

2018

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

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## CONTINENTAL EUROPE



GLASS LEWIS

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# Guidelines Introduction

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While corporate governance practices in Europe vary significantly by country, many principles and regulations are common to most European countries. Therefore, we have consolidated our proxy voting guidelines for companies located in Europe (with the exception of the UK and Ireland for which we have separate voting guidelines) into a single pan-European policy to reflect the growing convergence of both corporate governance regulations among EU member states as well as governance practices among European companies. Corporate governance practices in Europe are increasingly codified by legally-binding directives and non-binding recommendations of the European Commission and other European regulatory authorities, which apply to all European Union member states and are frequently adopted by non-member European states such as Switzerland and Norway. The EU Shareholder Rights Directive, last amended in 2017, has been particularly influential in driving the convergence of disclosure and governance standards.<sup>1</sup>

These guidelines are intended to summarise the underlying principles and definitions used by Glass Lewis and European regulatory authorities when applying market-specific policies across continental Europe. Throughout these guidelines, as applicable, we will identify policies, principles and definitions that may vary by market. However, although country specific practices are diminishing, for a complete view of Glass Lewis' approach to proxy advice for each market, these guidelines should be read in conjunction with country guidelines tailored to the unique corporate governance regulations, codes, practices and structures of the countries below:

<i>Austria</i>	<i>France</i>	<i>Luxembourg</i>	<i>Portugal</i>
<i>Belgium</i>	<i>Germany</i>	<i>Netherlands</i>	<i>Spain</i>
<i>Denmark</i>	<i>Greece</i>	<i>Norway</i>	<i>Sweden</i>
<i>Finland</i>	<i>Italy</i>	<i>Poland</i>	<i>Switzerland</i>

The country-specific policies outline the Glass Lewis approach to analysing issues for companies in that market, including where that approach differs from our pan-European approach, as well as regulations and codes applicable to that country. In all cases, the country specific policy controls.

## VOTING RECOMMENDATIONS

Throughout these guidelines, we reference our policies on recommending a vote for, against, or abstaining from certain proposals. In some markets and at certain companies, against or abstain may not be valid voting options. In these cases, we will adjust the recommendation accordingly. In other markets and at certain companies, an abstain vote may not be counted towards the quorum for a proposal. In such cases, where we have identified a significant deficit of relevant information, we will consider recommending that shareholders vote against the proposal in order to ensure that their votes are counted.

## SUMMARY OF CHANGES FOR THE 2018 CONTINENTAL EUROPE POLICY GUIDELINES

The significant changes and updates to our 2018 policy guidelines are summarised below:

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<sup>1</sup> Directive 2007/36/EC, which created common transparency standards for issuers and removed impediments to voting for shareholders in Europe, was amended by Directive 2017/828, which must be fully implemented into national law in 2019. Among other updates, the amended Directive creates additional transparency requirements for issuers and investors and sets a common framework for shareholder approval of executive remuneration and related party transactions.

## AFFILIATED DIRECTORS

We have updated our guidelines to clarify that we may consider a lookback period for former executives irrelevant in cases where the individual has other significant ties to the company, such as being a member of the founding family of the firm or continuing to receive variable compensation.

## BOARD SKILLS

We have updated our guidelines to reflect our stance as regards emerging best practice for disclosure of a board's skills and competencies. Specifically, we believe companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. If a board has failed to address material concerns regarding the mix of skills and experience of the non-executive element of the board, we will consider recommending voting against the chair of the nominating committee or equivalent (e.g. board chair).

## PAY RATIOS

We have updated our guidelines to reflect our position on the disclosure of pay ratios. Specifically, we recognise that the disclosure of pay ratios between the CEO and median or average employee may be useful in contextualising the levels of executive remuneration both within a business and within industries. As such, we encourage companies to disclose such pay ratios, accompanied by a description of the methodology for their calculation, going forward.

## INCENTIVE PLAN TARGETS

We have clarified that we may recommend voting against say on pay proposals where performance targets are set below targets provided in guidance to shareholders, absent a compelling rationale for lowering the target. Further, we generally expect performance metrics to have a clear and direct link to a company's strategy, including explicit references, where appropriate, to KPIs described in relevant business cycles such as transformation plans.

## EQUITY GRANTS TO SIGNIFICANT SHAREHOLDERS

We have clarified that, in general, where an executive owns or directly controls more than 10% of a company's shares, we would not expect the individual to participate in equity incentive schemes, considering the natural alignment with shareholder interests.

## RESPONSE TO SHAREHOLDER DISSENT

We have clarified that we consider that the board generally has an imperative to respond to shareholder dissent from a proposal at a general meeting of more than 20% of votes cast - particularly in the case of a compensation or director election proposal - in line with common practice in Europe. We continue to take into account a company's shareholder structure when determining what constitutes "significant" dissent.

## NON-FINANCIAL REPORTING

We have updated our guidelines to reflect the requirements of the Directive on Non-Financial Reporting, which takes effect for large companies in Europe in 2018 based on accounts prepared for the 2017 fiscal year. While we do not take a prescriptive approach to how companies should comply with requirements set out by national regulatory authorities, we do believe companies should make every effort to clarify how they have adapted reporting to reflect these requirements. Where companies fail to provide meaningful reporting on environmental, social and governance risks to shareholder satisfaction, we may recommend voting against the committee responsible for reviewing sustainability or non-financial issues. If no committee is explicitly tasked with oversight of this function, we may recommend voting against the chair of the audit committee.

# A Board of Directors that Serves Shareholder Interest

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A variety of board structures are available to companies in Europe. The two prevailing models are one-tiered boards, comprising both executive and non-executive directors, and two-tiered boards, with a board comprising non-executive members responsible for oversight of a separate executive board. In some countries, companies may choose a hybrid structure, with a corporate assembly or shareholders' committee of non-executive members responsible for oversight of a one-tiered board of directors. Other board structures are also available to certain types of companies, such as partnerships limited by shares.

Despite the many options for board structures at European companies, shareholders may typically elect only one oversight body, which is responsible for representing shareholders' interests. Throughout these guidelines, "board" will refer to the oversight body elected by and primarily accountable to shareholders, and "director" will refer to any member of the board including executives serving as directors, unless otherwise stated.

## ELECTION OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favor of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are independent, have a record of positive performance, and have members with a breadth and depth of experience.

## INDEPENDENCE

The independence of directors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of directors, we will take into consideration, when appropriate, whether a director has a record indicative of making objective decisions. Likewise, when assessing the independence of directors, we will also examine whether a director's record on multiple boards indicates a lack of objective decision-making. Ultimately, the determination of whether a director is independent or not must take into consideration compliance with the applicable independence criteria as well as judgments made while serving on the board.

We examine each director nominee's relationships with the company, the company's executives and other directors to determine if there are personal, familial or financial relationships (not including director compensation) that may influence the director's independent decision-making. We believe that such relationships make it difficult for a director to put shareholders' interests above personal or related party interests.

Thus, we typically put directors into the following categories based on an examination of the type of relationship they have with the company:

**Independent Director** — An independent director has no material financial, familial<sup>2</sup> or other current relationships with the company,<sup>3</sup> its executives, or other board members, except for board service and standard fees paid for that service.

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<sup>2</sup> Familial relationships include a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces, nephews, in-laws, and anyone (other than domestic employees) who shares such person's home. A director is an affiliate if the director has a family member who is employed by the company.

<sup>3</sup> A company includes any parent or subsidiary in a group with the company or any entity that merged with, was acquired by, or acquired the company.

**Affiliated Director** — An affiliated director has a material financial, familial or other relationship with the company, its independent auditor or its executives, but is not an employee of the company.<sup>4</sup> This may include directors whose employers have a material relationship with the company or its subsidiaries or major shareholders. Glass Lewis applies a three-year look back period to all relationships with directors who have an affiliation with the company other than former employment, for which we apply a five-year look back. In addition, we will consider directors affiliated if they:

1. Have been employed by the company within the past five years;<sup>5</sup>
2. Own or control 10% or more<sup>6</sup> of a company's share capital or voting rights or are employed by or have a material relationship with a significant shareholder;<sup>7</sup>
3. Have — or have had within the last three years — a material relationship with the company, either directly or as a partner, shareholder, director or senior employee of an entity that has such a relationship with the company;
4. Have close family ties with any of the company's advisors, directors or senior employees;
5. Hold cross directorships or have significant links with other directors through his/her involvement in other companies or entities; or
6. Have served on the board for more than three terms or for more than 12 years, whichever is longer.<sup>8</sup>

Definition of “**material**” — A material relationship is one in which the value exceeds:

- €50,000, or the equivalent (or 50% of the total compensation paid to a board member, or where no amount is disclosed) for board members who personally receive compensation for a professional or other service they have agreed to perform for the company, outside of their service as board members. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a board member receives fees directly;
- €100,000, or where no amount is disclosed, for those board members employed by a professional services firm such as a law firm, investment bank or large consulting firm where the firm is paid for services but the individual is not directly compensated. This limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director's firm;

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<sup>4</sup> If a company classifies a non-executive director as non-independent, Glass Lewis will classify that director as an affiliate, unless there is a more suitable classification (i.e., shareholder representative, employee representative).

<sup>5</sup> In our view, a five-year standard is appropriate because we believe that the unwinding of conflicting relationships between former management and board members is more likely to be complete and final after five years. However, Glass Lewis does not apply the five-year look back period to directors who have previously served as executives of the company on an interim basis for less than one year. In contrast, Glass Lewis may consider a look-back period irrelevant in cases where a former executive has other significant ties to the company, such as being a member of the founding family of the firm or a former executive who continues to receive variable compensation.

<sup>6</sup> In accordance with generally accepted best practice in Europe, we treat 10% shareholders as affiliates because they typically have access to and involvement with the management of a company that is fundamentally different from that of ordinary shareholders. More importantly, 10% holders may have interests that diverge from those of ordinary holders, for reasons such as the liquidity (or lack thereof) of their holdings, potential for materially increasing or decreasing their holdings in response to company performance, personal tax issues, etc. However, where local practice or regulations employ a lower threshold in a particular market, we will apply the respective recommended ownership threshold for classification purposes. Moreover, we may consider significant shareholders or representatives of significant shareholders owning or controlling less than 10% of a company's share capital to be affiliated when there is evidence of the shareholder having a significant influence on the board or engaging in business transactions with the company.

<sup>7</sup> Evidence of significant ties to a major shareholder may be considered material in some cases, even when no direct employment or consulting relationship exists. For example, a history of serving on boards of entities controlled by a major shareholder may be sufficient for Glass Lewis to consider a director to be affiliated. Moreover, we may affiliate directors based on directorships at entities controlled by a significant shareholder if the company does not disclose a director's independence classification.

<sup>8</sup> EU Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (“EU Commission Recommendation of 15 February 2005”), Annex II, Article 1 (h). Please see Glass Lewis' country guidelines for specifics. We may apply different standards provided by corporate governance codes where they differ in each market.

- 1% of either of the companies' consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company);
- 10% of shareholders' equity and 5% of total assets for financing transactions; or
- the total annual fees paid to a director for a personal loan not granted on normal market terms, or where no information regarding the terms of a loan have been provided.

**Inside Director** — An inside director simultaneously serves as a director and as an employee of the company. This category may include a board chair who acts as an employee of the company or is paid as an employee of the company.

**Employee Representatives** — An employee representative serves as a director to represent employees' interests. Employee representatives may be nominated and elected by employees pursuant to national law, or they may be nominated by employees and elected by shareholders.

### Voting Recommendations on the Basis of Board Independence

Glass Lewis believes a board will be most effective in protecting shareholders' interests when at least a majority of the directors are non-executive members. We apply additional independence standards that are consistent with local best practice in each market. Where a board's composition does not meet local best practice standards, we typically recommend voting against some of the inside and/or affiliated directors in order to satisfy the relevant threshold.<sup>9</sup> However, we generally accept the presence of representatives of significant shareholders in proportion to their equity or voting stake in a company.

We refrain from recommending to vote against any directors on the basis of lengthy tenure alone. However, we may recommend voting against certain long-tenured directors when lack of board refreshment may have contributed to poor financial performance, lax risk oversight, misaligned remuneration practices, lack of shareholder responsiveness, diminution of shareholder rights or other concerns. In conducting such analysis, we will consider lengthy average board tenure (e.g., more than 9-12 years, depending on the country), evidence of planned or recent board refreshment, and other concerns with the board's independence or structure.

Glass Lewis strongly supports the appointment of an independent presiding or lead director with authority to set meeting agendas and to lead sessions outside the insider or affiliated chair's presence. In accordance with best practice, we believe boards should appoint an independent lead director when the chair is not independent, especially when the board is insufficiently independent.

In addition, we scrutinise avowedly "independent" chairmen and lead directors. We believe that they should be unquestionably independent or the company should not tout them as such.

### Voting Recommendations on the Basis of Committee Independence

We believe that only non-executive board members should serve on a company's audit and compensation committees.<sup>10</sup> Further, we believe these committees should be sufficiently independent from the company and its significant shareholders, in line with best practice for each market.<sup>11</sup>

<sup>9</sup> With a staggered board, if the affiliates or insiders that we believe should not be on the board, are not up for election, we will note our concern regarding those directors. We may not recommend voting against the affiliates or insiders who are up for election solely to achieve a sufficient threshold for independence. However, we may recommend voting against affiliates or insiders who are up if there are independence concerns and if we have concerns with said directors.

<sup>10</sup> EU Commission Recommendation of 15 February 2005, Annex I, Articles 3.1 and 4.1.

<sup>11</sup> In general, we prefer majority independent committees, as recommended by EU Commission Recommendation of 15 February 2005, Annex I, Articles 3.1 and 4.1. We believe a majority of compensation committee members should be independent of the company and its controlling shareholders (i.e., owning at least 50% of the share capital or voting rights). Given the importance of the audit committee's work, we believe that a higher level of independence from major shareholders is necessary. As such, we believe a majority of audit committee members should always be independent of the company and shareholders holding more than 20% of the company's share capital or voting rights. However, we may apply more stringent recommendations, if any, provided by corporate governance codes in each market.

We believe the nominating committee should be sufficiently independent of company management and other related parties.<sup>12</sup> We accept the presence of representatives of significant shareholders on this committee in proportion to their equity or voting stake in the company.

## CONTROL-ENHANCING MECHANISMS

Shareholder Agreements: Where a group of shareholders, acting in concert, have entered into an agreement to control a company and its board or cooperate on significant strategic issues, we will consider the shareholder group a single entity for the purposes of identifying the company's shareholder structure and recommended thresholds for independence.

## CONTROLLED COMPANIES

We believe controlled companies warrant certain exceptions to our independence standards. The board's function is to protect shareholder interests; however, when an individual, entity (or group of shareholders party to a formal agreement) owns more than 50% of the voting shares, the interests of the majority of shareholders are the interests of that entity or individual. As stated above, we generally accept the presence of representatives of significant shareholders on the board in proportion to their equity or voting stake in a company.

Similarly, we accept the proportional representation of significant shareholders on the nominating committee when there is a controlling shareholder. However, we nevertheless believe that audit and compensation committees should remain sufficiently independent in line with local best practice. Regardless of a company's controlled status, we believe the interests of all shareholders must be protected by ensuring the integrity and accuracy of the company's financial statements and that incentive programs are fair and appropriate.

## OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

The most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. We look at the performance of these individuals as directors and executives of the company and of other companies where they have served. We also look at a director's experience, analyse possible conflicts of interest and consider how directors voted while on the board.

## PERFORMANCE

We believe shareholders should avoid electing directors who have a record of not fulfilling their responsibilities to shareholders at any company where they have held a board or executive position. We typically recommend voting against:

- A director who fails to attend a minimum of 75% of applicable board meetings and committee meetings.<sup>13</sup>
- A director who is also the CEO of a company where a serious and material restatement has occurred after the CEO had previously certified the pre-restatement financial statements.
- Some or all board members in the event a company's performance has been consistently lower than its peers and the board has not taken reasonable steps to address the poor performance.

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<sup>12</sup> In general, we recommend that nominating committees consist of a majority of members independent of company management and other insiders, unless a best practice recommendation for a particular market sets a different threshold.

<sup>13</sup> We will apply this threshold when attendance information is available. Where a director has served for less than one full year, we will not typically vote against the director for failure to attend 75% of meetings. Rather, we will note the failure with a recommendation to track this issue going forward. We will also refrain from voting against directors when the company discloses that the director missed the meetings due to serious illness or other extenuating circumstances.

## EXPERIENCE

We find that a director's past conduct is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred appearing at companies that follow these same patterns. Glass Lewis has a proprietary database that tracks the performance of directors across companies worldwide.

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with records of poor performance, overcompensation, audit- or accounting-related issues and/or other indicators of mismanagement or actions against the interests of shareholders.<sup>14</sup> Likewise, we examine the backgrounds of those who serve on key board committees to ensure that they have the required skills and diverse backgrounds to make informed judgments about the subject matter for which the committee is responsible.

## EXTERNAL COMMITMENTS

We believe that directors should have the necessary time to fulfill their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis. In addition, recent research indicates that the time commitment associated with being a director has been on a significant upward trend in the past decade. As a result, we typically recommend shareholders vote against a director who serves as an executive officer of any public company while serving on more than two public company boards and any other director who serves on more than five public company boards,<sup>15</sup> although this varies in accordance with market best practice. We generally count board chairships as two board seats given the increased time commitment associated with these roles.

When determining whether a director's service on an excessive number of boards may limit the ability of the director to devote sufficient time to board duties, we may consider relevant factors such as the size and location of the other companies where the director serves on the board, whether the director serves as an executive or non-executive director of any large privately-held companies, and the director's attendance record at all companies. Further, because we believe that executives will presumably devote their attention to executive duties, we may not recommend that shareholders vote against overcommitted directors at the companies where they serve an executive function. Similarly, we expect a chair of any public company to reduce his or her external commitments appropriately though we may not recommend that shareholders vote against overcommitted directors at companies where they serve as chair.

We may also refrain from recommending against certain directors if the company provides sufficient rationale for their continued board service. The rationale should allow shareholders to evaluate the scope of the directors' other commitments as well as their contributions to the board, including specialized knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide, and other relevant factors. We will also generally refrain from recommending to vote against a director who serves on an excessive number of boards within a consolidated group of companies or a director that represents a firm whose sole purpose is to manage a portfolio of investments which include the company.

## CONFLICTS OF INTEREST

In addition to the three key characteristics — independence, performance, and experience — that we use to evaluate individual board members, we consider conflict of interest issues in making voting recommendations.

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<sup>14</sup> We typically apply a three-year look-back to such issues and research to see whether the responsible directors have been up for election since the time of the failure.

<sup>15</sup> Pursuant to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRD IV"), executives of significant financial institutions are prohibited from serving on more than two outside boards, while non-executive directors of significant financial institutions are limited to four outside directorships.

We believe that a board should be wholly free of people who have an identifiable and substantial conflict of interest, regardless of the overall presence of independent directors on the board. Accordingly, we generally recommend that shareholders vote against the following:

- Directors who provide — or directors whose immediate family members provide — material professional services to the company. These services may include legal, consulting or financial services. We question the need for the company to have consulting relationships with its directors. We view such relationships as creating conflicts for directors, since they may be forced to weigh their own interests against shareholder interests when making board decisions. In addition, a company's decisions regarding where to turn for the best professional services may be compromised when doing business with the professional services firm of one of the company's directors. Where a director has a material business relationship with a company that falls under the normal course of business, we will generally refrain from recommending to vote against the director on that basis alone provided that the company has adequately disclosed the relationship and mitigated the potential for serious conflicts of interest and so long as the board and key committees are sufficiently independent. We will also hold the relevant senior director with oversight of related party transactions (whether a board committee, ad hoc committee, or the board as a whole, depending on the board's internal procedures) accountable for particularly egregious transactions concluded between the company and an executive director, which may pose a potential risk to shareholders' interest.
- Directors who engage in, or whose immediate family members engage in airplane, real estate or similar deals, including perquisite-type grants from the company amounting to more than €50,000. Directors who receive these sorts of payments from the company may have to make unnecessarily complicated decisions that pit their interests against shareholders.
- Directors who have interlocking directorships. We believe that CEOs or other top executives who serve on each other's boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.<sup>16</sup>

## BOARD STRUCTURE AND COMPOSITION

In addition to the independence of directors, other aspects of the structure and composition of a board may affect the board's ability to protect and enhance shareholder value. In Europe, these issues often play a central role in forming corporate governance best practices.

## SEPARATION OF THE ROLES OF CHAIR AND CEO

Glass Lewis believes that separating the roles of corporate officer and chair creates a better governance structure than a combined executive/chair position.<sup>17</sup> An executive manages the business according to a course the board charts. Executives should report to the board regarding their performance in achieving goals the board sets. This is needlessly complicated when a CEO sits on or chairs the board, since a CEO presumably will have a significant influence over the board.

It can become difficult for a board to fulfill its role of overseer and policy setter when a CEO/chair controls the agenda and the boardroom discussion. Such control can allow a CEO to have an entrenched position, leading to longer than optimal terms, fewer checks on management, less scrutiny of business operations, and limitations on independent, shareholder-focused goal-setting by the board.

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<sup>16</sup> There is no look-back period for this situation. This only applies to public companies and we only footnote it for the non-insider. In some markets, where interlocking directorships are more strictly defined by law or best practice, we will apply the relevant definition.

<sup>17</sup> The roles of chair and CEO may not legally be combined in some European countries. A majority of European codes of best practice for corporate governance recommend the separation of the roles of chair and CEO, where such a combined role is legally possible. Pursuant to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("CRD IV"), EU member states must enact provisions into national law prohibiting the CEO or managing director from simultaneously exercising the board chair or directors at significant financial institutions, unless a specific exemption is granted by competent regulatory authorities.

A CEO should set the strategic course for the company, with the board's approval, and the board should enable the CEO to carry out his or her vision for accomplishing the board's objectives. Failure to achieve the board's objectives should lead the board to replace that CEO with someone in whom the board has confidence.

Likewise, an independent chair can better oversee executives and set a pro-shareholder agenda without the management conflicts that a CEO and other executive insiders often face. Such oversight on behalf of shareholders allows for a more proactive and effective board of directors that is better able to look out for the interests of shareholders. When the company has not separated the two positions, we generally believe the presence of an independent lead director or vice chair can serve to mitigate any potential conflicts of interest that may affect the performance of the board.

When a board has a separate nominating committee, we generally do not recommend that shareholders vote against CEOs who serve on or chair the board. However, we may recommend voting against the nominating committee chair when the chair and CEO roles are combined without explanation and one of the following criteria is met: (i) the board is not sufficiently independent; or (ii) the board has failed to implement adequate measures to prevent and manage the potential conflict of interests deriving from the combination of the two positions such as appointing an independent lead or presiding director or adopting other countervailing board leadership structures. In the absence of a nominating committee, we may recommend voting against the board chair under these conditions. Further, we typically encourage our clients to support separating the roles of chair and CEO whenever that question is posed in a proxy, as we believe that it is in the long-term best interests of the company and its shareholders.

## SIZE OF THE BOARD OF DIRECTORS

While we do not believe there is a universally applicable optimum board size, we do believe boards should have at least five directors (or three directors in the event of small-cap companies) to ensure sufficient diversity in decision-making and to enable the formation of key board committees with independent directors. Conversely, we believe that boards with more than 20 members will typically suffer under the weight of "too many cooks in the kitchen" and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices can make it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

To that end, we typically recommend voting against the nominating committee chair if a board has more than 20 directors. Further, where a board has fewer than five directors we will recommend abstaining from voting on the election of the nominating committee chair. However, we may not apply this policy to small cap companies with smaller boards where a larger board may not be justified by the scope of the company's operations.<sup>18</sup>

## BOARD SKILLS

We believe companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. If a board has failed to address material concerns regarding the mix of skills and experience of the non-executive element of the board, we will consider recommending voting against the chair of the nominating committee or equivalent (e.g., board chair).

## BOARD DIVERSITY

In recent years, many European legislators and governance experts have advocated for more female directors on the boards of public companies. This effort, which has materialised in the form of new recommendations and legal requirements in a number of markets, will most likely continue to increase within Europe. While Glass Lewis values the importance of board diversity, believing there are a number of benefits from having individuals with a variety of backgrounds serving on boards, we generally do not base voting recommendations solely on strict board diversity quotas. When a board fails to meet legal requirements or the best practice standard

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<sup>18</sup> In the absence of a nominating committee, we will recommend voting against the board chair.

prevalent in the market and has not disclosed any cogent explanation or plan regarding board gender diversity, we will recommend voting against the nominating committee chair. Further, when boards of large companies subject to diversity policy disclosure requirements fail to nominate any women to the board or disclose a coherent board gender diversity policy, we may recommend voting against the nominating committee chair on that basis alone.

## BOARD-LEVEL RISK MANAGEMENT OVERSIGHT

Glass Lewis evaluates the risk management function of a public company board on a strictly case-by-case basis. Sound risk management, while necessary at all companies, is particularly important at financial firms, which inherently maintain significant exposure to financial risk. We believe financial firms should have a chief risk officer and/or a risk committee that reports directly to the supervisory board or a committee of the supervisory board charged with risk oversight. Moreover, many non-financial firms maintain strategies that involve a high level of exposure to financial risk. As such, any non-financial firm that has a significant hedging strategy or trading strategy that includes financial and non-financial derivatives should likewise have a chief risk officer and/or a risk committee that reports directly to the board or a committee of the board.

When analysing the risk management practices of public companies, we take note of any significant losses or write-downs on financial assets and/or structured transactions. In cases where a company has disclosed a sizable loss or write-down, and where a reasonable analysis indicates that the company's supervisory board-level risk committee should be held accountable for poor oversight, we would recommend that shareholders vote against such committee members on that basis. In addition, in cases where a company maintains a significant level of financial risk exposure but fails to disclose any explicit form of board-level risk oversight (committee or otherwise),<sup>19</sup> we will consider recommending to vote against the board chair on that basis.

## ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT

Companies face significant financial, legal and reputational risks resulting from poor environmental and social practices, or negligent oversight thereof. Therefore, Glass Lewis views the identification, mitigation and management of environmental and social risks as integral components when evaluating a company's overall risk exposure. We believe boards should ensure that management conducts a complete risk analysis of company operations, including those that have environmental and social implications. Directors should monitor management's performance in managing and mitigating these environmental and social risks in order to eliminate or minimise the risks to the company and its shareholders. In cases where the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively impact shareholder value, we will recommend shareholders vote against directors responsible for risk oversight in consideration of the nature of the risk and the potential effect on shareholder value.

## BOARD COMMITTEES

When a board fails to form audit and compensation committees, we will generally recommend voting against the board chair on this basis. This will generally not apply to small-cap companies with a sufficient number of independent board members.<sup>20</sup>

## AUDIT COMMITTEE PERFORMANCE

"Audit committees and an effective internal control system help to minimise financial, operational and compliance risks, and enhance the quality of financial reporting."<sup>21</sup>

<sup>19</sup> A committee responsible for risk management could be a dedicated risk committee, or another board committee (usually the audit committee or the finance committee), depending on a given company's board structure and method of disclosure. In some cases, the entire board is charged with risk management.

<sup>20</sup> At small companies, the functions assigned to the committee may be performed by the board as a whole, provided that it meets the composition requirements advocated for the committee and that adequate information is provided in this respect. EU Commission Recommendation of 15 February 2005, Section II, Article 7.2.

<sup>21</sup> Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directive 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

When assessing an audit committee's performance, we are aware that an audit committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or the disclosure provided to investors. Rather, an audit committee member monitors and oversees the process and procedures that management and auditors perform. As stated in EU regulations, "the audit committee should assist the (supervisory) board to at least: (i) monitor the integrity of the financial information provided by the company; (ii) review at least annually the internal control and risk management systems, with a view to ensuring that the main risks are properly identified, managed and disclosed; (iii) ensure the effectiveness of the internal audit function; (iv) monitor the external auditor's independence and objectivity; and (v) review the effectiveness of the external audit process."<sup>22</sup>

## STANDARDS FOR ASSESSING THE AUDIT COMMITTEE

For an audit committee to function effectively on investors' behalf, it must include members with sufficient knowledge to diligently carry out their responsibilities. In its recommendation on the role of non-executive directors of listed companies and on the committees of the board, the European Commission states "the members of the audit committee should, collectively, have a recent and relevant background in and experience of finance and accounting for listed companies appropriate to the company's activities."<sup>23</sup>

We believe shareholders should be wary of audit committees that include members that lack expertise in finance and accounting or in any other equivalent or similar areas of expertise. While we will not necessarily recommend voting against members of an audit committee when such expertise is lacking, we are more likely to recommend voting against committee members when there is evidence of poor accounting oversight resulting in problems like restatements and such expertise is lacking.

Glass Lewis generally assesses audit committees against the decisions they make with respect to their oversight and monitoring role. The quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions, and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors. The independence of the external auditors and the results of their work all provide useful information by which to assess the audit committee.

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and recommend voting in favor of its members, but we would recommend voting against the following members under the following circumstances:<sup>24</sup>

- The audit committee chair when: (i) audit and audit-related fees total less than 50% of the total fees billed by the auditor for two consecutive years; (ii) the company fails to disclose the fees paid to the auditor for two consecutive years; and/or (iii) the committee did not hold a sufficient number of meetings considering the company's financial situation and reporting requirements; and/or (iv) when we have concerns regarding the independence or tenure of the auditor and the auditor has not been proposed for election by shareholders.
- All members of an audit committee in office when: (i) material accounting fraud occurred at the company; (ii) financial statements had to be restated due to serious material fraud; (iii) the company repeatedly fails to file its financial reports in a timely fashion in successive years; and/or (iv) the company has aggressive accounting policies and/or poor disclosure or lack of sufficient transparency in its financial statements.

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<sup>22</sup> EU Commission Recommendation of 15 February 2005, Annex 1, Article 4.

<sup>23</sup> EU Commission Recommendation of 15 February 2005, Section III, Article 11.2.

<sup>24</sup> Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will note the concern with regard to the committee chair. In the absence of an audit committee, we will recommend voting against the board chair.

## COMPENSATION COMMITTEE PERFORMANCE

Compensation committees have the primary role in determining the compensation of executives. This includes deciding the basis on which compensation is determined, as well as the amounts and types of compensation to be paid. This process begins with the hiring and initial establishment of employment agreements, including the terms for such items as pay, pensions and severance arrangements. When establishing compensation arrangements, it is important that a significant portion of compensation be consistent with, and based on, the long-term economic performance of the business's long-term shareholders returns.

Compensation committees are also responsible for the oversight of the transparency of compensation. This oversight includes disclosure of compensation arrangements, the matrix used in assessing pay for performance, and the use of compensation consultants. It is important to provide investors with clear and complete disclosure of all significant terms of compensation arrangements in order to allow them to make informed decisions with respect to the oversight and decisions of the compensation committee.

Finally, compensation committees are responsible for oversight of internal controls over the executive compensation process. This includes controls over gathering information used to determine compensation, establishment of equity award plans, and granting of equity awards. Lax controls contribute to allowing conflicted consultants providing potentially biased information to boards. Lax controls can also contribute to improper awards of compensation such as through granting of backdated or spring-loaded options, or granting of bonuses when triggers for bonus payments have not been met.

## STANDARDS FOR ASSESSING THE COMPENSATION COMMITTEE

We evaluate compensation committee members based on their performance while serving on the compensation committee in question, even if they are not currently serving on the committee. When assessing the performance of compensation committees, we will recommend voting against the following:<sup>25</sup>

- The compensation committee chair if: (i) the compensation committee did not meet during the year, but should have (e.g., because executive compensation was restructured or a new executive was hired); (ii) the company has consistently had poorly structured and disclosed compensation programs and has not made any changes; and/or (iii) the company has bundled the approval of a compensation policy or report with other governance proposals.
- All members of the compensation committee (that served during the relevant time period) if: (i) the company entered into excessive employment agreements and/or severance agreements; (ii) performance goals were lowered when employees failed or were unlikely to meet original goals, or performance-based compensation was paid despite goals not being attained; (iii) excessive employee perquisites and benefits were allowed; (iv) other egregious policies or practices; (v) the committee failed to address shareholder concerns following majority shareholder rejection of the say-on-pay proposal in the previous year; and/or (vi) the say on pay proposal was approved but there was a significant shareholder vote (i.e., greater than 20% of votes cast) against the proposal in the prior year, and there is no evidence that the board responded accordingly to the vote including actively engaging shareholders on this issue.

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<sup>25</sup> Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will note our concern with regard to the committee chair. In the absence of a compensation committee, we will recommend voting against the board chair.

## NOMINATING COMMITTEE PERFORMANCE

The nominating committee, as an agent for the shareholders, is responsible and accountable for selection of objective and competent board members. We will recommend voting against the following nomination committee members under these circumstances:<sup>26</sup>

- The nominating committee chair: (i) if the nominating committee did not meet during the year, but should have (i.e., because new directors were nominated); (ii) when the board is not sufficiently independent; (iii) when there are less than three members on key board committees;<sup>27</sup> or (iv) for issues related to board size and, diversity, as well as directors' terms as further detailed throughout these guidelines.
- All members of the nominating committee (that served during the relevant time period) when the committee nominated or renominated an individual who had significant conflicts of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests. In addition, we may recommend voting against one or all of the nominating committee members up for election when the board fails to respond to a significant shareholder vote against a nominee previously elected.<sup>28</sup>

## ELECTION PROCEDURES

In Europe, shareholders may be asked to vote on a variety of procedures related to elections. These procedures often have a significant effect on shareholders' ability to hold the board accountable for its actions.

## CLASSIFIED/STAGGERED BOARDS AND TERM LIMITS

Although we recognise that classified boards and staggered board elections are common practice in most of Europe, Glass Lewis favors the annual election of directors. Directors on staggered boards or with lengthy terms of office are less accountable to shareholders than directors elected annually. Furthermore, we feel the annual election of directors encourages board members to be responsive to shareholder interests. Moreover, empirical studies have shown: (i) companies with staggered boards reduce a firm's value; and (ii) in the context of hostile takeovers, staggered boards operate as a takeover defense, which entrenches management, discourages potential acquirers and delivers a lower return to target shareholders.<sup>29</sup>

In light of the empirical evidence suggesting staggered boards reduce a company's value and the increasing shareholder opposition to such a structure, Glass Lewis supports the declassification of boards and the annual election of directors.

Given the existence of varying market practices, we will generally accept the presence of staggered boards, so long as director terms remain reasonable. However, we will recommend voting against the chair of the nominating committee when director terms exceed those advocated by best practice codes in a market without sufficient justification.

Moreover, in some cases, companies may propose amending their articles to explicitly establish staggered or classified board elections. If there is no current provision in the company's articles regarding the schedule for the election of directors and directors are not elected annually in practice, we will support the amendment if it

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<sup>26</sup> Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will note our concern with regard to the committee chair. In the absence of a nominating committee, we will recommend voting against the board chair.

<sup>27</sup> In the case of compensation and nominating committees, this will not apply to companies with small, sufficiently independent boards. At companies with small (supervisory) boards, the audit committee can be composed of only two members. Alternatively, the functions assigned to the audit committee may be performed by the board as a whole, provided that it meets the composition requirements advocated for the committee and that adequate information is provided in this respect. EU Commission Recommendation of 15 February 2005, Section II, Article 7.2 and Annex 1.

<sup>28</sup> We will generally consider a vote of 20% against or more to be significant, while taking into account the ownership structure and any mitigating circumstances around the specific vote when making this determination.

<sup>29</sup> Lucian Bebchuk, Alma Cohen, "The Costs of Entrenched Boards" (2004) and Lucian Bebchuk, Alma Cohen and Charles C.Y. Wang, "Staggered Boards and the Wealth of Shareholders: Evidence from a Natural Experiment," SSRN: <http://ssrn.com/abstract=1706806> (2010), p. 26.

is in line with market practice and if it introduces more regular elections than existing election cycles. However, whenever a proposed amendment to an existing election schedule would cause a board to become classified, we will support it only if it reduces the term lengths for directors or introduces more regular elections than the previous election schedule.

## **ELECTION OF DIRECTORS AS A SLATE**

Glass Lewis believes that the practice of electing directors as a slate rather than individually is contrary to principles of good corporate governance, as slate elections make it more difficult for shareholders to hold individual members of the board accountable for their actions. As such, we recommend voting against proposals whereby a company clearly states that it intends to elect the board as a slate in all markets where individual elections are common or accepted best practice.

In some cases, shareholders voting in person at general meetings vote on board nominees individually; however, shareholders voting by proxy may only be given the choice of electing directors as a slate. In such cases, we will typically recommend that shareholders voting by proxy vote for the slate of nominees, unless we have very serious concerns about the composition or acts of the board in which case we will recommend voting against the entire slate. Irrespective of whether directors are elected as a slate or individually, we will note our concerns with individual directors in our analysis of the board.

## **RATIFICATION OF THE CO-OPTION OF BOARD MEMBERS**

In certain instances, board members are appointed directly by the board to serve as directors. Shareholders are then asked to ratify the co-opted board member and formally appoint him/her for a new term. We apply the same standards for evaluating such directors as we do when evaluating directors elected at a general meeting.

## **BOARD EVALUATION AND REFRESHMENT**

Glass Lewis strongly supports routine director evaluation, including independent external reviews, and periodic board refreshment to foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Further, we believe the board should evaluate the need for changes to board composition based on an analysis of skills and experience necessary for the company, as well as the results of the director evaluations, as opposed to relying solely on age or tenure limits. When necessary, shareholders can address concerns regarding proper board composition through director elections.

In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. This said, we recognize that in rare circumstances, a lack of refreshment can contribute to a lack of board responsiveness to poor company performance.

On occasion, age or term limits can be used as a means to remove a director for boards that are unwilling to police their membership and enforce turnover. Some shareholders support term limits as a way to force change in such circumstances.

While we understand that age limits can aid board succession planning, the long-term impact of age limits restricts experienced and potentially valuable board members from service through an arbitrary means. We believe that shareholders are better off monitoring the board's overall composition, including its diversity of skillsets, the alignment of the board's areas of expertise with a company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules that don't necessarily correlate with returns or benefits for shareholders.

As such, we generally recommend voting against proposals that seek to introduce age or term limits. Similarly, we generally recommend voting for proposals that seek to repeal or increase age limits.

## LACK OF ADEQUATE DIRECTOR DISCLOSURE

Market practice for disclosure of information regarding board nominees varies widely across Europe. In some cases, where we believe shareholders have not been provided with sufficient information in order to make an informed decision regarding the election of a director, we recommend that shareholders vote against the candidate. We will recommend that shareholders vote against a candidate for election to the board when any of the following applies: (i) the name of the nominee has not been disclosed; (ii) no biographical details for the nominee have been disclosed; or (iii) the name of a natural person representing a legal person or entity, which is otherwise entitled to serve on the board, has not been disclosed.

In addition, we generally recommend that shareholders vote against a board nominee when a company's disclosure of biographical information for the nominee falls below market practice. Information that Glass Lewis considers particularly critical for shareholder review when evaluating a candidate for election include the following: (i) the independence of the nominee; (ii) the nature of any relationships between the nominee and the company, its directors and executives, major shareholders and any other related parties; (iii) the current occupation and outside directorships held by a nominee; and (iv) the relevant experience and skills possessed by a nominee.

# Transparency and Integrity in Financial Reporting

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## ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

As a routine matter, shareholders in European companies are asked either to approve a company's accounts and reports or to acknowledge receipt of the accounts and reports, which had previously been approved by the board and management.

A company's consolidated financial statements combine the activities of the company with the activities of its subsidiaries. Some companies may seek separate approval of the consolidated and standalone accounts and reports.

Unless there are concerns about the integrity of the financial statements or reports, we will recommend voting for these proposals. We will generally recommend voting for proposals seeking to acknowledge the receipt of a company's accounts and reports provided they are available to shareholders.

However, in the event that the audited financial statements have not been made available, we do not believe shareholders have sufficient information to make an informed judgment regarding these matters. As such, we will recommend that shareholders abstain from voting on the relevant agenda items.

## NON-FINANCIAL REPORTING

As of 2018, large companies in Europe are required to report on "non-financial" issues such as environmental, social or governance issues that are considered material to the firm.<sup>30</sup> While European regulatory authorities have not prescribed a certain format or template for reporting, guidance issued by the European Commission emphasise that companies may use existing international reporting frameworks and should develop said reporting around consistent, material KPIs that account for corporate strategy and stakeholder interests.<sup>31</sup> Companies subject to the Directive are also required to disclose a board diversity policy.

Glass Lewis believes that shareholders are best served when companies identify material risks to the company, which might not otherwise be adequately described in financial reports, in a consistent and coherent manner. While we do not take a prescriptive approach to how companies should comply with requirements set out by national regulatory authorities, we do believe companies should make every effort to clarify how they have adapted reporting to reflect these requirements. Where companies fail to provide meaningful reporting on environmental, social and governance risks to shareholder satisfaction, we may recommend voting against the committee responsible for reviewing sustainability or non-financial issues. If no committee is explicitly tasked with oversight of this function, we may recommend voting against the chair of the audit committee.

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<sup>30</sup> Directive 2014/95/EU of the European Parliament and of the Council on disclosure of non-financial and diversity information by certain large undertakings and groups ("Directive on Non-Financial Reporting") applies to companies with more than 500 employees and applies to all accounts for those companies from fiscal year 2017. While these reports are not required to be audited, the independent auditor must verify that a statement has been provided in compliance with the Directive. National implementation requirements vary and supervisory authorities provide additional guidance at the national level.

<sup>31</sup> The Guidelines on Non-Financial Reporting 2017/C 215/01 from the European Commission, issued in June 2017, are not binding and are only intended to guide companies in preparing their annual reporting in accordance with the requirements of the Directive on Non-Financial Reporting. The Guidelines suggest several well-known international reporting frameworks issued by the UN, the OECD, the International Organisation for Standardisation, the International Labour Organisation and the Global Reporting Initiative, among others.

## ALLOCATION OF PROFITS/DIVIDENDS

In many European markets, companies must submit the allocation of annual profits or losses for shareholder approval. We will generally recommend voting for such a proposal.

In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend to shareholders.<sup>32</sup> As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases. However, we may recommend that shareholders vote against a proposed dividend in cases where a company's dividend payout ratio, based on consolidated earnings, has decreased from a more reasonable payout ratio and for which no rationale or corresponding change in dividend policy has been provided by the company. In cases where a company has eliminated dividend payments altogether without explanation, we may recommend shareholders vote against the proposal. We will also scrutinise dividend payout ratios that are consistently excessively high (e.g., over 100%) relative to the company's peers, its own financial position or its level of maturity without satisfactory explanation.

## CAPITAL REPAYMENTS

In several European markets, capital repayments are increasingly used as substitutes for a traditional cash dividend due to more favorable taxation rules for such payments to shareholders. In order to effect a capital repayment, a company typically lowers the par value of its shares—shareholders then redeem the difference between the pre-reduction and post-reduction par value of each share as a “repayment.” We analyse these proposals in the same manner as dividend proposals, as described above. If we believe the proposed payout ratio is reasonable, we will recommend that shareholders support all related proposals to amend the par value of shares.

## BONUS SHARE ISSUES/DIVIDENDS-IN-KIND

Companies may propose to issue new shares to shareholders on a pro rata basis in lieu of, or in addition to, a cash dividend. Glass Lewis generally favors allowing shareholders to choose whether to receive dividends in cash or in the form of shares (also referred to as “scrip dividends”) since shareholders may thereby receive the dividend in a manner that suits them (e.g., to avoid negative tax consequences).

## ALLOCATIONS TO RESERVES/TRANSFER OF RESERVES

Glass Lewis believes that the board is in the best position to determine a company's capital structure. When a company proposes to allocate net profits or losses to reserves, or to transfer reserves between accounts, we will recommend that shareholders vote for the proposed allocation or transfer.

## APPOINTMENT OF AUDITOR AND AUTHORITY TO SET FEES

The auditor's role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and to do a thorough analysis of a company's books to ensure that the information provided to shareholders is complete, accurate, fair, and that it is a reasonable representation of a company's financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company's fiscal health.

Shareholders should demand the services of objective and well-qualified auditors at every company in which they hold an interest. Similar to directors, auditors should be free from conflicts of interest and should assiduously avoid situations that require them to make choices between their own interests and those of the shareholders they serve.

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<sup>32</sup> In cases where a company is distributing capital to shareholders by other means than a dividend payment, we will consider the total effect of all such distributions.

## Voting Recommendations on Auditor Appointment

We generally support a company's choice of auditor except when we believe the auditor's independence or audit integrity has been compromised. When audit and audit-related fees total less than one-half<sup>33</sup> of the total fees billed by the auditor, we usually recommend voting against the authority to set the auditor's fees, where such a vote is offered, or against the re-appointment of the auditor, if there is no separate vote on the auditor's fees, unless a specific, compelling justification is provided for a non-recurring payment.

Other reasons why we may not recommend support of the appointment of an auditor include:

- When audit and audit-related fees total less than one-half of the total fees billed by the auditor for several years in a row, or where there is other evidence that the auditor's independence may be compromised.
- Recent material restatements of annual financial statements, including those resulting in the reporting of material weaknesses in internal controls and including late filings by the company where the auditor bears some responsibility for the restatement or late filing.<sup>34</sup>
- When the company has aggressive accounting policies evidenced by restatements or other financial reporting problems.
- When the company has poor disclosure or lacks transparency in its financial statements.
- Presence of other relationships or concerns with the auditor that might suggest a conflict between the auditor's interests and shareholder interests.
- When the auditor's tenure does not comply with mandatory audit rotation rules and the board has not provided a compelling justification for the deviation.<sup>35</sup>

Where a company does not disclose sufficient information regarding the fees paid to the auditor for the past fiscal year, we will generally recommend shareholders vote against the authority to set the auditor's fees, where such a vote is offered, or against the re-appointment of the auditor, if there is no separate vote on the auditor's fees. We will also recommend abstaining from voting in cases where the company does not disclose the name of the audit firm up for ratification or appointment.

We are also mindful of fees for one-time corporate finance transactions and due diligence work related to mergers, acquisitions or disposals. While we are generally opposed to a company's independent auditor providing a significant amount of services unrelated to the audit, given the auditor's intimate knowledge of the companies that they audit and the important, complicated and non-recurring nature of these transactions, we consider their assistance in these matters to be acceptable, so long as their provision of such services does not persist. Therefore, in such cases we may determine it is reasonable for shareholders to support the auditor's appointment, despite the non-audit fees being greater than the audit fees.

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<sup>33</sup> In accordance with EU Regulation no. 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities, the total non-audit related fees paid to an independent auditor may not exceed 70% of the average audit and audit-related fees paid to the auditor during the previous three fiscal years. Additionally, the provision by the independent auditor of certain non-audit services, particularly those related to consulting, will be prohibited.

<sup>34</sup> An auditor does not audit all interim financial statements. Thus, we generally do not believe that an auditor's appointment should be opposed due to a restatement of interim financial statements unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

<sup>35</sup> In accordance with EU Regulation no. 537/2014 of the European Parliament and of the Council, auditors may serve for a maximum of ten years, with an additional term of up to ten years when the audit is tendered, or 14 years when a joint audit is adopted. From 2017, any auditor that has already served for at least ten years is subject to mandatory rotation. Based on the length of the current mandate, some auditors' tenures may extend beyond this deadline until 2023.

# The Link Between Compensation and Performance

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Glass Lewis carefully reviews the compensation awarded to senior executives, as we believe that this is an important area in which the board's priorities are revealed. Glass Lewis strongly believes executive compensation should be linked directly with the performance of the business the executive is charged with managing. We typically look for compensation arrangements that provide for a mix of performance-based short- and long-term incentives in addition to base salary.

Glass Lewis believes that comprehensive, timely and transparent disclosure of executive pay is critical to allow shareholders to evaluate the extent to which the pay is keeping pace with company performance. When reviewing proxy materials, Glass Lewis examines whether the company discloses the performance metrics used to determine executive compensation. We recognise performance metrics vary depending on the company and industry, among other factors, and may include any number of financial performance metrics. We believe companies should disclose why the specific performance metrics were selected and how the proposed incentive structure will provide alignment with strategy and performance, including explicit references, where appropriate, to KPIs described in relevant business cycles such as transformation plans.

We favor full disclosure for senior executive compensation packages and will generally support proposals seeking to improve transparency of senior executive pay amounts and structure.

## VOTE ON EXECUTIVE COMPENSATION (“SAY ON PAY”)

The European Union has taken a leading role in advocating executive compensation reform in member states in recent years. As early as 2004, the European Commission (“EC”) recommended that member states provide for the possibility of a shareholder vote on compensation policy at the annual meeting.<sup>36</sup> While a number of European states have introduced requirements for a shareholder vote on pay since 2004, as a result of the 2017 amendments to the Shareholder Rights Directive all companies in the EU will be required to offer an annual advisory vote on the remuneration report as well as a vote on the remuneration policy at least every four years.<sup>37</sup> These votes may take the form of an advisory vote on executive compensation policy, an advisory vote on the annual compensation report, a binding vote on the principles of executive compensation, or a binding vote on substantial changes to executive compensation policy. Some countries may also provide for multiple votes on compensation, generally encompassing components of the votes described above. Though we tailor our approach to evaluating compensation proposals in each relevant market accordingly, we generally refer to any vote relating to the approval of executive compensation, other than individual equity or incentive plans, as a “say on pay” vote.

Given the complexity of most companies' compensation programs, Glass Lewis applies a highly nuanced approach when analysing executive compensation. We review executive compensation on both a qualitative basis and a quantitative basis, recognising that each company must be examined in the context of industry,

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<sup>36</sup> Recommendation 4.1 of the Commission Recommendation 2004/913/EC of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies.

<sup>37</sup> These requirements, which must be implemented into national law by 2019, may introduce either an advisory or binding shareholder vote on remuneration at the discretion of member states. The vote must be held every time material changes are made to the policy, or at least every four years. Member states may choose not to apply the requirement for an annual vote on remuneration reports to smaller companies, so long as the remuneration report is subject to discussion at the annual meeting of shareholders.

size, financial condition, its historic pay-for-performance practices, ownership structure and any other relevant internal or external factors.

We believe that each company should design and apply specific compensation policies and practices that are appropriate to the circumstances of the company. In particular, they should aim to attract and retain competent executives and other staff, while motivating them to grow the company's long-term shareholder value.

Where we find those specific policies and practices serve to reasonably align compensation with performance, and such practices are adequately disclosed, Glass Lewis will recommend supporting the company's approach. If, however, those specific policies and practices fail to closely link compensation with performance, Glass Lewis will generally recommend voting against the say-on-pay proposal.

Glass Lewis focuses on four main areas when reviewing say-on-pay proposals:

- The overall design and structure of the executive compensation program;
- The quality and content of disclosure;
- The quantum paid to executives; and
- The link between compensation and performance as indicated by the company's recent and historic performance.

We also review any significant changes or modifications, and rationale for such changes, made to a company's compensation structure or award amounts, including base salaries.

## **SAY ON PAY VOTING RECOMMENDATIONS**

In cases where our analysis reveals a compensation structure or compensation disclosure in significant need of reform, we will recommend that shareholders vote against the say-on-pay proposal. Generally, such instances include evidence of a pattern of poor pay-for-performance practices, unclear or questionable disclosure regarding the overall compensation structure (e.g., limited information regarding benchmarking processes, limited rationale for bonus performance metrics and targets, etc.), questionable adjustments to certain aspects of the overall compensation structure (e.g., limited rationale for significant changes to performance targets or metrics, the payout of guaranteed bonuses or sizable retention grants, etc.) and/or other egregious compensation practices.

Although not an exhaustive list, we believe the following practices are indications of problematic pay practices which may cause Glass Lewis to recommend against a say on pay vote:

- Egregious or excessive bonuses, equity awards or severance payments, including golden handshakes and golden parachutes;
- Guaranteed bonuses;
- Incentive plan targets set at performance levels well below actual past performance or strategic targets provided in guidance to shareholders, absent a compelling rationale for lowering the target;
- Incentive plans that pay out below lower middle quartile peer performance levels;
- Lack of disclosure regarding performance metrics and targets;
- Performance targets not sufficiently challenging, and/or providing for unreasonably high potential payouts;

- Performance conditions do not adequately measure a company's performance or align with strategy over the long-term;
- Lowered performance targets without justification;
- Discretionary bonuses paid when short- or long-term incentive plan targets were not met;
- Executive pay that is high compared to the company's peers and is not correlated with outstanding company performance; and
- The terms of the long-term incentive plans are inappropriate and a separate vote on the long-term incentive plan(s) is not provided (please see "Long-Term Incentives" section).

In the instance that a company has failed to provide sufficient disclosure of its policies, we may recommend shareholders vote against this proposal solely on this basis, regardless of the appropriateness of compensation levels. Further, we may recommend voting against say-on-pay votes when the clarity of the compensation policy is extremely poor, such that it is not possible to adequately assess the link between pay and performance.

In the case of companies that maintain poor compensation policies and/or poor compensation disclosure year after year without any apparent steps to address the issues, we may also recommend that shareholders vote against the chair and/or other members of the compensation committee, especially if the say-on-pay vote received low levels of shareholder support. We may also recommend voting against the compensation committee members based on specific practices or actions such as approving large one-off payments, particularly when an adequate rationale is not provided, the inappropriate use of discretion, or sustained failure to link pay with performance.

## CHANGES TO COMPENSATION POLICY

We closely review changes to companies' compensation policies to determine whether the changes will benefit shareholders and therefore whether shareholders should support the proposals. Moreover, in several European markets (particularly Denmark and the Netherlands), shareholders may be asked to approve specific changes to the compensation policy. In other markets (particularly Germany, Norway and Sweden), shareholders are typically asked to approve revised compensation policies that apply to future payments in the current fiscal year. In such cases, where the proposed policy represents an improvement over the existing policy, we will generally recommend voting for the proposal, even when the proposed policy contains notable deficiencies.

## SHORT-TERM INCENTIVES

A short-term bonus or incentive ("STI") should be demonstrably tied to performance that supports a company's strategy. This alignment is generally clearest when awards are based on quantifiable performance against disclosed targets. Where a discretionary approach is used when evaluating individual metrics or the overall assessment is utilised, the committee should explain its overall methodology, and its rationale for individual allocations.

We believe performance measures for STIs should encompass a mix of corporate and individual performance measures, including internal financial measures such as net profit after tax, EPS growth and divisional profitability as well as non-financial factors such as those related to employee turnover, safety, environmental issues, and customer satisfaction. However, since performance metrics vary depending on company, industry and strategy, among other factors, we will consider metrics tied to the company's business drivers to be acceptable. Where the financial metrics used to determine payouts have been adjusted, such as to exclude exceptional items or other costs, the report should disclose how the calculation differs from reported accounting figures, and a rationale for these adjustments.

Where possible, companies should disclose the specific targets utilised as well as actual performance against the targets. Glass Lewis recognises that boards may be reluctant to disclose certain target data on the basis that it is commercially sensitive; however we believe companies should justify such non-disclosure, and commit to providing this information retrospectively.

Where targets are not disclosed or award levels are determined on a discretionary basis, or where performance over the previous year appears to be poor or negative, the company should provide a clear explanation for why the payments were made.

The target and potential maximum payouts that can be achieved under STI awards should be disclosed. Shareholders should expect stretching performance targets for the maximum award to be achieved. Any increase in the potential maximum award should be clearly justified to shareholders.

In addition, we believe that at least a portion of bonuses should be subject to “malus” provisions, which allow companies to reclaim unvested bonuses on the basis of poor performance. Further, we believe that companies should implement “clawback” provisions whereby any bonus awarded may be recouped by the Company in the event of misstatement, or material fraud or misconduct by the recipient of a bonus award. Furthermore, as set out by the European Parliament, we believe that a portion of significant bonus payments — typically at least 40% of large payouts — should be subject to a minimum deferral period of three years.<sup>38</sup>

## LONG-TERM INCENTIVES

Glass Lewis recognises the value of long-term incentive programs. When used appropriately, they can provide a vehicle for linking an executive’s pay to company performance, thereby aligning their interests with those of shareholders.

There are certain elements that Glass Lewis believes are common to most well-structured long-term incentive (“LTI”) plans. These include:

- No re-testing or lowering of performance conditions;
- Two or more performance metrics. We believe measuring a company’s performance with multiple metrics serves to provide a more complete picture of the company’s performance than a single metric, and multiple metrics are less easily manipulated.
- At least one relative performance metric that compares the company’s performance to a relevant peer group or index;
- Performance periods of at least three years;
- Performance metrics that cannot be easily manipulated by management;
- Stretching targets that incentivise executives to strive for outstanding performance;
- Individual limits expressed as a percentage of base salary; and
- Holding requirements for executives, preferably extending through the duration of their tenure.

Performance measures should be carefully selected and should relate to the specific business/industry in which the company operates and, especially, the key value drivers of the company’s business. Metrics may be financial and non-financial; however, there should be a strong emphasis on overall financial performance. Where the financial metrics used to determine payouts have been adjusted, such as to exclude exceptionals or other costs, the report should disclose how the calculation differs from reported accounting figures, and

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<sup>38</sup> Article 24 of the European Parliament Resolution of July 7, 2010 on Remuneration of Listed Companies and Remuneration Policies in the Financial Sector.

a rationale for these adjustments including the use of the adjusted financials by industry peers and financial analysts.

When utilised for relative measurements, external benchmarks such as a sector, index or peer group should be disclosed and transparent. Internal benchmarks (e.g., earnings per share growth) should also be disclosed and transparent, unless a cogent case for confidentiality is made and fully explained.

## COMPENSATION POLICY RELATIVE TO PEERS

Glass Lewis' analysis of compensation policies examines a company's compensation disclosure and structure as compared to peer practices, based on relevant stock market indices, market capitalisation, industry and/or liquidity. As a result, we generally apply higher standards to compensation policies and disclosure of the largest companies in a given market, as these multinational companies compete with international companies in similar industries for talented executives. In particular, we expect companies on blue-chip indices to provide better compensation-related disclosure than smaller companies in that country. We also expect these companies to apply compensation practices that meet at least a majority of local key recommendations for best practice, and align with international standards for best practice. In contrast, we might recommend support of a say on pay vote at a smaller company where the compensation policy generally aligns with key best practice recommendations in the relevant market and with the policy and disclosure of its peers, but does not meet more stringent standards for international best practice.

Further, we recognise that the disclosure of pay ratios between the CEO and median or average employee may be useful in contextualising levels of executive remuneration both within a business and within industries. As such, we encourage companies to disclose such pay ratios, including a description of the methodology for their calculation.

## COMPENSATION POLICY RELATIVE TO OWNERSHIP STRUCTURE

Glass Lewis recognises that differences in the ownership structure of listed firms can affect the incentive structure for executives. In particular, where a company is controlled and managed by a family, we believe the use of equity incentives for representatives of the family is inappropriate and may serve to further entrench the controlling shareholders' stake. Additionally, in general, we expect companies with more dispersed ownership to demonstrate a more precise and linear pay-performance link than those with more concentrated ownership. In general, where an executive owns or directly controls more than 10% of a company's shares, we would not expect the individual to participate in equity incentive schemes, considering the natural alignment with shareholder interests.

## EXECUTIVE COMPENSATION AT FINANCIAL INSTITUTIONS

Following the global financial crisis, the European Union has directed significant attention to the reform of compensation policies at financial institutions in order to mitigate risk to relevant stakeholders. Notably, the European Union introduced directives amending the existing Capital Requirements Directive in 2010 ("CRDIII") and 2013 ("CRDIV") in order to harmonise the supervision of compensation practices at financial institutions across the EU.<sup>39</sup> The amendments introduced with CRDIII established a requirement that national supervisory authorities directly oversee financial institutions' compensation policies and practices in order to "promote sound and effective risk management."<sup>40</sup> The more notable provisions from CRDIII and CRDIV that apply to executive compensation policies of affected firms<sup>41</sup> are the following:<sup>42</sup>

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<sup>39</sup> Directives 2010/76/EU and 2013/36/EU of the European Parliament and of the Council of 24 November 2010 and 26 June 2013, respectively, amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.

<sup>40</sup> Article 22(1) of Directive 2006/48/EC ("CRDIII").

<sup>41</sup> While all financial and credit institutions are affected by CRD III and CRD IV, a "proportionality rule" prevents all requirements from being strictly applied to smaller companies or to companies or individuals with less direct risk exposure.

<sup>42</sup> Annex V, Article 11(23.1) of CRDIII.

- Performance-related compensation must take into account the overall company results as well as financial and non-financial criteria;
- Fixed pay should be high enough relative to variable pay to adequately compensate individuals and avoid excessive risk-taking;
- Variable compensation plans should allow the possibility of receiving no payment in case of poor company performance;
- Variable compensation cannot exceed 100% of fixed compensation (or 200%, with shareholder approval);<sup>43</sup>
- At least 50% of variable compensation must be granted in the form of equity-linked or derivative instruments;
- At least 40% of variable compensation must be deferred over at least three to five years;<sup>44</sup>
- Up to 100% of variable compensation, including equity deferral, must be subject to clawback or malus provisions; and
- Make-whole payments related to previous employment packages must also include retention, deferral, performance and clawback elements.

Further, CRD III and CRD IV provide the European Banking Authority (“EBA”) broad authority to set and enforce Guidelines on Remuneration Policies and Practices (“Guidelines”) for financial institutions that should be applied by supervisory authorities in each EU member state.<sup>45</sup> These Guidelines provide specific guidance<sup>46</sup> on implementation of the principles and regulations in CRDIII. Among other recommendations, the Guidelines state that performance metrics should incorporate risk adjustment and economic efficiency measures.<sup>47</sup> The Guidelines provide examples of quantitative company performance metrics that adequately measure risk<sup>48</sup> and cautions against the sole use of performance metrics that measure profitability or share price.

In line with the approach advocated by European regulatory authorities, Glass Lewis believes that compensation structures at financial institutions often require unique consideration due to the heightened potential for shareholder value to be put at risk by poorly designed incentive programs. As such, we generally expect financial institutions to provide more robust justifications for any deviations from key best practice recommendations.

## AUTHORITIES TO INCREASE VARIABLE COMPENSATION

As described above, in accordance with CRDIV, significant financial institutions are required to seek shareholder approval in order to grant variable pay that exceeds 100% of base salary. Such proposals may request the authority to issue payments not exceeding 200% of base salary, although member states may stipulate lower maximums. In general, Glass Lewis will support such requests where a company has provided adequate rationale and demonstrated a close alignment between pay and performance.

<sup>43</sup> Member states may set lower thresholds in national implementation laws. Shareholders must approve any increase in variable compensation over the threshold of 100% of base salary by a 75% supermajority, or by a 66% supermajority if at least 50% of outstanding shares are represented. The EBA published an opinion on compliance with this rule in December 2015 in which it recommends further legislation to provide for consistent application of the rule. At that time, a number of member states were deemed non-compliant.

<sup>44</sup> For variable remuneration that is “particularly high,” at least 60% must be deferred.

<sup>45</sup> The Guidelines were developed and published by the predecessor to the EBA — the Committee of European Banking Supervisors (“CEBS”) — and were updated in December 2015 with final guidance on the calculation of bonus caps, which applies from January 2017.

<sup>46</sup> The Guidelines provide more specific guidance regarding which regulations apply to which individuals and companies based on the proportionality rule. For example, companies may be exempted from the aforementioned deferral requirements. Where a company or individual is exempted from more stringent requirements and chooses not to apply them, we expect the company to provide sufficient rationale for the chosen alternative compensation structure.

<sup>47</sup> Section 4.2.4 of the CEBS Guidelines on Remuneration Policies and Practices.

<sup>48</sup> These include risk-adjusted return on capital (RAROC), return on risk-adjusted capital (RORAC), economic profit, internal economic risk capital, net economic contribution, risk-adjusted cost of funding or pure accounting adjustments.

## EQUITY-BASED COMPENSATION PLAN PROPOSALS

We believe that equity compensation awards are useful, when not abused, for retaining employees and providing them with an incentive to act in a way that will improve company performance.

Equity-based compensation programs have important differences from cash compensation plans and bonus programs. Accordingly, our analysis takes into account factors such as plan administration, the method and terms of exercise, and express or implied rights to re-price.

Our analysis is both quantitative and qualitative. In particular, we examine the potential dilution to shareholders, the company's grant history and compliance with best practice recommendations.

We evaluate equity-based incentive plans based on the following principles:

- Total potential dilution to current shareholders should be reasonable and in line with a company's peers. We will consider annual grant limits to all plan participants and individual senior executives when making this assessment, and particularly whether such limits have been set and disclosed;
- Awards to executives should be conditional on stretching financial and/or non-financial performance targets;
- Awards should vest over several years;
- Companies should have a demonstrated history of making reasonable equity incentive grants over the past three fiscal years;
- Stock options should be granted at fair market value, unless a discount is sufficiently justified and explained; and
- Plans should not permit re-pricing of stock options without shareholder approval.

In addition to the aforementioned quantitative criteria, we compare the terms of the proposed plan with current best practice recommendations in Europe and the relevant local market. To this end, we will consider whether the award and/or exercise of equity are conditional on the achievement of detailed and challenging performance targets to adequately align management interests with those of shareholders. Successful plans will generally include long-term (at least three-year) performance targets which aim to reward executives who foster company growth while limiting excessive risk-taking. We feel that executives should be compensated with equity only when their performance and the company's performance warrant such rewards.

While we do not believe that equity-based incentive plans intended for employees below the senior executive level should necessarily be based on overall company performance metrics, we firmly believe equity grants to senior executives should nearly always be quantifiably linked to company performance. We will generally recommend voting against long-term incentive plans with senior executive participants that do not demonstrate such a link to company performance, taking into account the company's overall compensation structure and any other long-term incentive plans used or proposed by the company for senior executives. However, we will also account for best practices relative to a company's peers when assessing the appropriateness of performance metrics.

## OPTION REPRICING

Glass Lewis views option repricing with great skepticism. Shareholders have substantial risk in owning stock and we believe that the employees and officers who receive stock options should be similarly situated to align their interests with shareholder interests.

We are concerned that option grantees who believe they will be “rescued” from underwater options will be more inclined to take unjustifiable risks. Moreover, a predictable pattern of repricing substantially alters a stock option’s value because options that will practically never expire deeply out of the money are worth far more than options that carry a risk of expiration.

In short, repricings change the bargain between shareholders and employees after the bargain has been struck. Re-pricing is tantamount to re-trading.

There is one circumstance in which a repricing is acceptable: if macroeconomic or industry trends cause a stock’s value to decline dramatically, rather than specific company issues, and repricing is necessary to motivate and retain employees. In this circumstance, we think it fair to conclude that option grantees may be suffering from a risk that was not foreseeable when the original “bargain” was struck. In such a circumstance, we will support a repricing only if the following conditions are true:

- Officers and board members do not participate in the program;
- The stock decline mirrors the market or industry price decline in terms of timing and approximates the decline in magnitude;
- The exchange is value-neutral or value-creative to shareholders with very conservative assumptions and with a recognition of the adverse selection problems inherent in voluntary programs; and
- Management and the board make a cogent case for needing to motivate and retain existing employees, such as being in a competitive employment market.

## **SEVERANCE PAYMENTS**

In general, we believe that severance payments should be limited to two years fixed salary and should not be paid in the event of inadequate performance or voluntary departure. However, we will apply local best practice standards when analysing severance payments.

## **COMPENSATION PLANS FOR BOARD MEMBERS**

Glass Lewis believes compensation paid to non-employee board members for the time and effort they spend serving on the board and its committees should be reasonable and appropriate. Board fees should be competitive in order to retain and attract qualified individuals but should generally not be performance based. Excessive fees represent a financial cost to the company and, along with performance-based compensation, threaten to compromise the objectivity and independence of non-employee board members. In line with best practice in Europe, we generally recommend voting against stock option grants (if granted on the same terms as executive awards) and performance-based equity grants for non-executive directors.

However, we do not object to the payment of directors’ fixed fees in the form of equity provided that the vesting of such a grant is either immediate or does not require the directors’ continued service on the company’s board for payment to occur.

# Governance Structure, Capital Management and the Shareholder Franchise

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## AMENDMENTS TO THE ARTICLES OF ASSOCIATION

We will evaluate proposed amendments to a company's articles of association on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from reviewing each amendment on its own merit. In such cases, we will analyse each change on its own. We will recommend voting for the proposal only when, on balance, we believe the amendments are in the best interests of shareholders.

In Europe, it is common for proposed technical amendments to a company's articles of association, resulting from changes to corporate law or necessary changes to the wording of an article without changing the meaning of the article, to be bundled together under a single proposal. In such cases, we will recommend voting for the proposal.

## RATIFICATION OF BOARD, MANAGEMENT AND AUDITORS' ACTS

Shareholder ratification of board, management and/or auditors' acts during the previous fiscal year is required in many European markets. The legal consequences of the ratification vary by market, and our analysis and recommendations take this into account, including in particular potential prejudice to shareholder recourse from ratification.

We evaluate the various ratification proposals on a case-by-case basis and will generally recommend supporting such proposals except when we identify material concerns with the actions of the board, management or auditors' acts, as relevant, and/or with the integrity and performance of the individuals whose acts are subject to ratification. We will recommend abstaining from voting on the ratification of board, management and auditors' acts when the audited financial statements are not made available in sufficient time for shareholders to review prior to submitting votes, or when shareholders otherwise do not have enough information to make an informed decision regarding the board's, management's or the auditor's actions in the prior year. We may recommend voting against a ratification proposal under the following conditions:

- Where there has been a finding or conviction of fraud or other illegal activities, or credible, pending accusation of such, by members of the board, management or auditing firm that may be damaging to shareholders' interests;
- When there are serious, credible allegations or pending investigations of claims of fraud, illegal activities, or other actions resulting in, or with the likely potential to result in, material damage to shareholder value;
- The report of the independent auditor notes a material weakness, serious restatement, or failure to comply with accounting norms;

- In cases where there is ongoing legal action against or concerning members of the board, management or auditing firm and we believe the postponement of ratification or the individual ratification of board members (if possible) would better serve the interests of shareholders;
- The board has consistently failed to address material shareholder concerns; or
- Other exceptional cases in which the board's or management's actions (or their failure to act) have clearly damaged shareholder value. When we have serious concerns regarding the actions of the board and no members of the board are up for election, we may recommend voting against the ratification of board acts, depending on the materiality of the concerns.

## RELATED PARTY TRANSACTIONS

Shareholders may be given the opportunity to approve material related party transactions in Europe.<sup>49</sup> We will evaluate related party transactions on a case-by-case basis. We generally recommend approval of any transaction which falls within the company's regular course of business, so long as the terms of the transaction have been verified to be fair and reasonable by an independent auditor or independent board committee, in accordance with prevailing market practice.

## DIRECTOR INSURANCE AND INDEMNIFICATION

We generally recommend approval of directors' participation in insurance policies. However, we will evaluate these proposals on a case-by-case basis in line with market practice.

## ANTI-TAKEOVER DEVICES

Glass Lewis believes that provisions that are intended to prevent or thwart a potential takeover of a company are not conducive to good corporate governance and can reduce management accountability by substantially limiting returns for shareholders. See specific examples below.

## ISSUANCE OF SHARES/WARRANTS

In some markets, shareholders must explicitly approve any authority to issue shares or warrants that may be used as a takeover defense. Given our strong opposition to anti-takeover devices, we recommend that shareholders vote against these proposals.

## SHARE REPURCHASE PLANS

In some cases, companies may specify that share repurchase plans may be used as a takeover defense. Given our strong opposition to anti-takeover devices, we recommend that shareholders vote against these proposals. See below for our treatment of share repurchase proposals in general.

## CAPS ON VOTING RIGHTS

In several European markets, companies retain the right to impose absolute caps on the number of voting rights that may be exercised by a single shareholder or group of shareholders. Glass Lewis is strongly opposed to such measures and will recommend that shareholders vote to remove or increase any existing cap on voting rights that is posed in a proxy. We also recommend that shareholders vote against the introduction of any cap or restriction on shareholder voting rights or the lowering of any existing cap on voting rights.

<sup>49</sup> Directive 2017/828 amending the Shareholder Rights Directive sets new minimum standards for the independent review and disclosure and approval of material related party transactions. Member states, which must implement the requirements in national law by 2019, may require shareholders to approve such transactions, absent another satisfactory means of approval by an independent supervisory body.

## RESTRICTIONS ON SHARE REGISTRATION

In several European markets, companies may seek to impose restrictions, including limited or suspended voting rights, on share registration for shareholders who own shares through an intermediary and fail to fulfill certain reporting requirements. We will evaluate these proposals on a case-by-case basis. We will recommend voting against any proposed restrictions that are overly punitive or arbitrary in nature, and are not required by national law.

## OWNERSHIP REPORTING REQUIREMENTS

European shareholders whose percentage ownership of outstanding shares or voting rights in a company rises above or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50%, or 75% are required to notify the company, specifying the number of shares held and corresponding number of voting rights.<sup>50</sup> However, in several European markets, companies retain the right to set lower reporting thresholds in their articles of association. Glass Lewis recommends voting against any share ownership reporting threshold lower than the legal mandate. In our view, such low reporting thresholds create unnecessary administrative burdens for shareholders and are unlikely to have a positive effect on shareholder value.

## SUPERMAJORITY VOTE REQUIREMENTS

Glass Lewis believes that supermajority vote requirements act as impediments to shareholder action on ballot items that are critical to shareholder interests. One key example is in the takeover context, where supermajority vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business. While we recognise that supermajority voting requirements are imposed by national law for approval of certain proposals in most European markets, we will recommend voting against any proposal seeking to extend supermajority voting requirements to decisions where a supermajority requirement is not stipulated by law and such provisions are not clearly designed to protect the interests of minority shareholders.

In cases where a company seeks to abolish supermajority voting requirements we will evaluate such proposals on a case-by-case basis. In many instances, amendments to voting requirements may have a deleterious effect on shareholders rights where a company has a large or controlling shareholder. Therefore, in analysing such proposals Glass Lewis will take into account additional factors including: shareholder structure; quorum requirements; impending transactions – involving the company or a major shareholder – and any internal conflicts within the company.

## SHAREHOLDER LOYALTY INITIATIVES

Glass Lewis is generally opposed to measures that create different classes of shareholders or treat shareholders unequally. We recognise that some measures, such as granting loyalty dividends, bonus shares or warrants, or extra voting rights exclusively to long-term shareholders, are increasingly studied as acceptable methods for encouraging shareholders to remain invested in a company for an extended period of time. While we recognise that such loyalty incentives for shareholders may accomplish the intended effect of maintaining a stable shareholder structure and decreasing volatility, we believe the benefit to shareholders of such measures has not been sufficiently proven by academic literature nor have the consequences been fully studied. As a result, we will generally oppose proposals to implement loyalty programs for certain shareholders, since they unnecessarily create different classes of shareholders with disparate treatment.

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<sup>50</sup> Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC. Member states may allow companies to set additional ownership reporting thresholds other than those required by the Directive. Further, in accordance with the revised Shareholder Rights Directive 2017/828, member states must provide companies with the right to identify shareholders owning 0.5% of shares or voting rights, although lower thresholds may be set in national law.

## RIGHT OF SHAREHOLDERS TO CALL A SPECIAL MEETING

Glass Lewis strongly supports the right of shareholders to call special meetings. However, in order to prevent abuse and waste of corporate resources by a very small minority of shareholders, we believe that only shareholders holding at least 5% of a company's share capital should be allowed to call a special meeting.<sup>51</sup> A lower threshold may leave companies subject to meetings whose effect might be the disruption of normal business operations in order to focus on the interests of only a small minority of owners.

## ROUTINE ITEMS

In general, Glass Lewis believes that procedural matters, which are premised on physical attendance at the general meeting, do not harm shareholders' interests.

## TRANSACTION OF OTHER BUSINESS

In our view, this proposal is different from other routine items. We typically recommend that shareholders not give their proxy to management to vote on any other business items that may properly come before the annual meeting. In our opinion, granting unfettered discretion is unwise.

## AUTHORITY TO CARRY OUT FORMALITIES

As a routine matter, shareholders may be asked to grant management the authority to complete any and all formalities, such as required filings and registrations, needed to carry out decisions made at the meeting. Often, shareholders are also asked to approve the minutes. In general, we recommend voting for this proposal in order to help management complete the formalities necessary to validate the decisions made at the annual meeting, regardless of whether we support all the proposals presented at the meeting.

## MEETING PROCEDURES

In many European markets, companies ask that shareholders approve the opening of the meeting, the appointment of a presiding chair and/or meeting delegates, the agenda, the voting list, the presentation of reports, management speeches, the closing of the meeting, and the meeting minutes, etc. These items are generally routine and do not have an impact on shareholders. In most cases, shareholder votes serve as an acknowledgment that the meeting was properly conducted and all meeting procedures were met. As such, Glass Lewis always recommends voting for these items.

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<sup>51</sup> Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies sets this as a minimum ownership threshold. Where a company's management supports a lower threshold, Glass Lewis will also support the proposed threshold.

# Capital Management

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## INCREASES IN CAPITAL

Glass Lewis believes that adequate capital stock is important to a company's operation. European companies are authorised to increase share capital through several methods, which may or may not involve the issuance of shares.

## ISSUANCE OF SHARES AND/OR CONVERTIBLE SECURITIES

In general, issuing an excessive amount of additional shares and/or convertible securities can dilute existing holders. Further, the availability of additional shares, when the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, where we find that the company has not detailed a plan for use of the proposed shares, or where the number of shares far exceeds those needed to accomplish a detailed plan, we typically recommend against the authorisation of additional shares.

While we believe that adequate share issue authorities to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management should justify to shareholders the use of additional shares rather than shareholders providing the company a blank check in the form of a large pool of unallocated shares available for any purpose.

We will consider the discount price at which the new shares may be issued. Where a company seeks to issue shares at a significantly discounted price without a comprehensive explanation, we may recommend that shareholders do not support the authorisation in question.

## PREFERENCE SHARES AND ADDITIONAL SHARE CLASSES

We view issuances of preference shares and additions of new share classes on a case-by-case basis, with a focus on the rights of current shareholders.

We generally recommend voting against proposals where a new class of shares creates unequal or superior voting rights. When a company proposes to introduce or increase non-voting preference shares, we will take into account the size of the potential issuance relative to current share capital and the rationale provided by the company for the proposal.

## WITH OR WITHOUT PREEMPTIVE RIGHTS<sup>52</sup>

In our view, any general authorisation to issue shares and/or convertible securities with preemptive rights should not exceed 100% of a company's total share capital and any general authorisation to issue shares and/or convertible securities without preemptive rights should not exceed 20% of the company's total share capital. When sufficient information is disclosed to establish a broader context in which to consider the proposed increase, we may take into account a company's existing authorities to issue shares and/or convertible securities, and how they have been used, to evaluate the total potential dilution the proposed authority has on existing shareholders.

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<sup>52</sup> Please note that this policy does not apply to France.

## Rights Issues

When a company seeks shareholder approval of a specific plan to issue shares with preemptive rights, we will evaluate the plan on a case-by-case basis. We will generally approve rights issues, even in excess of 100% of a company's current issued share capital, when the following conditions are met: (i) the total number of shares to be issued, or intended proceeds of the issue, is reasonable; (ii) the price at which the shares will be issued is reasonable; and (iii) the intended uses of the proceeds from the issuance are sufficiently justified in light of the company's financial position and business strategy.

## Private Placements

We evaluate these proposals on a case-by-case basis. In general, we expect companies to provide a specific and detailed rationale for such proposals.

## Capitalisation of Reserves, Profits or Issue Premiums

The successive or simultaneous capitalisation (i.e., incorporation) of reserves, retained earnings or paid-in capital, resulting in the free allotment of shares and/or an increase in the par value of shares, is another method European companies may elect in order to increase their paid-in capital. In these cases, there is no risk of shareholder dilution. We believe that decisions regarding such changes to a company's capital structure are best left up to management and the board, absent evidence of egregious conduct, and will generally recommend that shareholders vote for related proposals.

## Financial Institutions and Contingent Convertible Securities

We often make exceptions to our recommended dilution thresholds for the issuance of shares with or without preemptive rights when a company explains that the capital increase is proposed in order to meet capital adequacy requirements applicable to financial institutions established at the international,<sup>53</sup> regional<sup>54</sup> and/or national level.

European regulations note that contingent convertible instruments ("CoCos") may be used to meet these capital requirements in certain instances.<sup>55</sup> We will generally support proposals to issue contingent convertible securities in cases where a company explains that the proposed issuance is motivated by consideration of these capital requirements.

## Supplying Equity Programs

In general, we recommend voting for authorities intended to supply awards under existing equity programs that were previously approved by shareholders. Where a company is seeking to renew an authority to issue new shares under a specific plan that is itself also being renewed, we will evaluate the proposal in line with the specified plan terms.

We view general authorities intended to service awards under a variety of equity programs, where a plan has not been specified, on a case-by-case basis. However, we generally expect such authorities to fall under 5% of a company's total issued share capital.

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<sup>53</sup> The Basel Committee on Banking Supervision establishes minimum standards regarding bank capital adequacy under Basel III which apply to all "internationally active banks" in G20 countries.

<sup>54</sup> In Europe, the European Commission incorporates Basel III recommendations into binding EU law through the Capital Requirements Directive ("CRD IV") and its associated Regulation, which went into effect on January 1, 2014. The European Banking Authority ("EBA") is tasked by CRD IV with overseeing implementation.

<sup>55</sup> CRD IV allows CoCos to be counted toward Additional Tier 1 capital, which must be written down or converted into Common Equity Tier 1 capital when the Common Equity Tier 1 capital ratio falls below a minimum level. The EBA further states that CoCos may be counted toward satisfying a company's Core Tier 1 ratio if they were issued before June 30, 2012 and they meet the specifications in the EBA's common termsheet for buffer convertible capital securities ("BCCS"). The EBA also notes that existing CoCos other than BCCS will not be counted toward the established target unless they were converted into Core Tier 1 capital by October 2012.

## **STOCK SPLIT**

We typically consider two metrics when evaluating whether a proposed stock split is reasonable: (i) the historical pre-split stock price; and (ii) the current price relative to the company's average trading price over the past 52 weeks. In general, we recommend voting for these proposals when a company's historical share price is in a range where a stock split could facilitate trading, assuming the board has provided adequate justification for the proposed split.

## **ISSUANCE OF DEBT INSTRUMENTS**

When companies seek shareholder approval to issue debt we evaluate the terms of the issuance, the requested amount and any convertible features, among other aspects. If the requested authority to issue debt is reasonable and we have no reason to believe that the increase in debt will weaken the company's financial position, we will usually recommend in favor of such proposals.

## **AUTHORITY TO REPURCHASE SHARES**

A company may want to repurchase or trade in its own shares for a variety of reasons. A repurchase plan is often used to increase the company's stock price, to distribute excess cash to shareholders or to provide shares for equity-based compensation plans for employees. In addition, a company might repurchase shares in order to offset dilution of earnings caused by the exercise of stock options.

We will recommend voting in favor of a proposal to repurchase company stock when the following conditions are met: (i) a maximum of 20% of the company's total shares may be repurchased, unless the company explicitly states that any shares repurchased above this 20% threshold will be held in treasury and cancelled; (ii) a maximum price which may be paid for each share (as a percentage of the market price) is set; and (iii) the share buyback may not be used as a takeover defense.

## **AUTHORITY TO CANCEL SHARES AND REDUCE CAPITAL**

In conjunction with a share repurchase program, companies often proceed to cancel the repurchased shares. When a company requires specific authorisation to cancel treasury shares, we generally recommend that shareholders vote for such proposals.

# Environmental, Social and Governance ("ESG") Issues and Shareholder Initiatives

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Glass Lewis generally believes decisions regarding day-to-day management and policy decisions, including those related to social, environmental or political issues, are best left to management and the board as they in almost all cases have more and better information about company strategy and risk. However, when there is a clear link between the subject of a shareholder proposal and value enhancement or risk mitigation, Glass Lewis will recommend in favor of such proposal where the company has failed to or inadequately addressed the issue.

We strongly feel that shareholders should not attempt to micromanage the company, its business or its executives through the shareholder initiative process. Rather, we believe shareholders should use their influence to push for governance structures that protect shareholders and promote director accountability. Shareholders should put in place a board they can trust to make informed decisions that are in the best interests of the business and its owners, and hold directors accountable through the election of directors.

To this end, we examine the circumstances at each company on a case-by-case basis. We thoroughly research each firm, using publicly available information, such as annual reports, sustainability reports, companies' websites, NGO websites, and news sources. When we identify situations where shareholder value may be at risk, we will note our concerns in the relevant section of the Proxy Paper analysis as well as in any applicable shareholder proposals. Though relatively rare in Europe, should a shareholder proposal seek action on a specific ESG issue, Glass Lewis will recommend voting in favor of such a proposal when we believe its implementation will enhance or protect shareholder value. We will also recommend voting in favor of a proposal if we believe supporting such proposal will promote disclosure of significant risk exposure. Only in rare cases will we recommend shareholders vote against board members based on ESG concerns. Please see "Transparency and Integrity in Financial Reporting" for further information on how we analyse mandatory non-financial and sustainability reporting requirements.

For a detailed review of how Glass Lewis approaches ESG issues and related shareholder initiatives, please refer to our comprehensive *Proxy Paper Guidelines on Shareholder Initiatives*.

## DISCLAIMER

This document is intended to provide an overview of Glass Lewis' proxy voting policies and guidelines. It is not intended to be exhaustive and does not address all potential voting issues. Additionally, none of the information contained herein should be relied upon as investment advice. The content of this document has been developed based on Glass Lewis' experience with proxy voting and corporate governance issues, engagement with clients and issuers and review of relevant studies and surveys, and has not been tailored to any specific person.

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