2018 Proxy Season Preview – United States

2017 was a momentous year in corporate governance. We observed a growing emphasis on investor stewardship as a global phenomenon, with the proliferation of investor stewardship codes around the globe and the formation of the ISG in the United States, a group whose stated principles of corporate governance and investor stewardship officially went into effect this January. Issues of climate change, gender equality and corporate behavior were frequently front-page news and front of mind for many investors in 2017.

The political climate in the United States throughout 2017 was tense, with a concerted push for deregulation standing in sharp contrast to a growing emphasis on corporate responsibility. This heightened emphasis on sustainable practices and identifying long-term material risks was underscored in a January 2018 open letter from Blackrock CEO Larry Fink. Writing to public company CEOs, Larry Fink called on companies to serve a greater purpose beyond profits on the balance sheet; one that that benefits a greater good for all stakeholders.

The dialogue between public companies and institutional investors also evolved in 2017, with engagement rapidly becoming an essential component of investor stewardship and public company accountability. The frequency and sophistication of conversation surrounding ESG topics grew substantially in the past year, and this will enable investors to have a more contextual reading of the public disclosures this proxy season. Increased engagement will also likely result in improved proxy disclosures, as companies identify more effective ways to address the developing topics of shareholder concern.

Looking ahead to the 2018 proxy season, investors will remain focused on these key topics of environment, human capital management, board accountability, and executive compensation.

Below is a summary of the key Glass Lewis policy updates for 2018, followed by a broader discussion of issues surrounding shareholder proposals.

Glass Lewis Policy Updates for 2018

• **Board Gender Diversity:** In 2018 Glass Lewis will highlight companies that have no female board members, and beginning in 2019 we will recommend voting against the nominating committee chair of a board
that has no female members, and which has not provided sufficient rationale for the lack of gender diversity, or has not disclosed a plan to address this issue. Companies with all-male boards are increasingly in the minority, with only three companies in the S&P 500 currently having no women. The issue of all-male boards is likely to be a more frequent concern at smaller market cap companies, where board diversity has historically not been a focus. Companies outside the Russell 3000 index are not subject to this policy.

- **Dual-Class Share Structures:** We’ve strengthened our language surrounding dual-class share structures and codified our policy as it pertains to companies that hold an IPO or spin-off resulting in a share structure with unequal voting rights. In 2018, the presence of dual-class share structures is an additional factor that may lead us to recommend voting against members of the governance committee in the year following an IPO or spin-off.

- **Prior Year Vote Results at Dual-Class Companies:** Beginning in 2018 we will review prior year voting results with greater scrutiny at dual-class companies. Where vote results indicate that a majority of unaffiliated shareholders supported a shareholder proposal or opposed a management proposal, we may recommend voting against members of the governance committee if the company does not demonstrate an appropriate level of responsiveness to the shareholder votes.

- **Board Responsiveness Threshold:** Our 2018 policy guidelines clarify that we believe the board generally has an imperative to respond to shareholder dissent from a proposal at an annual meeting of more than 20% of votes cast, particularly in the case of a compensation or director election proposal. While our guidelines previously specified 25% as an appropriate threshold, our updated guidelines reflect evolving investor sentiment as well as the common practices we have observed through our extensive engagement with public companies.

- **Virtual Shareholder Meetings:** Glass Lewis expects over 200 companies to hold their annual meetings by virtual means in 2018, with most of those companies opting to eliminate the option of attending the meeting in person. In 2018 Glass Lewis will highlight companies opting to hold virtual-only shareholder meetings, and beginning in 2019 we will generally recommend voting against members of the governance...
committee when the board is holding a virtual-only shareholder meeting and the company does not provide disclosure ensuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

- **Director Overboarding:** While there is no change to our general director overboarding thresholds (we allow a total of five boards for non-executive directors and a total of two boards for directors who also serve as an executive officer of a public company), we will take a more nuanced approach in 2018, particularly when reviewing the role of executive chair. We will consider extending our threshold for public executives to three total boards in cases where the executive role overlaps substantially with board service.

- **CEO Pay Ratio:** Rules requiring companies to disclose the ratio of CEO pay to median employee pay go into effect this year. In 2018 Glass Lewis will display the CEO pay ratio as a data point in our Proxy Papers, as available. While we believe the pay ratio has the potential to provide additional insight when assessing a company’s pay practices, at this time it will not be a determinative factor in our voting recommendations.

- **Glass Lewis Pay-for-Performance Grades:** While there is no change to our pay-for-performance model, our 2018 policy guidelines clarify the Glass Lewis grading system. Consistent with previous years, our pay-for-performance grades guide our evaluation of compensation committee effectiveness, and we generally recommend voting against say-on-pay proposals or compensation committee members at companies with a pattern of failing our pay-for-performance analysis. Unlike a school letter grade, however, a “C” does not indicate a significant lapse; rather, a “C” in the Glass Lewis grade system identifies companies where the pay and performance percentile rankings relative to peers are generally aligned.

- **Board Oversight of E&S:** In 2018, Glass Lewis will identify the directors who have been assigned specific oversight of environmental and social issues at the committee level, for companies in the S&P500 index.
Climate Change

The topic of climate change as a material risk factor for companies came into focus in 2017, with three shareholder proposals on the topic receiving majority support. The proposals, which request that companies provide more disclosure concerning the risks they face on account of climate change and attendant regulation received over 50% shareholder support at Occidental Petroleum, Exxon Mobil, and PPL Corp.

While the companies who received these proposals have all recently produced disclosure on this topic, numerous other companies—many of which received high, but not majority, votes on similar climate change resolutions—have also already produced or have committed to increase their disclosure of the risks they face on account of climate change. Many of these reports will follow, or are informed by, the reporting framework established by the Task Force on Climate-related Financial Disclosure (“TCFD”). This relatively new reporting framework, the final draft of which was finalized in the summer of 2017, seeks to establish voluntary climate-related financial disclosures that are “consistent, comparable, reliable, clear and efficient, and provide decision-useful information to lenders, insurers and investors.”

Unsurprisingly, many investors and companies have endorsed the TCFD reporting framework. While at this time last year only a handful of U.S. companies were providing comprehensive climate-related disclosure (such as 2-degree scenario analysis or detailed information concerning stranded asset risk), disclosure on this topic has improved significantly within the last several months. Given this rapid improvement, companies who fail to adequately respond to investor concerns surrounding climate-related disclosures will increasingly become outliers with respect to this issue.

Given the high support for climate-related shareholder resolutions in 2017, we expect that shareholders will continue to file similar resolutions at energy and utility companies in 2018. Additionally, shareholders will be closely evaluating the response of companies who received significant or majority votes on these resolutions in 2017 in order to assess their responsiveness to this issue.
Diversity and Human Capital Management

Board composition and diversity have played an increasingly important role in investors’ engagement with and evaluation of corporate boards. Many companies have responded by increasing their disclosure of their diversity considerations through mechanisms including board skills matrices. In addition, a record number of companies have appointed women and racial minorities to their boards of directors, leaving those who still have boards that solely consist of “pale, stale and male” directors as obvious outliers. As a natural extension of this focus on diversity, investors are increasingly concerned regarding companies’ diversity considerations within their workforces.

Within the last year, the Human Capital Management Coalition (“HCM Coalition”), a global group of institutional investors, petitioned the SEC to request more disclosure of information concerning companies’ management of human capital issues. In addition, there has been an intense response to the #MeToo movement that is increasingly casting scrutiny into the top ranks of companies. Given that every company has significant exposure to issues related to its management of human capital issues, it is likely that this issue will be a prominent feature of the 2018 proxy season.

In 2017, a number of companies in the financial and information technology sectors received shareholder proposals requesting that they disclose how they are minimizing gender (and, in one case, racial) pay inequity within their workforces. Although in 2016, one such proposal at eBay received majority shareholder support, in the last year, these proposals received only nominal shareholder support. However, given the clear link between pay equity and the growing focus on human capital management, it is likely that these and other proposals aimed at diversity and the treatment of employees will garner increased shareholder support in the coming year.

Opioid Epidemic

In recent years, companies involved in the manufacture and distribution of opioids have come under increasing scrutiny from regulators and investors as a result of their role in the opioid epidemic. Although certain shareholder proponents have historically focused on the pricing and distribution of pharmaceuticals, in the 2018 proxy season, this focus will be centered on those companies involved in opioid manufacture, distribution and treatment.
In the first half of 2018, investors may vote on up to 20 resolutions submitted on account of companies’ involvement in the opioid epidemic. Resolutions will span from those requesting that companies disclose their corporate political contributions and that companies appoint an independent chairman to more novel proposals requesting that companies not exclude compliance costs when determining metrics for executive compensation purposes and proposals requesting that companies disclose the steps they’ve taken in response to the opioid epidemic.

**Board Oversight of ESG**

Along with investors’ focus on board composition, there has been an increasing interest in the skills and competencies held by directors and the oversight responsibilities afforded to material issues at companies. Given the extent to which many companies are exposed to risks related to climate change and other environmental and social impacts, it is unsurprising that one of the key aspects of the New York City Comptroller’s Board Accountability Project 2.0 was ensuring that boards have the skills and expertise necessary to provide proper oversight to issues related to climate change, and environmental and social issues more broadly.

Glass Lewis believes that companies should identify and mitigate, to the best extent possible, material risks related to environmental and social issues. A key aspect of ensuring that these issues receive the appropriate priority at the board level is by providing board level oversight of environmental and social issues. Accordingly, in the coming year, Glass Lewis will begin to capture the directors who have been assigned specific oversight of environmental and social issues at the committee level. Capturing and displaying this data will help investors in ensuring that boards are adequately managing and responding to risks related to environmental and social issues.
PODCAST SHOW NOTES

SPEAKERS:
- Kern McPherson – Senior Director of Research
- Crystal Milo – Director of Research, North America
- Courteney Keatinge – Director of ESG Research
- Julian Hamud – Director of Compensation Research

SHOW NOTES:
- Spotlight on corporate culture (2:10)
- Board accountability, diversity & skills (4:02)
- Investor views on climate change (6:45)
- ESG and executive compensation (9:20)
- Tesla: moonshot pay package (13:05)
- Big names, big payouts (14:45)
- Pay Ratio (15:40)
- New Model of Engagement (16:50)
- Dual class share structures (20:05)
- Glass Lewis Governance Policy updates (21:18)
- Compensation Policy updates (22:50)
- Shareholder initiative Policy updates (24:00)
- Meetings to look forward to (25:30)

Produced by Martin Mortell