



**2020**

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

# ISRAEL



# Table of Contents

---

GUIDELINES INTRODUCTION .....	1
Corporate Governance Structure .....	1
Summary of Changes for the 2020 Israel Policy Guidelines .....	1
A BOARD OF DIRECTORS THAT SERVES THE INTERESTS OF SHAREHOLDERS .....	2
Regulatory Framework .....	2
Election of Directors .....	2
Independence .....	2
Control-Enhancing Mechanisms .....	6
Other Considerations for Individual Directors .....	6
Performance .....	6
Experience .....	6
Conflict of Interest .....	7
Board Structure and Composition .....	8
Separation of the Roles of Chair and CEO .....	8
Size of the Board of Directors .....	9
Board-Level Risk Management Oversight .....	9
Board Composition at Banking Corporations .....	9
Board Committees .....	10
Audit Committee Performance .....	11
Compensation Committee Performance .....	12
Nominating and/or Governance Committee Performance .....	13
Election Procedures .....	13
Elections Involving More Candidates than Seats .....	13
Classified/Staggered Boards and Term Limits .....	14
Election of Directors as a Slate .....	14
Mandatory Director Retirement Provisions .....	15
Lack of Adequate Director Disclosure .....	15
Exceptions for Recent IPOs .....	15
Companies with U.S. Listings .....	16
Environmental and Social Risk Oversight .....	16

TRANSPARENCY AND INTEGRITY OF FINANCIAL REPORTING.....	18
Accounts and Reports.....	18
Allocation of Profits/Dividends.....	18
Appointment of Auditor and Authority to Set Fees.....	18
Voting Recommendations on Auditor Appointment.....	19
THE LINK BETWEEN COMPENSATION AND PERFORMANCE.....	20
Vote on Executive Compensation (“Say-on-Pay”).....	20
Compensation Policies of Institutional Entities.....	21
Say-on-Pay Voting Recommendations.....	22
Structure of Compensation Policy.....	23
Changes to Compensation Policy.....	24
Other Compensation-Related Proposals.....	24
Compensation Relative to Peers.....	24
Compensation Relative to Ownership Structure.....	24
Equity-Based Compensation Plan Proposals.....	25
Grants of Front-Loaded Awards.....	25
Option repricing.....	26
Severance Payments.....	26
Compensation Plans for Board Members.....	27
GOVERNANCE STRUCTURE AND THE SHAREHOLDER FRANCHISE.....	28
Amendments to the Articles of Association.....	28
Related Party Transactions.....	28
Liability Insurance and Indemnification.....	28
Anti-Takeover Devices.....	29
Supermajority Voting Requirements.....	29
Rights of Shareholders to Call a Special Meeting.....	29
CAPITAL MANAGEMENT.....	30
Increases in Capital.....	30
Issuance of Shares and/or Convertible Securities.....	30
Stock Split.....	31
Issuance of Debt Instruments.....	31
Authority to Repurchase Shares.....	31
Authority to Cancel Shares and Reduce Share Capital.....	31
SHAREHOLDER INITIATIVES.....	32
Environmental, Social & Governance Initiatives.....	32

# Guidelines Introduction

---

## CORPORATE GOVERNANCE STRUCTURE

Corporate governance for listed companies in Israel is derived from the Companies Law of 1999 (“Companies Law”) and the Securities Law of 1968 (“Securities Law”) published by the Israeli Securities Authority (“ISA”). Banks are also governed by the Proper Conduct of Banking Business. Best practice in Israel is based primarily on the First Addendum: Recommended Corporate Governance Directives, which was added as part of Amendment 16 to the Companies Law in 2011.

## SUMMARY OF CHANGES FOR THE 2020 ISRAEL POLICY GUIDELINES

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis. This year we’ve made noteworthy revisions in the following areas, which are summarized below but discussed in greater detail in the relevant section of this document:

### BOARD AND COMMITTEE INDEPENDENCE

We clarify that, going forward, Glass Lewis will generally recommend voting against all non-independent directors that serve on the audit or compensation committees, including those affiliated due to tenure or where the Company has classified such director as non-independent but the reason for such classification is unclear.

### BOARD OF DIRECTORS AT BANKING CORPORATIONS

We codify our approach to the election of directors at banking corporations without a significant or controlling shareholder, a description which now applies to the three largest banks in Israel. We also provide further information on the background of the regulatory landscape affecting such banks.

### BOARD SKILLS AND “CONTESTED” DIRECTOR ELECTIONS

Following on from our 2019 Guidelines update, by which we codified our assessment of board skills as an integral part of the analysis of proposals to elect directors, particularly where there are more candidates than available board seats, we provide as an appendix to these policy guidelines an [overview of the skills](#) Glass Lewis considers in relation to certain key sectors.

### EXECUTIVE COMPENSATION

We have refined our guidelines to clarify that, in reviewing Israeli compensation policies and pay proposals, we will place greater emphasis on the existence of compensation components that tie payouts in practice to long-term stability and financial performance. In the absence of an LTI or equity-based plan, we look for some form of multi-year metric or deferred vesting provision under an STI plan.

Where a company’s compensation policy contains for LTI provisions but we see that in practice the company has not been utilizing these or there is an excessive focus on short-term performance, we may recommend a vote against a compensation policy on this basis if there is not adequate supporting disclosure.

# A Board of Directors that Serves the Interests of Shareholders

---

## REGULATORY FRAMEWORK

Many Israeli companies are dually-listed on other exchanges, often in both the U.S. and Israel, and are frequently owned and controlled by holding companies that invest in other companies characterized by vertical integration. Israeli companies are usually governed by a one-tier management structure. The board of directors may include both executive and non-executive members.

## 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. We note that in Israel, we also have a unique category, labeled as an "external" or "outside" director, who is similar to an independent director and specific to this market.

**Independent Director** — An independent director has no material financial,<sup>1</sup> 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.

To be classified as an independent director under Israeli Companies Law, a director may not serve on the board for more than nine years<sup>4</sup> and must also meet qualifications (ii) through (iv) listed for “external directors” below.

Nonetheless, directors serving at companies whose shares are traded on certain U.S. stock exchanges may be considered independent beyond nine years, provided the audit committee and the board approve that, in light of the director’s expertise and contribution, their appointment is to the benefit of the Company. The Company may appoint such independent directors beyond the nine year threshold for additional terms of no greater than three years at a time.<sup>5</sup>

**External Director** — Under Israeli law,<sup>6</sup> boards of Israeli companies generally include at least two directors who qualify as “external” or “outside” directors. On April 17, 2016, the Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trading on an Exchange Outside of Israel), 5760-2000) were amended such that companies listed on the NASDAQ or NYSE that have no controlling shareholder no longer are required to appoint external directors.<sup>7</sup> For all banks, one-third of its total membership must consist of external directors.<sup>8</sup> External directors must possess the following qualifications:

- i. must reside in Israel, unless the company is listed on an exchange outside of Israel;<sup>9</sup>
- ii. may not be a relative, director,<sup>10</sup> business partner, or employer/relative of a director who has had business dealings (other than of a trivial nature) with the controlling shareholder(s) in the last two years;<sup>11</sup>
- iii. may not receive any compensation beyond what is regulated by the Israeli Securities Authority;
- iv. may not be an employee of the Israeli Securities Authority or the Tel-Aviv Stock Exchange;
- v. must be either a financial and accounting expert or have requisite professional qualifications as

<sup>1</sup> “Material” as used herein means a relationship in which the value exceeds: (i) €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; (ii) €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; (iii) 1% of the company’s 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); (iv) 10% of shareholders’ equity and 5% of total assets for financing transactions; or (v) 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.

<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.

<sup>4</sup> Amendment 16, Companies Law (March 7, 2011). After nine years, the director must step down for at least two more years before he/she can be re-nominated as an independent director.

<sup>5</sup> Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trade on an Exchange Outside of Israel), 5760-2000: Article 5r.

<sup>6</sup> Articles 239 and 240, Companies Law.

<sup>7</sup> <http://www.justice.gov.il/SitePages/OpenFile.aspx?d=ak9evgbauyE4aFg%2b2I1QNMCCEv3eBRDm4eG79jHJQ8gY%3d>.

<sup>8</sup> Articles 24-25, Proper Conduct of Business Banking, Directive No. 301..

<sup>9</sup> In addition, on March 8, 2016, Article 240(x) was amended to allow a company whose primary offices are located outside of Israel to appoint external directors who do not reside in Israel, as long the company’s board has certified that a) the nature of the company’s operations warrant the appointment of a non-Israel resident to this role, b) the director will be capable of attending board meetings, and c) the director has an address in Israel where he or she may receive court documents (Companies Regulations Additional Categories of Companies at which Appointing External Directors Who are Not Residents of Israel is Permitted) [https://www.nevo.co.il/law\\_word/Law06/tak-7639.pdf](https://www.nevo.co.il/law_word/Law06/tak-7639.pdf).

<sup>10</sup> This excludes external director positions when preparing for a company’s IPO.

<sup>11</sup> If the company has no controlling shareholder(s), the director may not at the time of appointment have any business dealings (other than of a trivial nature) with the company’s chair, CEO, significant shareholder, or senior financial officers.

defined by law (one of the two requisite external directors must be a financial and accounting expert); and

- vi. must be elected with one of the following requirements:
- vii. support by the majority of shareholders who participate in the meeting (excluding abstentions) who are not controlling shareholders and have no personal interest in the election; or
- viii. shareholder(s) who vote against the external director, excluding controlling shareholder(s) and those with a personal interest, may not exceed 2% of the total voting rights in the company.

We also note that external directors may serve a maximum of three three-year terms and two external directors may not serve on each others' boards.

The nominee's identity is in most cases proposed by the company, although minority shareholders are allowed to nominate candidates to serve as director, including for an external directorship position.<sup>12</sup>

**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>13</sup> This may include directors whose employers have a material relationship with the company or its subsidiaries or major shareholders. In addition, we will consider directors affiliated if they:

- Have been employed by the company within the past five years;<sup>14</sup>
- Own or control 10% or more<sup>15</sup> of a company's share capital or voting rights or are employed by or have a material relationship with a significant shareholder;<sup>16</sup>
- 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;<sup>17</sup>
- Have close family ties with any of the company's advisors, directors or senior employees;
- Hold cross directorships or have significant links with other directors through his/her involvement in other companies or entities; or

---

<sup>12</sup> Article 66(א) of the Companies Law allows for one or more shareholders holding no less than 1% of the voting rights in a company to request to include certain matters in such company's next general meeting of shareholders.

<sup>13</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). However, if the company is listed on a foreign exchange, and the company says the director meets the standards of independence set by the foreign exchange (e.g., NASDAQ or NYSE), we will consider the company's classification of the director to be independent, even if the company discloses that the director is not classified as independent under Israel's Companies Law.

<sup>14</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.

<sup>15</sup> 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. 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>16</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>17</sup> For directors who previously worked for the company's auditing firm, we expect a cooling-off period of at least two years between resigning from the audit firm and serving on the board (cf. Companies Law: Article 240(א), which calls for an independent director to have completed two years without having had any business relations with the company).

- Have served on the board for more than nine years.<sup>18</sup>

**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 Representative** — An employee representative serves as a director to represent employees' interests. Employee representatives may be nominated by employees and elected by shareholders.

### Voting Recommendations on the Basis of Independence

Best practice for boards in Israel is established by the First Addendum of the Companies Law, which recommends that the majority of the directors sitting on the board of a non-controlled company be independent. Where a board's composition does not meet this local best practice standard, we typically recommend voting against some of the inside and/or affiliated directors in order to satisfy the relevant threshold.<sup>19</sup>

Glass Lewis strongly supports the appointment of an independent presiding or lead director with authority to set meeting agendas and to lead sessions without the insider or affiliated chair's presence. Independent board leadership is even more crucial when a board is insufficiently independent.

**Exception for Controlled Companies** — As mentioned previously, many publicly held companies in Israel either have a controlling shareholder or a shareholders' agreement whereby a group of shareholders collectively own a controlling stake in the company and have the power to exert control over the direction of the company as the "controlling shareholder(s)."

As it relates to board independence, Israeli law generally defines "control" as holding at least 25% of the voting rights at shareholder meetings or the right to appoint directors or the CEO. Controlled companies present an exception to our independence recommendations. The board's function is to protect shareholder interests; however, when an individual or entity holds such rights in the company, the interests of the majority of shareholders are the interests of that entity or individual. Consequently, Glass Lewis does not recommend voting against boards whose composition reflects the makeup of the shareholder population. In other words, affiliates and insiders who are associated with the controlling entity are not subject to the one-half independence rule.

So long as the insiders and/or affiliates are connected with the controlling entity or controlling block and represent no more than two-thirds of the total number of directors, we accept the presence of non-independent board members.

**Special Considerations for Pyramid Structures** — Since December 2013, the Law on the Advancement of Competition and the Reduction of Concentration, 5774-2013 has reduced the incidence of pyramid group structures in the Israeli capital markets, where one public company (A) controls another public company (B), which in turn controls a third public company (C, and so on). The law also bans simultaneous controlling ownership of non-financial companies and major financial institutions.

The law was passed with the aim of diffusing the concentration of market share held by conglomerates and set a December 2019 for such groups to reach the maximum allowed two-level formation (i.e. an A- and B- level of public companies). Most affected groups have already divested of their holdings or taken

---

<sup>18</sup> Amendment 16, Companies Law (March 7, 2011). While we will classify board members as affiliates in accordance with this standard, we will evaluate voting recommendations based on this issue on a case-by-case basis. When a board or committee does not meet the independence standards set forth in these guidelines solely as a result of a nominee's length of service on the board, we may refrain from recommending voting against the nominee if the board or relevant committee is otherwise sufficiently independent.

<sup>19</sup> With a staggered board, if the affiliates and/or insiders that we believe should not be on the board are not up for election, we will express 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.



layers of the pyramid private in compliance with the law.

We believe both A- and B-level companies in instances such as these should abide by the minimum independence standards outlined above.

## 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.

## OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

### PERFORMANCE

The most crucial test of a board's commitment to a 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, analyze possible conflicts of interest and consider how directors voted while on the board.

#### Voting Recommendations on the Basis of Performance

We disfavor 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:

1. A director who fails to attend a minimum of 75% of applicable board meetings and committee meetings.<sup>20</sup>
2. However, if a board member has served for less than a full year, we will not typically recommend voting against him/her for attendance issues. Rather we will note the failure and track the situation going forward.
3. A director who is also the CEO of a company where a serious and material restatement occurred after the CEO had previously certified the pre-restatement financial statements.
4. 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.

### 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, over-remuneration, audit- or accounting-related issues and/or other indicators of mismanagement or actions against the interests of shareholders.<sup>21</sup>

---

<sup>20</sup> We will apply this threshold when attendance information is available. We will also refrain from voting against directors when the proxy discloses that the director missed the meetings due to serious illness or other extenuating circumstances.

<sup>21</sup> We typically apply a three-year look-back period to such issues, and we also research to see whether the responsible directors have been up for election since the time of the failure.

Similarly, 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 relevant subject matter.

## CONFLICT OF INTEREST

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

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

- A director who is on an excessive number of boards. 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. However, we also take the following into consideration:
  - For companies that are not listed in the U.S, we count chairships as double given the increased time commitment.<sup>22</sup> 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, 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.
  - 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.
  - Finally, we may also refrain from recommending against the director if the company provides a sufficiently compelling explanation regarding his or her significant position on the board, specialized knowledge of the company's industry, strategic role (such as adding expertise in regional markets or other countries), etc.
- Directors who provide, or 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.
- Directors who engage in, or whose immediate family members engage in airplane, real estate or similar deals, including perquisite-type grants from the company.
- 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>23</sup>

---

<sup>22</sup> For companies primarily listed in the U.S, we will count board chairships as one board, consistent with our guidelines for U.S companies.

<sup>23</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.

## 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.

### SEPARATION OF THE ROLES OF CHAIR AND CEO

Israeli law provides that the CEO of a company may only simultaneously serve as the chair if a resolution is passed at the general meeting with the approval of the majority<sup>24</sup> of shareholders not affiliated with the controlling shareholder(s). Moreover, a relative of the chair may not serve as CEO unless a similar resolution is passed.<sup>25</sup>

In general, Glass Lewis believes that separating the roles of corporate officer and chair creates a better governance structure than a combined executive/chair position. 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.

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 and concern for 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 a lead independent director or vice chair can serve to oversee any potential conflicts of interest that may affect the performance of the board.

In Israel, it is extremely uncommon for the CEO to serve on the board, let alone as chair, and as noted above, disinterested shareholders must approve such simultaneous service.

Accordingly, unless a company is under controlling ownership of more than 50% of outstanding share capital, we will recommend voting against a proposal to unite the positions of chair and CEO (or to instate a relative/affiliate of the CEO as chair), unless certain board independence criteria are met, as follows:

(i) After accounting for significant shareholder proportional representation, a majority of the board is independent and, in addition; (ii) the key board committees meet our independence standards (fully independent audit committee and fully independent compensation committee after accounting for proportional representation of larger shareholders, and excluding insiders or affiliates of insiders).

For controlled companies (50%+ major shareholder), we will generally support a board's decision on this matter as long as we have not identified concerns with the performance of a board chair / CEO and/or with the independence level of the audit committee.

---

<sup>24</sup> On February 17, 2016, Amendment 27 to the Companies Law took effect, requiring approval by a simple majority of disinterested shareholders in order for one person to serve as both chair and CEO. Previously, the approval of two-thirds of such shareholders was required.

<sup>25</sup> Articles 95 and 121, Companies Law.

## SIZE OF THE BOARD OF DIRECTORS<sup>26</sup>

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 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<sup>27</sup> chair if a board has: (i) fewer than five directors; provided, however, that this will generally not apply to small-cap companies with smaller boards;<sup>28</sup> or (ii) more than 20 directors.

## 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 board or a committee of the 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 analyzing 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 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>29</sup> we will consider recommending to vote against the board chair on that basis.

## BOARD COMPOSITION AT BANKING CORPORATIONS

We codify our approach to the election of directors at banking corporations, particularly those without a significant or controlling shareholder, a classification which now applies to the three largest banks in Israel.

### Background

The Bank of Israel supervises Israeli banks through the Supervisor of the Banks, whose remit and authority are based on several laws and accompanying directives. Under banking regulations, the board of a non-controlled publicly listed bank does not have the power to appoint its own directors. Instead the Bank of Israel appoints an external committee (the “Appointments Committee”) tasked with nominating director candidates to fill vacancies on the boards of a non-controlled bank.

The Appointments Committee must have five members, including two from the relevant bank in relation to its own director elections, and three non-director members. The chair of this committee must be a retired judge proposed by the Minister of Justice, and the other two members are proposed by this chair, who also has a

<sup>26</sup> There are no legal constraints on board size in Israel. The company’s articles of association may establish its proper size. Article 219, Companies Law.

<sup>27</sup> In the absence of a nominating committee, we will recommend voting against the board chair.

<sup>28</sup> Because voting against the chair of the nominating committee could result in the board becoming even smaller, we will signal our concern to investors and monitor the issue going forward.

<sup>29</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.

decisive vote on tied committee resolutions.

The board may not offer candidates to the Appointments Committee. The board may, if there is a vacancy between AGMs, and with the Supervisor's approval, appoint directors in the interim period.

The Appointments Committee proposes as many directors as required to fill vacancies, plus one additional candidate for each classification of director, those being: (i) an external director according to the Companies Law, (ii) external director according to Banking Directive 301; and (iii) an "other" (non-external) director – all of which must fulfil largely the same strict independence conditions that apply to external directors. As such, every director election at such a bank presents shareholders with a choice of candidates for a limited number of seats.

Regardless of their classification, directors may not serve more than three three-year terms in succession. The board chair of a banking corporation is elected by board members from among their number. Upon election, the Supervisor of the Banks must approve the proposed chair's appointment. Chairing a non-controlled public banking corporation requires close to a full-time role commitment and we typically classify the chair as an insider during their term of service as chair.

Also, from July 1, 2020, the regulations of the Banking Supervision Department shall enter into effect within the framework of the new formula of Directive 301 under which, inter alia: (i) The number of board members in a banking corporation shall not exceed ten directors; ii) At least a third of the board members shall have "banking experience", as the term is defined in the new formula of Directive 301; iii) At least one director shall have proven knowledge and experience in the field of information technology.

### **Glass Lewis Policy**

Previously, due to the three distinctions in classification under banking regulations between external directors (divided between those appointed strictly in accordance with the Companies Law and those appointed under Banking Directive 301), and non-external "other" directors, we have historically classified the latter category of "other" directors as "affiliated" since the banks themselves do not classify such directors as "independent" for the purposes of Companies Law / Directive 301 above.

However, given that "other" directors at such banks must in any case meet strict independence requirements and in order to alleviate confusion for our foreign shareholder clients arising from the excess of regulatory definitions governing banks, effective immediately, we will begin classifying all directors at non-controlled banks, excluding the board chair, as "independent", unless we have identified factors that under in the normal course would lead to us classifying such directors as affiliated.

Since the Appointments Committee nominates more candidates than seats, we apply our nuanced analysis of such "contested" elections in a similar way to such occurrences at other companies. For more information our considerations in this respect, please refer to "Elections Involving More Candidates Than Seats".

## **BOARD COMMITTEES**

Pursuant to the Companies Law, the board shall establish an audit, compensation, and a financial statements review committee.<sup>30</sup> However, the audit committee may simultaneously serve as the financial statements review committee in some cases, as further explained below. Further, a company's audit committee may serve as the company's compensation committee, as well, if the composition of the committee meets the requirements for compensation committees under the Companies Law.<sup>31</sup> In the absence of the requisite committees, we will recommend voting against the board chair, as we believe he/she should be held accountable for the company's failure to meet a legal requirement.

<sup>30</sup> Israeli banks also are required to have a risk management committee. Section 301, Article 33, Proper Conduct of Banking Business.

<sup>31</sup> As of February 17, 2016, pursuant to Amendment 27 of the Companies Law.

We note that Israeli companies are not required to establish nominating and/or governance committees. However, a large number of Israeli companies are dually-listed on foreign exchanges, primarily the NASDAQ. In these cases, the existence of the aforementioned committee(s) is more common.

## AUDIT COMMITTEE PERFORMANCE<sup>32</sup>

In general, an audit committee member monitors and oversees the process and procedures that management and auditors perform. In Israel, the audit committee should consist of at least three members and include a majority of independent directors.<sup>33</sup> Audit committees should also consist entirely of non-executive directors and include all external directors on the board. Furthermore, it should be chaired by an external director<sup>34</sup> and the board chair should not serve on this committee. Directors or affiliates of controlling shareholder(s) also should not serve on the audit committee. Glass Lewis will generally recommend voting against all non-independent directors that serve on the audit committee, including those affiliated due to tenure or where the Company has classified such director as non-independent but the reason for such classification is unclear, unless there is a cogent rationale for their presence on the committee.

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. The audit committee should ensure 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.<sup>35</sup>

For an audit committee to function effectively on investors' behalf, it must include members with sufficient knowledge to diligently carry out their responsibilities. We are skeptical of audit committees that include members that lack expertise in finance and accounting or in any other equivalent or similar areas of expertise.<sup>36</sup> While we will not necessarily vote against members of an audit committee when such expertise is lacking, we are more likely to vote against committee members when a problem such as a restatement occurs 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

---

<sup>32</sup> Article 115, Companies Law.

<sup>33</sup> Companies listed on the NASDAQ, however, are required to maintain an audit committee that is 100% independent. Rule 5615-3, NASDAQ Marketplace Rules. <sup>34</sup> On April 17, 2016, the Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trading on an Exchange Outside of Israel), 5760-2000) were amended such that companies listed on the NASDAQ or NYSE that have no controlling shareholder no longer are required to appoint external directors. Thus, requirements related to external directors mentioned in this section and the section on compensation committee performance do not apply to such companies.

<sup>35</sup> Financial statements are approved by the board only after the financial statements review committee, which usually comprises the same members as the audit committee, has provided recommendations on matters such as the following: (i) valuations and estimates in the financial statements; (ii) internal controls over financial reporting; (iii) completeness of disclosure; (iv) accounting policies.

<sup>36</sup> The law considers a director to have "financial and accounting expertise" if "the director is an accounting and financial expert who, as part of his education, experience, and skills, has a high level of skill and comprehension in business matters — accounting, internal auditing, and financial statements — in a manner that enables him to thoroughly comprehend the company's financial statements and to raise discussions regarding the way the financial data are presented. The evaluation of the accounting and financial expertise of the director shall be done by the board." Conditions and Criteria for a Director with Accounting and Financial Expertise, Companies Law (2005).

under the following circumstances:<sup>37</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; and/or (ii) the committee did not hold a sufficient number of meetings considering the company's financial situation and reporting requirements.
- **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 for more than one year in a row; and/or (iv) the company has aggressive accounting policies and/or poor disclosure or lack of sufficient transparency in its financial statements.

## COMPENSATION COMMITTEE PERFORMANCE

In Israel, the compensation committee should consist of at least three members and include a majority of external directors. Furthermore, it should be chaired by an external director, include all external directors on the board, and the board chair should not serve on this committee. Directors or affiliates of controlling shareholder(s) also should not serve on the compensation committee. Given the potential for conflicts of interests, executives and employees should also not be members of the compensation committee.<sup>38</sup> Glass Lewis will generally recommend voting against all non-independent directors that serve on the compensation committee, including those affiliated due to tenure or where the Company has classified such director as non-independent but the reason for such classification is unclear, unless there is a cogent rationale for their presence on the committee.

Compensation committees are responsible for evaluating and prescribing the remuneration of directors, supervisors and executives. This oversight includes deciding the bases on which remuneration is determined, as well as the amounts and types of remuneration to be paid. It is important that remuneration be consistent with, and based on, the long-term economic performance of a business' and long-term shareholder returns.

Compensation committees are also responsible for overseeing the transparency of remuneration. This oversight includes the disclosure of remuneration arrangements, the matrices used in assessing pay-for-performance and the use of remuneration consultants. It is important for investors to have clear and complete disclosure of all the significant terms of remuneration arrangements in order to reach informed opinions regarding the compensation committee.

Finally, compensation committees are responsible for overseeing internal controls in the executive remuneration process. This includes monitoring controls over gathering information used to determine remuneration, establishing equity award plans and granting equity awards. Lax controls can contribute to conflicting information through the use of nonobjective consultants, for example. Lax controls can also contribute to the granting of improper awards, such as backdated or spring-loaded options, or the granting of bonuses when triggers for such payments have not been met.

We evaluate compensation committee members on the basis of their performance while serving on the compensation committee in question, and not for actions taken solely by prior committee members who are not currently serving on the committee.

When assessing the performance of compensation committees, we will recommend voting against the follow-

---

<sup>37</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 simply express our concern with regard to the committee chair. In the absence of an audit committee, we will recommend voting against the board chair.

<sup>38</sup> Article 118(a), Companies Law. At banks, at least one member of the compensation committee must be an expert in risk management and control. Section 301, Article 38(a), Proper Conduct of Banking Business.

ing members under the following circumstances:<sup>39</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 received consistent poor structure and disclosure ratings from Glass Lewis without indicating any proposed 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) we have identified other egregious policies or practices; (v) the committee failed to address shareholder concerns following majority, or majority of disinterested shareholders, 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 25% 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.

## NOMINATING AND/OR GOVERNANCE 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>40</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; or (iii) when there are less than three members on key board committees.<sup>41</sup>
- **All members of the nominating committee** (that served during the relevant time period) when the committee nominated or re-nominated an individual who had significant conflicts of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.

However, as previously noted, Israeli companies are not required to have nominating and/or governance committees.

## ELECTION PROCEDURES

### ELECTIONS INVOLVING MORE CANDIDATES THAN SEATS

In Israeli director elections involving more candidates than available board seats, management generally does not express a recommendation regarding a preferred candidate and shareholders are left to apply their discretion as to which candidate to support. Shareholders are not prevented from supporting all candidates, even if there are more candidates than available board seats.

Factors we will contemplate when reviewing contested elections include but are not limited to: (i) company performance under existing board including with respect to governance and compensation issues; (ii) the identity of the nominator (independent nominating committee, controlled board, institutional shareholder, or

<sup>39</sup> If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered or due to a by-election, we do not recommend voting against any members of the committee who are up for election; rather, we will express our concern regarding the committee chair. In the absence of a remuneration committee, we will recommend voting against the board chair.

<sup>40</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 simply express our concern with regard to the committee chair. In the absence of a nominating committee, we will recommend voting against the board chair.

<sup>41</sup> In the case of compensation and nominating committees, this will not apply to companies with small, sufficiently independent boards.



other) in the context of the company's shareholder ownership landscape; (iii) tenure / refreshment levels of existing board; (iv) diversity of existing board, including with respect to professional skills, background, experience and gender; and (v) leadership credentials of nominee.

Glass Lewis is generally wary about replacing incumbent board members with a competing nominee absent persuasive rationale in favor of such action. This is a particularly strong consideration for elections at large or complex corporate entities such as banking corporations, and/or where incumbent nominees have served on the board for fewer than nine years and there are limited arguments in favor of replacing a qualified director.

We believe that at certain companies, particularly those with a dominant controlling nucleus and a prevalence of related party transactions, shareholders benefit from more verifiably "outside" representation on the board. In such instances, we will consider recommending to vote for director nominees proposed by minority shareholders where sufficient information regarding the nominee has been disclosed, and when we deem the nominee truly independent and appropriately qualified for the role. In cases where multiple minority representative candidates have been nominated, we will base our recommendation on the nominees' qualifications and experience, and on the company's shareholder structure.

Moreover, where we have any concerns that an incumbent candidate, whether initially proposed by the company or by a minority shareholder, is not independent or has not demonstrated sufficiently independent judgment in their performance on the board, we will consider supporting a competing candidate providing the criteria above are met.

In evaluating the suitability of competing candidates to the board, we may include a board skills matrix, company disclosure permitting, to aid in assessing the current board's competencies and identifying any potential skills gaps.<sup>42</sup>

## CLASSIFIED/STAGGERED BOARDS AND TERM LIMITS

Pursuant to the Companies Law, a director's term ends at the end of the annual meeting that follows his/her appointment. Directors will be reelected annually by law, unless the company's articles dictate otherwise.<sup>43</sup> As an exception, external directors serve a three-year term by law and may be reelected no more than twice.<sup>44</sup> However, external directors serving at companies whose shares are traded on a foreign exchange may be reelected for more than three three-year terms, as long as the reasons why the company's audit committee and board view such a re-election as benefiting the company are placed before shareholders beforehand.<sup>45</sup>

Excluding external directors whose three-year terms are mandated by law, we believe staggered boards, or boards with lengthy terms of office, are less accountable to shareholders than boards that are elected annually. Furthermore, we feel the annual election of directors encourages board members to focus on 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>46</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. Further, we believe the election of a director to an unlimited term, such that, once elected, the director would never be placed before shareholders for re-election, is an egregious action that limits shareholder rights. In such cases, we will recommend voting against the nominee on this basis alone.

In some cases, companies may propose amendments to their articles to explicitly instate staggered or classi-

---

42 See [Board Skills Appendix](#) for an overview of skills Glass Lewis considers in relation to certain key sectors.

43 Article 222, Companies Law.

44 Article 245, Companies Law.

45 Companies Regulations (Leniencies for Public Companies Whose Shares are Listed for Trade on an Exchange Outside of Israel), 5760-2000: Article 5(1).

46 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.

fied 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 is in line with market practice and if it introduces more regular elections than existing election cycles. 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 for than the previous election schedule.

## ELECTION OF DIRECTORS AS A SLATE

Glass Lewis believes that the practice of electing directors as a slate 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 a market such as Israel's where individual elections are common.

In some cases, shareholders voting 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. Whether voting for the board as a slate or individually, we will note our concerns with individual directors in our analysis of the board.

## MANDATORY DIRECTOR RETIREMENT PROVISIONS

Glass Lewis believes that age limits are not in shareholders' best interests. Academic literature suggests that there is no evidence of a correlation between age and director performance. Like term limits, age limits are a crutch for boards that are unwilling to police their membership and decide when turnover is appropriate.

While we understand some institutions' support for age limits as a way to force change where boards are unwilling to make changes on their own, the long-term impact of age limits is to restrict experienced and potentially valuable board members from service through an arbitrary cut-off date. Further, age limits unfairly imply that older (or in rare cases, younger) directors cannot contribute to company oversight. A director's experience can be valuable to shareholders because directors navigate complex and critical issues when serving on a board.

We believe that shareholders are better off monitoring the board's approach to corporate governance and the board's stewardship of company performance rather than imposing inflexible rules that do not necessarily correlate with returns or benefits for shareholders. As such, we will generally recommend voting for any proposal that seeks to repeal or increase age limits.

## LACK OF ADEQUATE DIRECTOR DISCLOSURE

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 abstain from voting on the candidate. We will recommend that shareholders abstain from voting on 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 abstain from voting on 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 external directorships held by a nominee; and (iv) the relevant experience and skills possessed by a nominee. When any of this information has not been disclosed, Glass Lewis may recommend that shareholders abstain from voting on the nominee.

## EXCEPTIONS FOR RECENT IPOs

We believe that companies that have recently completed an initial public offering (“IPO”) should be allowed adequate time to fully comply with marketplace listing requirements as well as to meet basic corporate governance standards. We typically believe that a one-year grace period immediately following the date of a company’s IPO is sufficient time for most companies to comply with all relevant regulatory requirements and to meet such corporate governance standards. Except in egregious cases, Glass Lewis refrains from issuing voting recommendations on the basis of corporate governance best practices (e.g., board independence, committee membership and structure, meeting attendance, etc.) during the one-year period following an IPO.

## COMPANIES WITH U.S. LISTINGS

A number of Israeli companies are listed in the United States and may qualify as foreign private issuers under the Securities and Exchange Act Rules.<sup>47</sup> Israeli companies qualifying as foreign private issuers in the United States may avail of exemptions to certain corporate governance requirements and instead follow local market practice and Israeli Companies Law.<sup>48</sup> Foreign private issuers availing of such exemptions are required to disclose a concise summary of the significant differences between local market practice and the standards applicable to other listed U.S. companies in their annual report. We may consider factors such as a company’s trading position in the United States and a company’s board structure when deciding which market and exchange specific voting policies to apply.

Recent amendments to Israeli Companies Law Regulations reduce duplicative compliance requirements for Israeli companies without controlling shareholders which trade on certain U.S. exchanges including the NASDAQ and the NYSE.<sup>49</sup> Pursuant to the amendments, qualifying Israeli companies will be exempt from certain board and committee composition requirements under the Companies Law. Specifically, these companies will be exempt from the requirement to appoint external directors, the requirement to appoint these directors to the audit and compensation committees and the requirement that an external director serve as chair of the audit and compensation committees; provided, however, that such companies instead comply with the listing rules and regulations applicable to U.S. companies traded on U.S. exchanges.<sup>50</sup>

For non-controlled Israeli companies adopting board and committee composition structures which reflect U.S. corporate governance standards and applicable listing requirements, we will consider applying U.S. specific voting policies which we may deem more suitable in such instances including, but not limited to: (i) the requirement that audit, compensation and nominating/corporate governance committees are comprised entirely of independent directors; (ii) the requirement that boards be comprised of two-third independent directors; and (iii) the requirement to appoint a financial expert to serve on the Company’s audit committee. For the purposes of applying these standards we will generally defer to U.S. independence classification criteria which may differ from Israeli market practices, for example, with respect to affiliations based on board tenure and significant beneficial ownership.<sup>51</sup>

We will generally support a company’s decision regarding whether to follow Israeli market practices or to defer

---

47 A foreign private issuer under SEC regulations is defined as a foreign (non-U.S.) issuer, other than a foreign government, except for an issuer meeting the following conditions: (i) on the last business day of its most recently completed second fiscal quarter more than 50% of its outstanding voting securities are directly or indirectly held of record by residents of the United States; (ii) the majority of the executive officers or directors are citizens of the United States; (iii) more than 50% of the assets of the issuer are located in the United States; or (iv) the business of the issuer is administered principally in the United States.

48 NASDAQ Listing Rule 5615(a) and NYSE Listing Manual Section 303A.

49 U.S. exchanges qualifying for such exemptions are: (i) the New York Stock Exchange (NYSE); (ii) the American Stock Exchange; (iii) the National Association of Securities Dealers Automated Quotation (NASDAQ) – Global Select Market; (iv) the NASDAQ Global Market; and (v) the NASDAQ Capital Market.

50 Companies Regulations (Leniencies for Companies Whose Shares are Listed for Trading on an Exchange Outside of Israel), 5760-2000: Article 5D.

51 Under SEC rules and NASDAQ/NYSE listing requirements directors may continue to be considered independent after serving nine consecutive years on the board. Furthermore, the beneficial ownership threshold for determining whether directors will be considered independent under SEC and NASDAQ/NYSE listing rules is 20% of a company’s share capital or voting rights (or if such director has a material relationship with a 20% beneficial owner).

to U.S. corporate governance principles, SEC regulations and listing requirements. Further, we do not believe that the adoption of U.S. corporate governance standards in lieu of Israeli corporate governance standards will have a negative impact on shareholder rights, provided that other key governance metrics are strong and in line with foreign exchange best practices.

## **ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT**

Glass Lewis understands the importance of ensuring the sustainability of companies' operations. We believe that an inattention to material environmental and social issues can present direct legal, financial, regulatory and reputational risks that could serve to harm shareholder interests. Therefore, we believe that these issues should be carefully monitored and managed by companies, and that companies should have an appropriate oversight structure in place to ensure that they are mitigating attendant risks and capitalizing on related opportunities to the best extent possible.

Glass Lewis believes that companies should ensure appropriate board-level oversight of material risks to their operations, including those that are environmental and social in nature. Accordingly, for large cap companies and in instances where we identify material oversight issues, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of environmental and/or social issues.

Where it is clear that a company has not properly managed or mitigated environmental or social risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, Glass Lewis may consider recommending that shareholders vote against members of the board who are responsible for oversight of environmental and social risks. In the absence of explicit board oversight of environmental and social issues, Glass Lewis may recommend that shareholders vote against members of the audit committee. In making these determinations, Glass Lewis will carefully review the situation, its effect on shareholder value, as well as any corrective action or other response made by the company.

# Transparency and Integrity in Financial Reporting

---

## ACCOUNTS AND REPORTS

As a routine matter, Israeli company law requires that shareholders receive and consider the company's annual financial statements and the report of the board of directors.<sup>52</sup> Most often this is a non-voting proposal in Israel.

In cases where the approval of the financial statements is required, we will recommend voting for this proposal, unless there are concerns about the integrity of the statements/report. 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.

## ALLOCATION OF PROFITS/DIVIDENDS

In Israel companies may submit the allocation of profits for shareholder approval. We will generally recommend voting for such a proposal. In accordance with Israel company law, shareholders have the right to a dividend or bonus shares if the company passes such a resolution.<sup>53</sup>

With respect to dividends, we generally support the board's proposed dividend (or the absence thereof). However, we will give particular scrutiny to cases where a company's dividend payout ratio, based on consolidated earnings, has decreased to an exceptionally low level (i.e., less than 10%) from a more reasonable payout ratio (i.e., over 10%), or where a company has eliminated dividend payments altogether without explanation. We will also scrutinize dividend payouts that are consistently excessively high relative to peers (i.e., over 100%) without satisfactory explanation. 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. As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases.

## 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.

---

<sup>52</sup> Article 60, Companies Law.

<sup>53</sup> Article 306 of the Israeli Companies Law.

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.

## 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 there have been material restatements of annual financial statements or material weaknesses in internal controls, we usually recommend voting against the auditor. We do not hold a company's auditor responsible for the company's failure to comply with reporting obligations or a lack thereof.

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, unless a specific justification is provided.
- 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>54</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.
- We also look for other relationships or concerns with the auditor that might suggest a conflict between the auditor's interests and shareholder interests.

We note that in Israel, however, companies often disclose the amount paid to the auditor(s) for audit and tax services combined. Although we strongly prefer that companies disclose tax and audit fees separately, given that it is common practice in Israel for these fees to be disclosed as a lump sum in accordance with Israeli accounting standards, if the fees paid for other services appear reasonable, we do not believe this issue alone merits voting against such proposals.

We are also mindful of fees for one-time corporate finance transactions and due diligence work related to mergers, acquisitions or disposals, and we may grant one-time exceptions when these fees make up a significant portion of the year's non-audit work. 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 importance of these types of transactions, we consider their assistance in these matters to be acceptable, so long as their provision of such services does not persist.

Finally, in cases where the company does not disclose sufficient information regarding the appointment or ratification of the auditor (e.g., the name of the auditor), we will recommend an abstain vote.

---

<sup>54</sup> An auditor does not audit all interim financial statements. Thus, we generally do not believe that an auditor 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.

# The Link Between Compensation and Performance

---

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.

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

We define any vote involving executive compensation, other than long-term incentive plans, as a “say-on-pay” vote. Public companies incorporated in Israel are required to formulate compensation policies for executives and directors and submit this policy for approval by the compensation committee, the board, and the majority of non-controlling and non-interested shareholders before implementation.<sup>55</sup> In a company with three or more tiers of a pyramidal structure,<sup>56</sup> the vote of these non-controlling and non-interested shareholders is binding. In all other cases shareholders' approval is binding, although a board may push through a rejected compensation policy if it discusses the policy again and discloses its rationale for why the adoption of the policy is warranted and in the company's best interests.<sup>57</sup> Approval of a policy is required at least once every three years.<sup>58</sup> In addition to full compensation policies applicable to senior executives generally, public companies are required to receive shareholder approval of specific compensation-related decisions from time to time. These decisions include pay arrangements for certain executives including the CEO, pay arrangement for individuals who are related to company insiders, and awards or other decisions which exceed the limits of a previously-approved compensation policy.

Some of the information companies must provide in the compensation policy include the following: (i) comparisons between the employment costs of directors and executives with those of the company's other employees and contractors; (ii) the relationship between fixed and variable components and an explanation of how the variable compensation is primarily based on long-term, measurable performance goals; (iii) caps on variable compensation, as well as on retirement bonuses; and (iv) clawback provisions.

Given the complexity of most companies' compensation programs, Glass Lewis applies a highly nuanced approach when analyzing votes on executive compensation. We review each vote on a case-by-case basis, with the belief that each company must be examined in the context of industry, 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 and, in particular, will attract and retain competent executives and other staff, while motivating them to grow the company's long-term shareholder value.

---

<sup>55</sup> This requirement began with the passage of Amendment 20 to the Companies Law. Amendment 20 took effect December 12, 2012, with significant updates on July 31, 2013.

<sup>56</sup> Such as a public company that is controlled by another public company, that is itself held by a public company, all of which are controlled by a controlling shareholder.

<sup>57</sup> Article 267<sup>(x)</sup>, Companies Law. See also Licht, Talmore, and Sachs. “Israel's Executive Compensation Reform.” *Harvard Law School Forum on Corporate Governance and Financial Regulation*. January 7, 2013.

<sup>58</sup> Article 267<sup>(x)</sup>, Companies Law.

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 demonstrably 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 current and past 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.

## COMPENSATION POLICIES OF INSTITUTIONAL ENTITIES

On April 12, 2016, the Compensation for Officers of Financial Corporations Law (Special Approval and Disallowance of Expenses for Tax Purposes in Respect to Exceptional Compensation), 2016 ("the Compensation Law") came into effect. The law applies to financial companies including those operating in the banking and insurance sectors. The law effects a cap of NIS 2.5 million on the annual salaries of executives. Any amount paid in excess of that sum will be ineligible for deduction for income and corporation tax purposes, and would require the approval of the company's compensation committee, board and shareholders. Furthermore, Section 2(b) of the Compensation Law specifies that salaries must not exceed 35 times the lowest salary of any worker in the company, including contractual workers.

In light of these restrictions, many affected financial institutions are setting the compensation of their top executives to be comprised only of fixed compensation that is not performance-based. Bearing in mind the competitive disadvantage that the Compensation Law might place on Israeli financial institutions compared to international peers, we will generally recommend that shareholders defer to the board's judgement regarding employment agreements that are crafted in line with the restrictions of the new law.

Nonetheless, we believe shareholders should carefully scrutinize any agreements which impose additional or unnecessary costs on a company. Where a company expects to pay increased tax on any excess expenditure caused by exceeding the NIS 2.5 million salary cap, we believe companies should fully disclose the actual cost of employment of their highest earners, including full disclosure of all tax penalties associated with executive compensation packages.

In addition, Israeli banks' and institutional entities' compensation policies must comply with tighter compensation restrictions set out by regulatory bodies overseeing these companies, such as requirements to defer variable payouts above a certain size, condition most variable pay on measurable goals, and lay out stricter clawback provisions than are generally used in the market.

For a fuller discussion of the requirements governing compensation policies at financial and institutional entities, and Glass Lewis policy in relation to these, please refer to our dedicated [Compensation Appendix](#) on the subject.



## SAY-ON-PAY VOTING RECOMMENDATIONS

In cases where our analysis reveals a compensation structure or compensation disclosure in drastic need of reform, we will recommend that shareholders vote against the say-on-pay proposal. For compensation policies, we believe that shareholders should be provided with clear disclosure of an appropriate framework for managing executive compensation. While this framework will vary for each company, it should generally provide an explicit link to the Company's strategy, setting appropriate quantum limits along with structural safeguards to prevent excessive or inappropriate payments and particularly any reward for failure; whilst providing sufficient flexibility to allow boards to manage matters of recruitment, severance and professional development as they arise to avoid the necessity of seeking shareholder approval for policy amendments or special payments outside the policy.

For most companies we expect a compensation policy to:

- Emphasise incentive pay in the form of equity, weighted towards performance- and/or holding-periods of three or more years;
- Incentivise executives based on goals aligned with strategy while avoiding structures that encourage excessive risk-taking;
- Set reasonable award limits for normal and exceptional circumstances;
- Limit the application of discretion to clearly defined circumstances;
- Include structural safeguards such as clawback/malus provisions as required, deferral, and extended holding periods;
- Disclose a clear approach to recruitment, including reasonable award limits and delivery structures that align the interests of incoming executives with those of shareholders; and
- Disclose all relevant details of executive service contracts, limiting notice period entitlements to salary and benefits.

When a company's compensation policy or a decision made outside of the policy deviates from these guidelines, we expect a clear and compelling rationale for why the proposed structure or practice is appropriate for the company.

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;
- Guaranteed bonuses;
- Bonus or long-term plan targets set at negative performance levels;
- Performance targets not sufficiently challenging, and/or providing for unreasonably high potential payouts;
- 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.

In the instance that a company has simply 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.

On March 8, 2016, the Companies Law (First Addendum A, Part 2) was amended to allow a CEO to receive an amount equal to three months of base salary per year in variable compensation based on non-measurable criteria, while considering the CEO's contribution to the company. The law also was amended such that the bonuses of office holders who are subordinate to the CEO may be based entirely on non-measurable criteria.<sup>59</sup> We will generally oppose proposals whose main objective is to amend the compensation policy to allow for bonuses to be based purely on such discretionary criteria.

## STRUCTURE OF COMPENSATION POLICY

In addition to the general guidelines noted above, we believe that several specific features are important in well-designed compensation policies. Compensation policies should include an appropriate balance of fixed and variable pay. To minimize the incentives for excessive risk-taking, the fixed component should represent a sufficiently high proportion of total compensation. Moreover, companies should set explicit limits in their policies on variable components in relation to fixed salary.

With respect to variable compensation, we believe that pay should be demonstrably tied to performance. For short-term bonuses or incentives ("STI"), we believe a mix of corporate and individual performance measures is appropriate. We normally expect to see an emphasis on internal financial measures and non-financial factors, although other arrangements are acceptable if they are tied to a company's business drivers. Further, when a company includes provisions for awards in the event of poor performance, we believe that a clear discussion on the circumstances for such payments should be provided. Additionally, any such award should be subject to disclosed limits. Lastly, we believe that the best-designed STI plans provide for mandatory deferral of a portion of payments over a multiyear period and include malus provisions.

With respect to long-term incentives ("LTI"), Glass Lewis recognizes the value of these arrangements. 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. Well-designed LTI arrangements include a mixture of service-based awards which vest over at least three years as well as awards which only vest upon achievement of performance conditions beyond implicit share-price hurdles. In Glass Lewis' view, long-term performance is best measured by a mixture of performance metrics which include absolute measures and relative goals measured against a relevant peer group or index.

We recognize that such robust performance-based long-term incentive plans are somewhat rare in Israel. As such, we generally accept the practice of granting non-performance equity-based awards to senior executives, so long as such grants are reasonable and part of a compensation program that demonstrates a well-structured pay-for-performance link. In the absence of a defined LTI or equity-based plan, we expect to see at least one of the following criteria satisfied under the compensation policy:

- i. Multi-year performance criteria under the STI annual bonus scheme and/or some form of provision which (a) defers a portion of the bonus over at least an additional two years, vesting subject to further satisfaction of performance criteria in those subsequent years, or (b) defers a portion of the bonus into share-based units with a minimum restriction or holding period of at least two years.
- ii. Disclosure of clear and persuasive rationale as to how a policy, absent such long-term alignments or

---

<sup>59</sup> Companies Directive (Change to First Addendum A), 5776-2016) [https://www.nevo.co.il/law\\_word/Law06/tak-7639.pdf](https://www.nevo.co.il/law_word/Law06/tak-7639.pdf).

deferral, is designed to successfully ensure long-term company stability and pay for performance.

Where a company's compensation policy contains LTI provisions but we see that in practice the company has not been utilizing these or there is an excessive focus on short-term performance, we may recommend a vote against a compensation policy on this basis if there is not adequate supporting disclosure.

## CHANGES TO COMPENSATION POLICY

Where a company has proposed significant improvements to its compensation policy, we will take this into account when making voting recommendations. Moreover, in Israel, shareholders may be asked to approve specific changes to the compensation policy. In such cases, where the proposed policy represents an improvement over the existing policy, we will recommend voting for the proposal, even when the existing policy contains notable deficiencies.

## OTHER COMPENSATION-RELATED PROPOSALS

Glass Lewis analyzes proposals on specific aspects of compensation, such as executive employment agreements or additional bonus awards which require shareholder approval, on a case-by-case basis. If a proposal is in line with a company's shareholder-approved compensation policy, we will consider the appropriateness of the previously proposed policy and, if there are any significant concerns with the policy, whether the proposed structure or practice exhibits any of the same issues. In addition, we will consider whether there are any additional factors which may impact our recommendation on the proposal.

If a company indicates that a proposal is not congruous with a company's current compensation policy, we expect a clear and compelling rationale for why the deviation from the shareholder-approved arrangements is necessary. If such a structure or practices is not sufficiently justified, does not appear to be reasonable relative

to market practice or is otherwise not in shareholders' interests, we may recommend that shareholders vote against such a proposal.

For proposals which include equity grants, we may consider a company's broader equity award practices in developing our recommendation, particularly if the company does not regularly afford shareholders an opportunity to vote on its these broader practices. For more information on our treatment of equity as a component of compensation, please refer to the "Equity-Based Compensation Plan Proposals" on page 24.

## COMPENSATION 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 capitalization, 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 relatively better compensation-related disclosure than other companies in a market. 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.

## COMPENSATION RELATIVE TO OWNERSHIP STRUCTURE

Glass Lewis recognizes that differences in the ownership structure of listed firms necessarily 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 are inappropriate and may serve to further

entrench the controlling shareholders' stake. Similarly, we question equity grants to executives who have, or represent a shareholder who has, a significant equity stake in the company.

## EQUITY-BASED COMPENSATION PLAN PROPOSALS

While companies listed only in Israel are not required to receive shareholder approval for their equity compensation plans, companies listed in the U.S generally are required to do so. We believe that equity compensation awards are useful, when not abused, for retaining employees and providing an incentive for them 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 of both equity compensation plans and individual grants is both quantitative and qualitative. In our evaluation, 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 voting power 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.
- Companies should have a demonstrated history of reasonable equity incentive grants.
- Awards should be granted at fair market value, unless a discount is sufficiently justified and explained.
- Plans should not permit re-pricing of stock options without shareholder approval.
- Plans should not allow for automatic accelerated vesting in the event of a change in control of the company.

We will consider whether the award and exercise of stock options or restricted stock is conditional on the achievement of detailed and challenging performance targets to adequately align management interests with those of shareholders. Successful plans and acceptable grants will generally include long-term (at least three-year) performance targets, in addition to any share price hurdles, 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.

## GRANTS OF FRONT-LOADED AWARDS

Many firms in Israel have chosen to provide large grants, usually in the form of equity awards, that are intended to serve as compensation for multiple years. This practice, often called front-loading, is taken up either in the regular course of business or as a response to specific business conditions and with a predetermined objective. We believe shareholders should generally be wary of this approach, and we accordingly weigh these grants with particular scrutiny.

While the use of front-loaded awards is intended to lock-in executive service and incentives, the same rigidity also raises the risk of effectively tying the hands of the compensation committee. As compared with a more responsive annual granting schedule program, front-loaded awards may preclude improvements or changes to reflect evolving business strategies. The considerable emphasis on a single grant can place intense pressures on every facet of its design, amplifying any potential perverse incentives and creating greater room for unintended consequences. In particular, provisions around changes of control or separations of service must

ensure that executives do not receive excessive payouts that do not reflect shareholder experience or company performance.

We consider a company's rationale for granting awards under this structure, and also expect any front-loaded awards to include a firm commitment not to grant additional awards for a defined period, as is commonly associated with this practice. Even when such a commitment is provided, unexpected circumstances may lead the board to make additional payments or awards for retention purposes, or to incentivize management towards more realistic goals or a revised strategy. If a company breaks its commitment not to grant further awards, we may recommend against the relevant executive's proposed compensation package unless a convincing rationale is provided.

The multiyear nature of these awards generally lends itself to significantly higher compensation figures in the year of grant than might otherwise be expected. In analyzing the grant of front-loaded awards to executives, Glass Lewis considers the quantum of the award on an annualized basis, rather than the lump sum, and may compare this result to prior practice and peer data, among other benchmarks.

## 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. Furthermore, Glass Lewis is generally skeptical of proposals which would provide additional compensation or benefits to departing executives beyond those which are included in the relevant compensation policy or employment agreement. However, we will apply local best practice standards when analyzing severance payments.

## COMPENSATION PLANS FOR BOARD MEMBERS

Glass Lewis believes that non-employee board members should receive compensation for the time and effort they spend serving on the board and its committees. 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. We generally recommend voting against stock option grants when excessive, deeply discounted, or granted on the same terms as executives and performance-based equity grants for non-executive directors.

In Israel, shareholders may decide the amount of fees to be paid to directors as compensation for their services as a member of the board. It should also be noted that at times, proposals regarding director compensation qualify as related-party transactions, and in these cases shareholder approval is required by law.<sup>60</sup> We also note that it is common in Israel for companies to include a separate proposal for the approval of a bonus payment to be granted to the chair. We prefer that all directors, including the chair, receive only fixed compensation. Given the market practice of granting variable pay to chairs of Israeli companies, however, we will generally accept a small amount of variable pay offered to chairs who devote a significant amount of their time to their duties.

Companies often set the compensation of their directors other than the chair to be equal to that of their external directors. The Companies Regulations (Rules Regarding Compensation and Expenses of an External Directors), 5760-2000, provides companies two options on the cash compensation payable to external directors.<sup>61</sup>

---

<sup>60</sup> Article 270, Companies Law.

<sup>61</sup> Please refer to our Director [Compensation Appendix](#).

# Governance Structure and the Shareholder Franchise

---

## 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 analyze each change on its own. We will recommend voting for the proposal only when, on balance, we believe that the amendments are in the best interests of shareholders.

## RELATED PARTY TRANSACTIONS<sup>62</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.

In Israel, shareholders are generally requested to approve any agreement to be entered into, directly or indirectly, between the company and its directors, officers, controlling shareholders, and/or any party related to the controlling shareholder.<sup>63</sup> These agreements often include: (i) agreements between the company and interested parties, such as those listed above; (ii) insurance policies for directors or officers; and (iii) severance plans or employment agreements of employees who are related to the controlling shareholder(s). Such agreements must be reapproved by shareholders every three years.<sup>64</sup>

## LIABILITY INSURANCE AND INDEMNIFICATION

Under Israeli law, a company may enter into a contract to indemnify a director or officer of a company for debts or expenses imposed upon him/her pursuant to being a director or an officer if such a provision is provided in the company's articles of association.<sup>65</sup> In certain cases, shareholder approval is required not only for these article amendments but also for granting indemnification agreements or purchasing liability insurance plans.

While we strongly believe that directors and officers should be held to the highest standard when carrying out their duties to shareholders, some protection from liability is reasonable for directors and officers. As such, we find it reasonable for a company to enter into indemnification agreements with its directors and officers and/or to purchase liability insurance so long as the terms of such agreements are reasonable.

We note that, under the Companies Law as well as the Securities Law, directors and officers will continue to be held accountable in the case of certain violations of the law including intended or reckless violations of fiduciary or care duties. Companies may nonetheless offer partial indemnification of certain Securities Law violations if a provision authorizing indemnity for such breaches is included in a company's articles of association.<sup>66</sup>

<sup>62</sup> Articles 270, 273 and 275, Companies Law.

<sup>63</sup> We note that if the controlling shareholder is a company, this would include the company that controls this shareholder as well.

<sup>64</sup> Article 275(1)(1x) of the Companies Law.

<sup>65</sup> Article 260, Companies Law.

<sup>66</sup> Article 52QQ(a) and Seventh Schedule, Securities Law.

Although the extension of partial indemnification for the aforementioned list of violations is permitted by the Israeli Securities Law, if included in a company's articles of association, companies are not required to indemnify directors or officers for these violations.

While Glass Lewis believes that shareholders should not be involved in the approval and negotiation of individual liability insurance policies and that such matters should be left to the board, when the transaction requires shareholder approval and the policy does not extend beyond the legal boundaries discussed above, we will generally recommend supporting the proposal.

Although we generally recommend supporting liability and indemnification proposals, in accordance with best practice in Israel, in the event a company proposes to indemnify its directors/officers for an amount that exceeds 25% of the company's equity, we will oppose such proposals. Where the details of the proposed liability or indemnification proposal have not been provided, we will recommend that shareholders abstain from voting on the proposal. Finally, we recommend that shareholders vote against proposals to exempt directors or officers from liability for any reason.

## **ANTI-TAKEOVER DEVICES**

Glass Lewis believes that authorities 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 opportunities for shareholders.

In particular, we note that under Israeli law, companies may create different classes of shares with different rights, including shares providing certain preferred or additional rights regarding dividends and capital repayment, as well as other matters. Nevertheless, the authority to issue a new class of shares requires an amendment to the articles of association to be approved by the company's shareholders.<sup>67</sup>

## **SUPERMAJORITY VOTING 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 recognize 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.

## **RIGHTS 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>68</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.

---

<sup>67</sup> Article 20, Companies Law.

<sup>68</sup> Article 63, Companies Law.



# Capital Management

---

## INCREASES IN CAPITAL

Glass Lewis believes that adequate capital stock is important to a company's operation. Israeli companies are authorized to increase share capital through several methods that may or may not involve the issuance of shares.<sup>69</sup>

## 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, where 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 authorization of additional shares.

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

In Israel, shareholders are required to approve all proposals related to the increase of the registered share capital. According to Israeli law, the board may issue shares and other convertible securities up to the limit of the company's registered share capital.<sup>70</sup>

### With or Without Preemptive Rights

In our view, any authorization to issue shares and/or convertible securities with preemptive rights should not exceed 100% of the company's total share capital and any authorization to issue shares and/or convertible securities without preemptive rights should not exceed 20% of the company's total share capital.

When information is available, in order to establish a broader context in which to consider a proposed increase, we may also take into account a company's existing authorities to issue shares and/or convertible securities in order to determine the total potential dilution to shareholders should the proposal be approved.

### 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 disclosed; (ii) the price at which the shares will be issued is disclosed; 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.

---

<sup>69</sup> Article 286, Companies Law.

<sup>70</sup> Article 288, Companies Law.

## 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.

## 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 SHARE CAPITAL

In conjunction with a share repurchase program, companies often proceed to cancel the repurchased shares. Under Israeli law, shareholders are allowed to cancel any un-allotted share capital provided that the company is under no obligation to issue these shares.<sup>71</sup> We generally recommend that shareholders vote for such proposals.

---

<sup>71</sup> Article 287, Companies Law.

# Shareholder Initiatives

---

Although uncommon in Israel, should a shareholder proposal arise, we will evaluate it on a case-by-case basis. Glass Lewis typically prefers to leave decisions regarding day-to-day management and policy decisions, including those related to social and social issues to management and the board, except when there is a clear link between the proposal and value enhancement or risk mitigation. 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 then 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 then 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 always note our concerns in the relevant section of the Proxy Paper analysis as well as in any applicable shareholder proposals. Though relatively rare in Israel, should a shareholder proposal seek action on a specific ESG issue, Glass Lewis will recommend voting "For" such a proposal when we believe its implementation will enhance or protect shareholder value. We will also recommend voting "For" a proposal if we believe supporting such proposal will promote disclosure of significant risk exposure. Only in extreme cases will we recommend shareholders vote against board members based on ESG concerns.

## ENVIRONMENTAL, SOCIAL & GOVERNANCE INITIATIVES

For a detailed review of our policies concerning compensation, environmental, social and governance shareholder initiatives, please refer to our comprehensive *Proxy Paper Guidelines for Shareholder Initiatives*, available at [www.glasslewis.com](http://www.glasslewis.com).

---

## 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.*

*No representations or warranties express or implied, are made as to the accuracy or completeness of any information included herein. In addition, Glass Lewis shall not be liable for any losses or damages arising from or in connection with the information contained herein or the use, reliance on or inability to use any such information. Glass Lewis expects its subscribers possess sufficient experience and knowledge to make their own decisions entirely independent of any information contained in this document.*

*All information contained in this report is protected by law, including but not limited to, copyright law, and none of such information may be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without Glass Lewis' prior written consent.*

© 2019 Glass, Lewis & Co., Glass Lewis Europe, Ltd., and CGI Glass Lewis Pty Ltd. (collectively, "Glass Lewis"). All Rights Reserved.

## North America

### UNITED STATES

Headquarters  
255 California Street  
Suite 1100  
San Francisco, CA 94111  
+1 415 678 4110  
+1 888 800 7001

44 Wall Street  
Suite 503  
New York, NY 10005  
+1 212 797 3777

2323 Grand Boulevard  
Suite 1125  
Kansas City, MO 64108  
+1 816 945 4525

## Europe

### IRELAND

15 Henry Street  
Limerick  
+353 61 292 800

### UNITED KINGDOM

80 Coleman Street  
Suite 4.02  
London, EC2R 5BJ  
+44 207 653 8800

### GERMANY

IVOX Glass Lewis  
Kaiserallee 23a  
76133 Karlsruhe  
+49 721 3549622

## Asia Pacific


### AUSTRALIA

CGI Glass Lewis  
Suite 5.03, Level 5  
255 George St  
Sydney NSW 2000  
+61 2 9299 9266

[www.glasslewis.com](http://www.glasslewis.com)

 @GlassLewis

 @CGIGlassLewis

 Glass, Lewis & Co.



# GLASS LEWIS