant Company | TNC |
| The Chefs' Warehouse, Inc. | CHEF |
| Tile Shop Holdings, Inc. | TTS |
| Timken Steel Corporation | TMST |
| Tivity Health, Inc. | TVTY |
| Tivo Corporation | TIVO |
| TTM Technologies, Inc. | TTMI |
| U S Concrete, Inc. | USCR |
| U.S. Physical Therapy, Inc. | USPH |
| U.S. Silica Holdings, Inc. | SLCA |
| Unifi, Inc. | UFI |
| Unisys Corporation | UIS |
| United Fire Group, Inc. | UFCS |
| United Insurance Holdings Corp. | UIHC |
| Universal Electronics, Inc. | UEIC |
| Universal Forest Products Inc. | UFPI |
| Universal Insurance Holdings, Inc. | UVE |
| Varex Imaging Corporation | VREX |
| Vicor Corporation | VICR |
| Virtus Investment Partners, Inc. | VRTS |
| Virtusa Corporation | VRTU |
| Vitamin Shoppe,Inc. | VSI |
| William Lyon Homes | WLH |
| World Acceptance Corporation | WRLD |
| Xperi Corporation | XPER |
| Zumiez Inc. | ZUMZ |

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