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Alert

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Heads-Up for the 2021 Proxy Season: Glass Lewis Issues Policy Updates

New Policies Focus on Racial/Ethnic Board Diversity, ESG Risk Oversight, Board Refreshment, SPACs and Executive Compensation

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Glass Lewis has released updates to its proxy voting guidelines applicable generally for shareholder meetings held after January 1, 2021 (available here). Noteworthy changes focus on board diversity and refreshment, board oversight responsibilities relating to environmental, social and governance issues (ESG), special purpose acquisition companies (SPACs) and executive compensation topics. The updates also refine and codify certain other existing policies. In a prior Alert, we discussed 2021 policy updates by Institutional Shareholder Services. Companies and directors should familiarize themselves with these policies, which could influence the results of director elections.

In this Alert, we summarize Glass Lewis' key voting policy updates and provide practical tips on "What to do Now?"

Key Glass Lewis Policy Developments for 2021

- Glass Lewis has eliminated the temporary COVID-19 exception to its policy on virtual-only shareholder meetings; its standard policy is back in effect, requiring robust disclosure on how shareholders can participate in the meeting.
- In 2021, Glass Lewis will note a concern if there are fewer than two female directors; starting in 2022, Glass Lewis will issue a negative recommendation for the nominating committee chair of a board with fewer than two female directors (for boards with more than six members).
- For meetings held after December 31, 2021, Glass Lewis will apply relevant state law board diversity requirements for recommendations in director elections when such state laws come into effect.
- Glass Lewis will track proxy statement disclosures relating to director diversity and skills.
- Starting in 2021, Glass Lewis will note a concern when boards of S&P 500 companies do not clearly disclose board-level oversight of ESG issues; in 2022, Glass Lewis will generally recommend voting against the governance chairs of companies that fail to provide such disclosure.
- Glass Lewis will note concern where the average tenure of non-employee directors is 10 years or more and no new directors have been elected to the board in the past five years.
- Glass Lewis has clarified its approach to several common issues relating to SPACs, including deadline extensions for completing business combinations and independence considerations.
- Glass Lewis has codified its approach to certain executive compensation practices, including evaluating changes to short- and long-term incentives.

Policy on Virtual-Only Shareholder Meetings

Virtual-Only Shareholder Meetings. The temporary exception to its policy on virtual-only shareholder meetings expired June 30, 2020. Accordingly, for companies choosing to hold their meeting in a virtual-only format during the 2021 proxy season, Glass Lewis expects robust proxy statement disclosure addressing the ability of shareholders to participate in the meeting – i.e., shareholders' ability to ask questions at the meeting; procedures, if any, for posting appropriate questions received during the meeting and the company's answers on its public website; as well as logistical details for meeting access and technical support. Glass Lewis will generally recommend voting against the governance committee chair and possibly other committee members when such disclosure is not provided.

Policy Updates Affecting Board Diversity, Refreshment and ESG Risk Oversight

Gender Diversity. Glass Lewis' current policy is to recommend against the nominating committee chair of a board that has no female directors. Starting in 2021, Glass Lewis will note as a concern boards that have fewer than two female directors, and, in 2022, Glass Lewis will generally recommend voting against the nominating committee chair of a board with fewer than two female directors if the board has more than six total members. Consistent with its current policy, Glass Lewis may also recommend against other members of the nominating committee where the committee chair is not up for election due to a classified board structure, or based on other factors including the company's size and industry, applicable state laws, and overall governance profile. Additionally, when making these voting recommendations, Glass Lewis will carefully review a company's disclosure of its diversity considerations and may not recommend against directors of companies outside the Russell 3000 index, or when boards have provided sufficient rationale or a plan to address the lack of board diversity. Glass Lewis did not specify what qualifies as "sufficient rationale."

Compliance with State Laws on Diversity. As we discussed here and here, there is growing momentum for state action on board diversity. For annual meetings held after December 31, 2021, Glass Lewis will make recommendations in director elections in accordance with board composition requirements set forth in applicable state laws when they come into effect. For example, if a California-headquartered company holds its annual meeting in 2022 and does not have (or appropriately disclose that it has) two female directors and one director from an underrepresented community, which will be the thresholds then in effect, Glass Lewis will generally recommend voting against the chair of the nominating committee (and other directors, as appropriate).

Board Attributes. Starting in 2021, Glass Lewis will assess the quality of proxy statement disclosure in its evaluation of the mix of diverse attributes and skills of directors. Glass Lewis will evaluate, among other things, how the proxy statement presents:

- The current percentage of the board's racial/ethnic diversity;
- The board's definition of diversity and whether it includes gender, race and ethnicity;
- A board policy akin to the NFL's "Rooney Rule" – e.g., requiring women and minorities to be included in the initial pool of director candidates; and
- The board's skills.

Board Refreshment. Starting in 2021, Glass Lewis will note as a concern instances where the average tenure of non-executive directors is 10 years or more and no new independent directors have joined the board in the last five years. Although Glass Lewis will not make recommendations solely on this basis in 2021, board refreshment may be a contributing factor in their recommendations when additional board-related concerns have been identified.

ESG Risk Oversight. Stating its view that the board should oversee ESG issues, starting in 2021, Glass Lewis will note as a concern when boards of S&P 500 companies do not provide clear disclosure concerning the board-level oversight of ESG issue. In 2022, Glass Lewis will generally recommend voting against the governance chairs of S&P 500 companies that fail to provide explicit disclosure concerning the board's role in overseeing these issues. Glass Lewis' existing policy provides it will recommend against members of the board that are responsible for ESG risk oversight where Glass Lewis believes that the company has not managed or mitigated environmental or social risks to the detriment of the shareholder value. In the absence of explicit board oversight of ESG issues, Glass Lewis may recommend against the election of members of the audit committee. It should also be noted that Glass Lewis also has a separate policy document providing its views on ESG related matters in greater detail, which is available here.

Policy Relating to IPO or Spin-off Governance Structures and Provisions

Governance Following an IPO or Spin-off. Glass Lewis clarified that it will generally recommend against all members of the governance committee if Glass Lewis determines that the board has approved overly restrictive governing documents in connection with an IPO or a spin-off. Glass Lewis will consider the presence of a classified board, poison pill, supermajority vote requirements to amend governing documents, exclusive forum or fee-shifting provisions, restrictions on shareholders' ability to act by written consent or call special meetings, plurality voting in director elections, the ability to remove directors without cause, evergreen provisions in equity plans and multi-class share structures. Glass Lewis will generally recommend voting against all of the members of the board that served at the time of the IPO if preceding the IPO, the board adopted a multi-class share structure where voting rights are not aligned with the economic interests, or an anti-takeover provision (such as a poison pill or classified board) if such structures and provisions (i) are not submitted for a shareholder vote at the first annual meeting following the IPO or (ii) include a reasonable sunset (i.e., seven years or less for a multi-class share structure; three to five years for a classified board or poison pill).

New Policies Affecting SPACs

SPACs. Glass Lewis has added a new section describing its approach to common issues associated with SPACs, which are formed solely for the purpose of raising capital through an initial public offering (IPO) to acquire an existing company within a set timeframe identified in its charter.

- **Extension of Business Combination Deadline.** Glass Lewis will generally defer to management's recommendation and support reasonable extensions of the business combination deadlines in light of the short timeframe within which a SPAC must consummate a business combination (usually between 18 and 24 months).
- **Independence.** NYSE and Nasdaq rules and related guidance generally permit a board to determine that a former SPAC executive officer may qualify as an independent director on the board of the combined operating company absent an employment or other material financial relationship with the company following the business combination. Similarly, Glass Lewis will generally consider a former SPAC executive to be an independent director of the combined operating company if his or her only position is that of an otherwise independent director. Therefore, if an executive officer of the SPAC resigns from his or her executive position in connection with the closing of the SPAC business combination and does not have a continuing material financial interest in the combined entity, Glass Lewis will consider such individual to be an independent director.

Compensation-Related Policy Changes and Clarifications

Incentive Awards. Glass Lewis has codified certain considerations when assessing a company's short- and long-term incentive awards and clarified that it expects clearly disclosed justifications to accompany any significant changes to both short- and long-term equity plan structures and use of upward discretion, which also includes instances of retroactively prorated performance periods.

- **Short-term Incentives:** Glass Lewis refined its policy for disclosure of performance targets for short-term incentive plans by clarifying that the performance and corresponding payout levels that can be achieved under short-term incentive plans should be disclosed. Glass Lewis also clarified that justification for both increases in the potential target and maximum awards and decreases in performance levels should be clearly disclosed to shareholders.

- **Long-Term Incentives:** Glass Lewis updated its policy to clarify its application of the inappropriate performance-based award allocation as criterion, which may, in the presence of other significant concerns, contribute to a negative recommendation. Glass Lewis also clarified that, outside of exceptional circumstances, the significant rollback or elimination of performance-based awards from a company's long-term incentive plan will generally be viewed as negative and may also lead to a negative recommendation. Additionally, Glass Lewis also clarified that it expects long-term incentive equity granting practices to be clearly disclosed.

Option Exchanges and Repricing: Glass Lewis clarified its approach for evaluating option exchanges and repricing proposals. Glass Lewis may support such proposals when the option exchange or repricing approximately reflects the market or industry price decline in terms of timing and magnitude on the basis that option grantees may be suffering from a risk that was not foreseeable when the awards were granted, if certain other conditions are met. These conditions include that officers and board members to be excluded from the program and that the program is value-neutral or value-creative to shareholders.

What To Do Now?

- Take a fresh look at the board's policies and processes around board self-evaluation, refreshment and recruitment, and engage in candid conversations about board composition, including tenure, skills and qualifications, and diversity (not limited to gender). Ensure that the company's public disclosure on these matters is accurate and understandable.
- Review how the board's attributes, including gender, racial and ethnic diversity as well as skills and qualifications, are disclosed in the company's proxy statement and confirm that it appropriately highlights the board's view of its diversity and its policies and procedures for refreshment.
- Review legislative updates relating to board diversity to ensure that the board is actively pursuing compliance with these requirements.
- Ensure appropriate oversight of ESG matters, whether by the full board or through the express delegation of such oversight to a board committee. Disclose the role and responsibilities of the board or its committees in overseeing the company's ESG efforts.
- Be mindful of heightened interest in climate-risk disclosure among institutional investors, including in risk factors and board risk oversight disclosure. Glass Lewis announced a new tool to assess company disclosures in accordance with the standards of the Task Force on Climate-Related Financial Disclosures (TCFD), which Glass Lewis clients could also customize to their specific climate-related voting policies.
- Consult Glass Lewis and ISS policies in addition to stock exchange listing rules when composing a SPAC board in connection with the IPO and the subsequent business combination.
- Thoughtfully consider post-IPO governance requirements, transition rules and phase-outs when adopting initial organizational documents and educate boards about the impacts on director elections of adopting certain provisions that restrict shareholder rights.
- Review short- and long-term incentive plans for any problematic practices identified by Glass Lewis' policies. Ensure that the company's proxy statement includes sufficiently detailed disclosure of the reasoning for the compensation committee's determinations of executive and director compensation, especially any retrospective changes to plans and awards, particularly in light of various changes made in response to unanticipated COVID-19 related impacts.
- For companies conducting a virtual-only shareholder meeting, consider and disclose how shareholders can participate online in the same way that they would be able to at an in-person shareholder meeting.

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