

**2021**

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

# CONTINENTAL EUROPE



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# Guidelines Introduction

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

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

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

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

## SHAREHOLDER RIGHTS DIRECTIVE II

The European Union Shareholder Rights Directive ("SRD II") is a legally binding regulatory act which has been particularly influential in driving the convergence of governance and disclosure norms. In 2017, SRD II was amended to improve issuer transparency of related party transactions and executive remuneration, while also standardising board and shareholder approval procedures of those issues. As an EU Directive, the substance of the regulations must be implemented separately in each of the 28 EU member states and may vary from country to country, within the framework of minimum standards set by SRD II. The deadline for implementation was June 2019 and, as of August 2020, all but seven EU member states have transposed the Directive into national law.

With regard to executive remuneration, SRD II sets minimum standards for detailed disclosure of each component of executive remuneration as well as performance criteria. Remuneration policies should include non-financial criteria and describe their application in detail, though specific requirements are left to member states. Shareholders must have the right to vote on executive remuneration policies at least every four years. They will also have a vote on the remuneration report on implementation of the policy annually, unless a member state makes use of the option to make the remuneration report a non-voting discussion item for smaller companies.

With regard to approval of related party transactions, member states must set materiality thresholds for evaluating RPTs. Material RPTs must be publicly disclosed and either approved by the board or shareholders, without the participation of interested parties. Member states may also require the publication of a fairness opinion.

Finally, SRD II also imposes certain disclosure requirements for EU-based asset managers and asset owners on engagement and investment strategies. It also imposes shareholder identification and data transmission requirements for intermediaries. The overall purpose of these requirements of SRD II is to enhance the flow of information across the institutional investment community and to promote common stewardship objectives between institutional investors and asset managers, while improving transparency of issuers, investors and intermediaries.

## **VOTING RECOMMENDATIONS**

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

## **SUMMARY OF CHANGES FOR THE 2021 CONTINENTAL EUROPE 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 WORKFORCE DIVERSITY**

Glass Lewis believes boards in countries that have well-established gender quotas in law or best practice should be composed of at least 30% of directors of each gender. In any case, we expect the boards of all companies on mid-cap or large-cap European indices to meet this standard by 2022. Further, we have updated these guidelines to reflect our expectation that the boards of all European companies listed on a main market -- irrespective of country of trade or incorporation -- should not be composed solely of directors of the same gender. Where a proposed board election foresees an all-male board, we will generally recommend that shareholders vote against the chair of the nominating committee (or equivalent) or a new nominee to the board, as appropriate. Exceptions to this policy may be granted to boards consisting of four or fewer directors and to companies that present a credible, near-term plan to address the lack of gender diversity on the board.

Additionally, we have clarified that we may recommend shareholder action in egregious cases where a board has failed to satisfactorily address legitimate shareholder concerns regarding the diversity of ethnicity and national origin at board level, or regarding a company's workforce diversity and inclusivity policies, practices and disclosure.

Please refer to the "Human Capital Management and Diversity" section of these guidelines for further information.

### **HUMAN CAPITAL MANAGEMENT**

We have updated our guidelines to state that in egregious cases where a board has failed to respond to legitimate concerns with a company's human capital management practices, we may recommend voting against the chair of the committee tasked with oversight of the company's governance practices or the chair of the board, as applicable.

Please refer to the "Human Capital Management and Diversity" section of these guidelines for further information.

### **ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT**

We have updated our guidelines with respect to board-level oversight of environmental and social issues. Be-

ginning in 2021, Glass Lewis will note as a concern when boards of companies listed on major European blue chip indices do not provide clear disclosure concerning the board-level oversight afforded to environmental and/or social issues. Beginning with shareholder meetings held after January 1, 2022, we will generally recommend voting against the governance chair of a board who fails to provide explicit disclosure concerning the board's role in overseeing these issues.

Please refer to the "Environmental and Social Risk Oversight" section of these guidelines for further information.

## **ENVIRONMENTAL AND SOCIAL INITIATIVES**

We have updated our guidelines on environmental, governance and social initiatives to clarify our approach to these issues. In particular, we have clarified that we generally support shareholder proposals that seek to improve governance structures or promote relevant disclosure that serves the long-term interests of shareholders. Additionally, we have clarified that we assess shareholder proposals on environmental and social issues in the context of financial materiality.

Please refer to the "Environmental, Social & Governance Initiatives" section of these guidelines for further information.

## **VIRTUAL SHAREHOLDER MEETINGS**

We have updated these guidelines to outline our expectations in respect to the organisation and disclosure of virtual shareholder meetings, as well as in respect to proposals that seek to amend a company's articles of association to allow for virtual shareholder meetings and/or the virtual attendance of directors and executives at shareholder meetings.

While Glass Lewis unequivocally supports companies facilitating the virtual participation of shareholders in general meetings, we believe that clear procedures should be set and disclosed to ensure that shareholders can effectively participate in virtual-only shareholder meetings and meaningfully communicate with company management and directors.

Please refer to the "Virtual Shareholder Meetings" section of these guidelines for further information.

## **DIRECTOR AGE/TERM LIMITS**

We have amended these guidelines to outline that we will no longer generally recommend withholding support from proposals that seek to introduce or amend director age or term limits in line with prevailing market practice.

Further, we have clarified our view that, where age/term limits exist, these should be applied equally to all directors. Where a director election/re-election is proposed in contravention of existing age/term limits, we may recommend that shareholders hold the chair of the nominating committee or equivalent accountable.

Please refer to the "Board Evaluation and Refreshment" section of these guidelines for further information.

## **REMUNERATION COMMITTEE DISCRETION AND STAKEHOLDER ALIGNMENT**

We have amended these guidelines to clarify our expectation that remuneration committees retain a level of discretion to ensure that remuneration outcomes for executive directors align with company performance, as well as shareholder and employee experiences. We may recommend that shareholders vote against the remuneration report where there is substantial misalignment in this regard. Furthermore, we have outlined that forward-looking decisions regarding executive remuneration should also take into account shareholders and employees. We may recommend that shareholders vote against the remuneration policy where there is

evidence that executive fixed pay and/or total opportunity increases are substantially outpacing employee salary increases.

Please refer to the “Discretion” and “Remuneration Relative to Stakeholder Experience” section of these guidelines for further information.

## **ANTI-TAKEOVER DEVICES**

We have amended these guidelines to clarify that we may recommend voting for share issues in the context of a takeover offer (i.e. poison pill) where the proposal is limited in timing and scope to accomplish a particular objective such as the closing of an important merger, or where an exceptional justification is provided.

In addition, we have made minor clarifications, which do not materially alter our policies, throughout these guidelines to account for regulatory updates and to provide additional explanation or clarification of how we apply certain policies.

# A Board of Directors that Serves the Interest of Shareholders

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A variety of board structures are available to companies in Europe. The two prevailing models are:

- One-tiered boards comprising both executive and non-executive directors; and
- Two-tiered boards, with a board comprising non-executive members responsible for oversight of a separate executive board.

In some countries, companies may choose a hybrid structure, with a corporate assembly or shareholders' committee of non-executive members responsible for oversight of a one-tiered board of directors. Other board structures are also available to certain types of companies, such as partnerships limited by shares.

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

## ELECTION OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favour 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 the independence criteria under applicable legislation and best practice codes, 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 that may influence the director's independent decision-making. We believe that such relationships make it difficult for a director to put shareholders' interests above personal or related party interests.

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

**Independent Director** — An independent director has no material financial, familial<sup>1</sup> or other current relationships with the company,<sup>2</sup> its executives, or other directors, except for board service and standard fees paid for that service.

**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>3</sup> This may include directors whose employers have a material relationship with the company or its subsidiaries or major shareholders. Glass Lewis applies a three-year look back period to all relationships with directors who have an affiliation with the company other than former employment, for which we apply a five-year look back. In addition, we will consider directors affiliated if they:

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

Definition of “**material**” — A material relationship is one in which the value<sup>8</sup> exceeds:

- €50,000, or 50% of a director's total remuneration, for directors who personally receive remuneration for a professional or other service they have agreed to perform for the company, outside of their service as directors. This limit would also apply to cases in which a consulting firm that is owned by or appears to be owned by a director receives fees directly;

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1 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.

2 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.

3 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).

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

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

6 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.

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

8 In cases where the value of a related party transaction with a director or related party of a director has not been disclosed, we will generally classify a director as affiliated.

- €100,000 for directors 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 remunerated. This limit would also apply to charitable contributions to schools where a director is a professor, or charities where a director serves on the board or is an executive, or any other commercial dealings between the company and the director or the director's firm;
- 1% of either of the companies' consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company);
- 10% of shareholders' equity and 5% of total assets for financing transactions; or
- the total annual fees paid to a director for a personal loan not granted on normal market terms, or where no information regarding the terms of a loan has been provided.

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

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

### Voting Recommendations on the Basis of Board Independence

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

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

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

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

### Voting Recommendations on the Basis of Committee Independence

We believe that only non-executive directors should serve on a company's audit and remuneration commit-

<sup>9</sup> With a staggered board, if the affiliates or insiders that we believe should not be on the board, are not up for election, we will note our concern regarding those directors. 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.

tees.<sup>10</sup> Further, we believe these committees should be sufficiently independent from the company and its significant shareholders, in line with best practice for each market.<sup>11</sup>

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

## CONTROL-ENHANCING MECHANISMS

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

## CONTROLLED COMPANIES

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

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

## OTHER CONSIDERATIONS FOR INDIVIDUAL DIRECTORS

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

## PERFORMANCE

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

- A director who fails to attend a minimum of 75% of applicable board meetings and committee meetings.<sup>13</sup>
- A director who is also the CEO of a company where a serious and material restatement has occurred

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

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

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

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

after the CEO had previously certified the pre-restatement financial statements.

- Some or all directors 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, overcompensation, audit- or accounting-related issues and/or other indicators of mismanagement or actions against the interests of shareholders.<sup>14</sup> Likewise, we examine the backgrounds of those who serve on key board committees to ensure that they have the required skills and diverse backgrounds to make informed judgments about the subject matter for which the committee is responsible.

## EXTERNAL COMMITMENTS

We believe that directors should have the necessary time to fulfill their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis. We will generally recommend that shareholders oppose the election of a director who:

- Serves as an executive officer of any public company while serving on more than two public company boards; or
- Serves on more than five public company boards.<sup>15</sup>

We generally count board chair positions as two board seats given the increased time commitment associated with these roles.

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

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

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

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

sents a firm whose sole purpose is to manage a portfolio of investments which include the company. In these cases, we nevertheless believe that it is incumbent on companies to proactively address potential shareholder concerns regarding a director's overall commitment level.

## CONFLICTS OF INTEREST

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

We believe that a board should be wholly free of individuals who have an identifiable and substantial conflict of interest. Accordingly, we generally recommend that shareholders vote against the following:

- Directors who provide — or directors whose immediate family members provide — material professional services to the company, based on the same materiality thresholds set out above (see "Independence"). These services may include legal, consulting or financial services. We question the need for a 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 its directors. We will also hold the relevant senior director with oversight of related party transactions (whether a board committee, ad hoc committee, or the board as a whole, depending on the board's internal procedures) accountable for particularly egregious transactions concluded between the company and an executive director, which may pose a potential risk to shareholders' interest.

However, we will consider the specific nature of the professional services relationship between the company and a director, the independence profile of the board and its key committees and the conflict mitigation procedures in place when making voting recommendations on this basis. We expect directors who may face a potential conflict of interest to refrain from serving on any key board committees. Specifically, where a director has a material business relationship with a company that falls under the normal course of business, we will generally refrain from recommending to vote against the director on that basis alone provided that the company has adequately disclosed the relationship and mitigated the potential for serious conflicts of interest.

- Directors who engage in, or whose immediate family members engage in, airplane, real estate or similar deals, including perquisite-type grants, from the company amounting to more than €50,000. Directors who receive these sorts of payments from the company may have to make unnecessarily complicated decisions that pit their interests against shareholders.
- Directors who have interlocking directorships. We believe that CEOs or other top executives who serve on each other's boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.<sup>16</sup>

## BOARD RESPONSIVENESS

Glass Lewis believes that when 20% or more of minority shareholders vote contrary to the recommendation of management, the board should, depending on the issue, demonstrate some level of responsiveness to address shareholder concerns, particularly in cases where we have identified particular issues of concern. These include instances when 20% or more of shareholders: (i) abstain from or vote against a director nominee; (ii) abstain from or vote against a management-sponsored proposal; or (iii) vote for a shareholder proposal. In our view, a 20% threshold is significant enough to warrant a close examination of the underlying issues and an evaluation of whether or not a board response was warranted and, if so, whether the board responded appropriately following the vote.

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

While the 20% threshold alone will not automatically generate a negative vote recommendation from Glass Lewis on a future proposal (e.g. to recommend against a director nominee, against a remuneration proposal, etc.), it will be a contributing factor to recommend a vote against management's recommendation in the event we determine that the board did not acknowledge and/or address such dissent appropriately. Further, we may, where appropriate, hold chairs and members of the relevant committees accountable via a recommendation against the relevant board ratification proposal(s) and/or their re-election where the response to shareholder concerns has fallen below a qualitative threshold. In the absence of an option to escalate concerns to specific directors, we may instead recommend a vote against the receipt of the annual report and accounts.

As a general framework, our evaluation of board responsiveness involves a review of publicly available disclosures released following the date of the company's last annual meeting up through the publication date of our most current Proxy Paper. Depending on the specific issue, our focus typically includes, but is not limited to, the following:

- At the board level, any changes in directorships, committee memberships, disclosure of related party transactions, meeting attendance, or other responsibilities;
- Any revisions made to the company's articles of incorporation, bylaws or other governance documents;
- Any press or news releases indicating changes in, or the adoption of, new company policies, business practices or special reports;
- Any modifications made to the design and structure of the company's remuneration programme; and
- Any modifications made to the company's capital management powers such as share issuance authority or buyback programmes.

Our Proxy Paper analysis will include a case-by-case assessment of the specific elements of board responsiveness that we examined along with an explanation of how that assessment impacts our current vote recommendations.

## **BOARD STRUCTURE AND COMPOSITION**

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

### **SEPARATION OF THE ROLES OF CHAIR AND CEO**

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

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

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

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

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

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

## SIZE OF THE BOARD OF DIRECTORS

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

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

## HUMAN CAPITAL MANAGEMENT AND DIVERSITY

[Glass Lewis believes](#) that diversity in organisations and the boards that lead them is a positive force for driving corporate performance. Research indicates that diverse and inclusive companies with robust human capital management policies yield superior returns, are more innovative than their peers, and outperform in attracting and retaining talent.<sup>18</sup> In addition to setting the tone from the top, we believe that a diverse board – particularly where a company's key stakeholders are taken into account in the composition of the board – also benefits companies by providing a broader and more representative range of perspectives and insights, which enhances board dynamics and can help boards to overcome groupthink.

### Gender Diversity at Board Level

While pan-EU legislation aimed at increasing the representation of the under-represented gender on the

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<sup>18</sup> See: Credit Suisse (2019) [CS Gender 3000 in 2019](#); Boston Consulting Group (2017) [The Mix That Matters - Innovation Through Diversity](#); Deloitte (2017) [Unleashing the power of inclusion: Attracting and engaging the evolving workforce](#).

boards of European companies has been debated for some time, draft legislation has not been approved. In recent years, most European countries have introduced or announced measures intended to address the gender imbalance on the boards of publicly-listed companies. These measures vary by jurisdiction and include legally-binding gender quotas, comply-or-explain recommendations regarding gender representation on the board, and requirements to set and disclose targets or diversity policies.

In markets where gender quotas are well established in law or best practice recommendations, we generally expect directors of each gender to comprise at least 30% of the board. In 2021, this includes main market listed companies in Belgium, France, Italy, the Netherlands, Norway, and Portugal, as well as companies listed on the following indices: ATX (Austria), DAX (Germany), IBEX35 (Spain), and OMX Nordic 120 (Denmark, Finland, Sweden). In our view, directors of both genders should comprise at least 30% of the boards of all European companies listed on a mid-cap or large-cap index by no later than the 2022 annual general meeting.

Given the progress in increasing female representation at board level in Europe, we believe that the boards of all European companies listed on a main market should be composed of directors of both genders. Where a proposed election foresees a board consisting solely of directors of one gender, Glass Lewis will generally recommend that shareholders vote against the re-election of the chair of the nominating committee (or equivalent); when director nomination decisions are taken at full-board level, we will instead generally recommend that shareholders vote against the re-election of the board chair or Lead Independent Director. We may provide limited exceptions to this policy where a company discloses a credible plan to address the lack of gender diversity on the board within a near-term and defined timeframe (e.g. by the time of the next annual meeting or scheduled board election).

In the case of a by-election, we will consider recommending that shareholders vote against the election of the new nominee where the election foresees the board consisting solely of directors of one gender unless a commitment is provided that the board will address its gender imbalance by the time of the next scheduled board election.

We will generally provide exceptions to these gender diversity policies to boards consisting of four or fewer members where a company provides compelling disclosure as to why it has failed to ensure the representation of both genders at board level.

Further, we will take into account recent progress made to improve board diversity while maintaining the required balance of board skills and refreshment, when accompanied by a commitment to address the gender gap in upcoming election cycles.

### **Diversity of Ethnicity and National Origin at Board Level**

Glass Lewis generally believes that the composition of a board should be representative of a company's workforce, the jurisdictions in which it principally conducts its business activities, and its other key stakeholders. Accordingly, we believe that boards should consider including diversity of ethnicity and national origin as attributes in their composition profiles, whether defined targets for diversity of ethnicity and national origin should be set, and the manner and extent to which the ethnic and national backgrounds of directors and board nominees is publicly disclosed. We are mindful that a board's decisions in this regard will be predicated on the diversity of ethnicity and national origin of the company's key stakeholders, as well as local legislation regarding the disclosure of protected characteristics.

In egregious cases where a board has failed to address legitimate shareholder concerns regarding the diversity of ethnicity and national origin at board level, we may recommend that shareholders vote against the re-election of the chair of the nominating committee (or equivalent).

### **Diversity of Skills and Experience at Board Level**

We believe companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. Our analysis of election proposals at large European companies includes an [explicit](#)

[assessment of skills disclosure](#). We expect these companies to provide a robust, meaningful assessment of the board's profile [in terms of skills and experience](#) in order to align with developing best practice standards.

If a board has failed to address material concerns regarding the mix of skills and experience of the non-executive element of the board, we will consider recommending voting against the chair of the nominating committee (or equivalent). In the case of a by-election where it is unclear how the election of the candidate will address a substantial skills gap, we may consider recommending voting against the new nominee to the board.

In egregious cases where the disclosure of a large European company does not allow for a meaningful assessment of the key skills and experience of incumbent directors and nominees to a board, we will also consider recommending voting against the chair of the nominating committee (or equivalent).

### **Workforce Diversity and Inclusivity Measures**

Glass Lewis believes that human capital management is an area of material importance to all companies. Maintaining a diverse and engaged workforce can help mitigate risks related to low worker productivity, employee turnover, and lawsuits based on discrimination or harassment.

Given the importance of this issue, we believe that companies should provide shareholders with adequate information to be able to assess the oversight of this critical aspect of their operations, and the mitigation of any attendant risks. Examples of disclosure in this regard include information on a company's workforce diversity policy, data on the diversity of underrepresented groups (e.g. gender) in management positions and in the wider workforce, measures to increase the representation of underrepresented groups, as well as other relevant policies and performance on hiring, retention, and equal treatment (e.g. measures to attract and retain staff from underrepresented groups, gender pay gap data, etc.).

In egregious cases where boards have failed to respond to legitimate concerns regarding a company's policies, practices and disclosure, we may recommend voting against the chair of the governance committee (or equivalent), the chair of the board, and/or board ratification proposals as appropriate.

### **Human Capital Management Oversight**

Glass Lewis believes that effective board oversight of human capital management issues is not limited to a company's policies and disclosure on workforce diversity and inclusivity measures; rather, boards should be considered broadly accountable for direct oversight of workplace issues at large, which includes labour practices, employee health and safety, and employee engagement, diversity, and inclusion.<sup>19</sup> In egregious cases where a board has failed to respond to legitimate concerns with a company's human capital management practices, we may recommend voting against the chair of the committee tasked with oversight of the company's governance practices or the chair of the board, as applicable.

## **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 analysing the risk management practices of public companies, we take note of any significant losses or write-downs on financial assets and/or structured transactions. In cases where a company has disclosed a sizable loss or write-down, and where a reasonable analysis indicates that the company's supervisory board-level

<sup>19</sup> SASB Universe of Sustainability Issues

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>20</sup> we will consider recommending to vote against the board chair on that basis.

## ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT

Glass Lewis recognises the importance of ensuring the sustainability of companies' operations. We believe that insufficient oversight of 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 capitalising on related opportunities to the best extent possible.

To that end, Glass Lewis believes that companies should ensure that boards maintain clear 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 concerns, 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. Beginning in 2021, Glass Lewis will note as a concern when boards of companies listed on a major European blue-chip index do not provide clear disclosure concerning the board-level oversight afforded to environmental and/or social issues. Beginning with shareholder meetings held after January 1, 2022, we will generally recommend voting against the governance chair of these boards which fail to provide explicit disclosure concerning the board's role in overseeing these issues.

When evaluating the board's role in overseeing environmental and/or social issues, we will examine a company's proxy statement and governing documents (such as committee charters) to determine if directors maintain a meaningful level of oversight of and accountability for a company's environmental and/or socially-related impacts and risks. While we believe that it is important that these issues are overseen at the board level and that shareholders are afforded meaningful disclosure of these oversight responsibilities, we believe that companies should determine the best structure for this oversight for themselves. In our view, this oversight can be effectively conducted by specific directors, the entire board, a separate committee, or combined with the responsibilities of a key committee.

In situations where we believe 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 recommend that shareholders vote against the 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.

## BOARD COMMITTEES

When a board fails to form audit and remuneration committees, we will generally recommend voting against the board chair on this basis. This will generally not apply to small-cap companies with a sufficient number of independent directors.<sup>21</sup>

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<sup>20</sup> A committee responsible for risk management could be a dedicated risk committee, or another board committee (usually the audit committee or the finance committee), depending on a given company's board structure and method of disclosure. In some cases, the entire board is charged with risk management.

<sup>21</sup> At small companies, the functions assigned to the committee may be performed by the board as a whole, provided that it meets the composition requirements advocated for the committee and that adequate information is provided in this respect. EU Commission Recommendation of 15 February 2005, Section II, Article 7.2.

## AUDIT COMMITTEE PERFORMANCE

“Audit committees and an effective internal control system help to minimise financial, operational and compliance risks, and enhance the quality of financial reporting.”<sup>22</sup>

When assessing an audit committee’s performance, we are aware that an audit committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or the disclosure provided to investors. Rather, an audit committee member monitors and oversees the process and procedures that management and auditors perform. As stated in EU regulations, “the audit committee should assist the (supervisory) board to at least: (i) monitor the integrity of the financial information provided by the company; (ii) review at least annually the internal control and risk management systems, with a view to ensuring that the main risks are properly identified, managed and disclosed; (iii) ensure the effectiveness of the internal audit function; (iv) monitor the external auditor’s independence and objectivity; and (v) review the effectiveness of the external audit process.”<sup>23</sup>

## STANDARDS FOR ASSESSING THE AUDIT COMMITTEE

For an audit committee to function effectively on investors’ behalf, it must include members with sufficient knowledge to diligently carry out their responsibilities. In its recommendation on the role of non-executive directors of listed companies and on the committees of the board, the European Commission states “the members of the audit committee should, collectively, have a recent and relevant background in and experience of finance and accounting for listed companies appropriate to the company’s activities.”<sup>24</sup>

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

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

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and recommend voting in favour of its members, but we would recommend voting against the following members under the following circumstances:<sup>25</sup>

- The audit committee chair when: (i) non-audit fees exceed the total of audit and audit-related fees billed by the auditor for two consecutive years; (ii) the company fails to disclose the fees, or breakdown of fees, paid to the auditor for two consecutive years; and/or (iii) the committee did not hold a sufficient number of meetings considering the company’s financial situation and reporting requirements (at least once per quarter, when a company releases quarterly financial statements); (iv) when we have concerns regarding the independence or tenure of the auditor and the auditor has not been proposed for election by shareholders.
- All members of an audit committee in office when: (i) material accounting fraud occurred at the

<sup>22</sup> Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directive 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

<sup>23</sup> EU Commission Recommendation of 15 February 2005, Annex 1, Article 4.

<sup>24</sup> EU Commission Recommendation of 15 February 2005, Section III, Article 11.2.

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

company; (ii) financial statements had to be restated due to serious material fraud; (iii) the company repeatedly fails to file its financial reports in a timely fashion in successive years; (iv) the company has aggressive accounting policies and/or poor disclosure or lack of sufficient transparency in its financial statements; and/or (v) the committee presided over a significant failure to oversee material environmental and social risks, in the absence of a separate committee with dedicated environmental and/or risk oversight functions.

## REMUNERATION COMMITTEE PERFORMANCE

Remuneration committees have the primary role in determining the remuneration of executives. This includes deciding the basis on which remuneration is determined, as well as the amounts and types of remuneration to be paid. This process begins with the hiring and initial establishment of employment agreements, including the terms for items such as fixed pay, pensions and severance agreements. The remuneration committee is also generally responsible for approving variable, performance-based remuneration, including annual cash bonuses and awards granted under long-term equity-based incentive plans. When establishing remuneration arrangements, it is important that a significant portion of remuneration is based on the company's long-term economic performance, and consistent with long-term shareholder returns.

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

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

## STANDARDS FOR ASSESSING THE REMUNERATION COMMITTEE

We evaluate remuneration committee members based on their performance while serving on the remuneration committee in question, even if they are not currently serving on the committee. When assessing the performance of remuneration committees, we will recommend voting against the following:<sup>26</sup>

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

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

## NOMINATING COMMITTEE PERFORMANCE

The nominating committee, as an agent for the shareholders, is responsible and accountable for selection of objective and competent directors. We will recommend voting against the following nomination committee members under these circumstances:<sup>27</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 there are ongoing concerns regarding the independence of the board; (iii) when there are less than three members on key board committees;<sup>28</sup> or (iv) for issues related to board size and, diversity, as well as directors' terms as further detailed throughout these guidelines.
- All members of the nominating committee (that served during the relevant time period) when the committee nominated or renominated an individual who had significant conflicts of interest or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests. In addition, we may recommend voting against one or all of the nominating committee members up for election when the board fails to respond to a significant shareholder vote against a nominee previously elected.<sup>29</sup>

## ELECTION PROCEDURES

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

## CLASSIFIED/STAGGERED BOARDS AND TERM LIMITS

Although we recognise that classified boards and staggered board elections are common practice in most of Europe, Glass Lewis favours the annual election of directors. Directors on staggered boards or with lengthy terms of office are less accountable to shareholders than directors elected annually. Furthermore, we feel the annual election of directors encourages directors to be responsive to shareholder interests. Moreover, empirical studies have shown: (i) companies with staggered boards reduce a firm's value; and (ii) in the context of hostile takeovers, staggered boards operate as a takeover defence, which entrenches management, discourages potential acquirers and delivers a lower return to target shareholders.<sup>30</sup>

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

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

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

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<sup>27</sup> Where the recommendation is to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will note our concern with regard to the committee chair. In the absence of a nominating committee, we will recommend voting against the board chair.

<sup>28</sup> In the case of remuneration and nominating committees, this will not apply to companies with small, sufficiently independent boards. At companies with small (supervisory) boards, the audit committee can be composed of only two members. Alternatively, the functions assigned to the audit committee may be performed by the board as a whole, provided that it meets the composition requirements advocated for the committee and that adequate information is provided in this respect. EU Commission Recommendation of 15 February 2005, Section II, Article 7.2 and Annex 1.

<sup>29</sup> We will generally consider a vote of 20% against or more to be significant, while taking into account the ownership structure and any mitigating circumstances around the specific vote when making this determination.

<sup>30</sup> Lucian Bebchuk, Alma Cohen, "The Costs of Entrenched Boards" (2004) and Lucian Bebchuk, Alma Cohen and Charles C.Y. Wang, "Staggered Boards and the Wealth of Shareholders: Evidence from a Natural Experiment," SSRN: <http://ssrn.com/abstract=1706806> (2010), p. 26.

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

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

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

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

## **RATIFICATION OF THE CO-OPTION OF DIRECTORS**

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

## **BOARD EVALUATION AND REFRESHMENT**

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

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

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

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

We do however recognise that it has become common and accepted practice for the boards of European companies to include director age or term limits in their board composition profiles. As such, we will generally not recommend voting against proposals that seek to introduce or amend director age or term limits in a company's articles of association.

Nevertheless we believe boards that have adopted age/term limits should apply these equally for all members

of the board. If a board waives its age/term limits, Glass Lewis will consider recommending shareholders vote against the chair of the nominating committee or equivalent, unless compelling rationale is provided for why the board is proposing to waive this rule through an election/re-election.

## **LACK OF ADEQUATE DIRECTOR DISCLOSURE**

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

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

# Transparency and Integrity in Financial Reporting

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## ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

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

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

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

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

## NON-FINANCIAL REPORTING

Large companies in Europe are required to report on "non-financial" issues such as environmental, social or governance issues that are considered material to the firm.<sup>31</sup> While European regulatory authorities have not prescribed a certain format or template for reporting, guidance issued by the European Commission emphasise that companies may use existing international reporting frameworks and should develop said reporting around consistent, material KPIs that account for corporate strategy and stakeholder interests.<sup>32</sup> Companies subject to the Directive are also required to disclose a board diversity policy.

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

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<sup>31</sup> Directive 2014/95/EU of the European Parliament and of the Council on disclosure of non-financial and diversity information by certain large undertakings and groups ("Directive on Non-Financial Reporting") applies to companies with more than 500 employees and applies to all accounts for those companies from fiscal year 2017. While these reports are not required to be audited, the independent auditor must verify that a statement has been provided in compliance with the Directive. National implementation requirements vary and supervisory authorities provide additional guidance at the national level.

<sup>32</sup> The Guidelines on Non-Financial Reporting 2017/C 215/01 from the European Commission, issued in June 2017, are not binding and are only intended to guide companies in preparing their annual reporting in accordance with the requirements of the Directive on Non-Financial Reporting. The Guidelines suggest several well-known international reporting frameworks issued by the UN, the OECD, the International Organisation for Standardisation, the International Labour Organisation and the Global Reporting Initiative, among others.

## ALLOCATION OF PROFITS/DIVIDENDS

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

In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend to shareholders.<sup>33</sup> As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases. However, we may recommend that shareholders vote against a proposed dividend in cases where a company's dividend payout ratio, based on consolidated earnings, has decreased from a more reasonable payout ratio and for which no rationale or corresponding change in dividend policy has been provided by the company. In cases where a company has eliminated dividend payments altogether without explanation, we may recommend shareholders vote against the proposal. We will also scrutinise dividend payout ratios that are consistently excessively high (e.g., over 100%) relative to the company's peers, its own financial position or its level of maturity without satisfactory explanation.

## CAPITAL REPAYMENTS

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

## BONUS SHARE ISSUES/DIVIDENDS-IN-KIND

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

## ALLOCATIONS TO RESERVES/TRANSFER OF RESERVES

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

## APPOINTMENT OF AUDITOR AND AUTHORITY TO SET FEES

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

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

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<sup>33</sup> In cases where a company is distributing capital to shareholders by other means than a dividend payment, we will consider the total effect of all such distributions.

## Voting Recommendations on Auditor Appointment

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

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

- When non-audit fees exceed the total of audit and audit-related fees billed by the auditor for several years in a row, or where there is other evidence that the auditor's independence may be compromised.
- Recent material restatements of annual financial statements, including those resulting in the reporting of material weaknesses in internal controls and including late filings by the company where the auditor bears some responsibility for the restatement or late filing.<sup>34</sup>
- When the company has aggressive accounting policies evidenced by restatements or other financial reporting problems.
- When the company has poor disclosure or lacks transparency in its financial statements.
- Presence of other relationships or concerns with the auditor that might suggest a conflict between the auditor's interests and shareholder interests.
- When the auditor's tenure exceeds 10 years (or 14 years in case of a joint audit assignment) and, in the absence of a competitive tender during the past ten years, the company has not provided a compelling justification nor a timeline for tendering the audit contract. We will also take auditor tenure into consideration when assessing any pattern of inaccurate audits and any ongoing litigation or significant controversies which call into question an auditor's effectiveness when making this determination.<sup>35</sup>

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

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

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

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

# The Link Between Pay and Performance

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Glass Lewis carefully reviews the remuneration 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 remuneration should be linked directly with the performance of the business the executive is charged with managing. We typically look for remuneration arrangements that provide for a mix of performance-based short- and long-term incentives in addition to base salary.

Glass Lewis believes that comprehensive, timely and transparent disclosure of executive pay is critical to allow shareholders to evaluate the extent to which the pay is keeping pace with company performance. We favour full disclosure for senior executive remuneration packages and will generally support proposals seeking to improve transparency of senior executive pay amounts and structure.

## VOTES ON EXECUTIVE REMUNERATION (“SAY-ON-PAY”)

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

Given the complexity of most companies' remuneration programmes, Glass Lewis applies a highly nuanced approach when analysing executive remuneration. We review executive remuneration on both a qualitative basis and a quantitative basis, recognising 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 also review any significant changes or modifications, and associated rationale, made to a company's remuneration structure or award levels, including base salaries.

## VOTE ON REMUNERATION POLICY

We generally believe that remuneration policies should provide clear disclosure of an appropriate framework for managing executive remuneration. While this framework will vary by company, it should generally provide an explicit link to the company's strategy, set appropriate quantum limits along with structural safeguards to prevent excessive or inappropriate payments and particularly any reward for failure. Remuneration policies should also provide sufficient flexibility to allow boards to manage matters of recruitment and professional development as they arise.

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

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

Some of the potentially troubling issues we consider when analysing remuneration policies, and when weighing a vote against related proposals, are as follows:

- The policy allows for high pay (as compared to the company's benchmark) that is not subject to relevant and challenging performance targets over the period or has not otherwise been merited by outstanding company performance over the period;
- We do not consider the overall remuneration structure or the balance between short- and long-term incentive plans to be appropriate or in shareholders' best interests;
- Pay levels are benchmarked above median without sufficient justification;
- Performance targets are not sufficiently challenging, or not aligned with business strategy;
- Non-executive directors are eligible for cash and/or equity awards on similar terms as those granted to executives;
- Discretion retained by the board is not limited to clearly-defined circumstances;
- No portion of variable remuneration is linked to multi-year, forward-looking vesting conditions;
- The policy does not include structural safeguards and risk mitigating features, such as clawback/malus provisions, deferral, post-vesting holding periods, and post-employment shareholding requirements;
- If the company has failed to sufficiently disclose the terms of its policy, we may recommend shareholders vote against the proposal solely on this basis; and
- Where substantial changes to the existing policy have been proposed and have not been adequately explained or justified, we may recommend voting against the policy on this basis if the changes mark a worsening of the overall structure.

We closely review changes to companies' remuneration policies to determine whether the changes will benefit shareholders and therefore whether shareholders should support the proposals. Where a proposed policy represents a significant improvement over the existing policy, we may recommend voting for the proposal, even when the proposed policy contains some deficiencies.

## VOTE ON REMUNERATION REPORT

Our analysis of the remuneration report focuses on the board's implementation and administration of the company's remuneration policy. However, we also believe that this annual vote provides shareholders with an important opportunity to express concern with a company's remuneration policies and practices that are not explicitly limited to the year under review. As such, our voting recommendations may reflect substantial ongoing concerns with a company's remuneration policy, in addition to the remuneration decisions and outcomes during the past fiscal year.

Regarding disclosure, we note that SRDII states that where applicable, the remuneration report shall contain the following information regarding each individual director's remuneration:

- the total remuneration split out by component, the relative proportion of fixed and variable remuneration, an explanation of how the total remuneration complies with the adopted remuneration policy, including how it contributes to the long-term performance of the company, and information on how the performance criteria were applied;
- the annual change of remuneration, of the performance of the company, and of average remunera-

tion on a full-time equivalent basis of employees of the company other than directors over at least the five most recent financial years, presented together in a manner which permits comparison;

- any remuneration from any undertaking belonging to the same group;
- the number of shares and share options granted or offered, and the main conditions for the exercise of the rights including the exercise price and date and any change thereof;
- information on the use of the possibility to reclaim variable remuneration; and
- information on any deviations from the procedure for the implementation of the remuneration policy, including the explanation of the nature of the exceptional circumstances and the indication of the specific elements derogated from.

In assessing implementation during the year under review, we pay particular attention to the alignment between performance and pay outcomes, and the committee's level of disclosure regarding any application of discretion. In cases where our analysis reveals remuneration practices or disclosure in significant need of reform, we will generally recommend that shareholders vote against the remuneration report. Generally, such instances include evidence of a pattern of poor pay-for-performance practices, unclear or questionable disclosure regarding the overall remuneration structure (e.g. limited information regarding benchmarking processes, limited rationale for bonus performance metrics and targets, etc.), questionable adjustments to certain aspects of policy implementation and/or outcomes (e.g. limited rationale for significant changes to performance targets or metrics, the payout of guaranteed bonuses or sizeable retention grants, etc.) and/or other egregious remuneration practices.

While not an exhaustive list, we believe the following practices are indications of problematic pay practices which may cause Glass Lewis to recommend against the remuneration report:

- Egregious or excessive bonuses, equity awards or severance payments, including golden handshakes and golden parachutes;
- Guaranteed bonuses;
- Incentive plan targets set at performance levels well below actual past performance or strategic targets provided in guidance to shareholders;
- Lowered performance targets without justification;
- Incentive plans that pay out for performance below lower middle quartile peer performance levels;
- Lack of disclosure regarding performance metrics and targets;
- Performance targets not sufficiently challenging and/or providing for unreasonably high potential payouts;
- Performance conditions do not adequately measure a company's performance or align with strategy over the long term;
- Discretionary bonuses paid outside of short- and long-term incentive plans;
- Executive pay that is high compared to the Company's peers and is not correlated with outstanding company performance; and
- The terms of a long-term incentive plan are inappropriate and a separate vote on the plan is not provided (please see "Long-Term Incentives" section).

In the case of a company that maintains poor remuneration policies year after year without any apparent steps to address the issues, we may also recommend that shareholders vote against the chair and/or other members of the remuneration committee. In addition, we may recommend voting against the entire committee based on the practices or actions of its members, such as approving large one-off payments, the inappropriate use of discretion in determining variable remuneration, or sustained poor pay-for-performance practices.

## SHORT-TERM INCENTIVES

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

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

Where possible, companies should disclose the specific targets utilised as well as actual performance against the targets. Glass Lewis recognises that boards may be reluctant to disclose certain target data on the basis that it is commercially sensitive; however we believe companies should justify such non-disclosure, and commit to providing this information retrospectively. Moreover, we believe it reasonable for companies to disclose the relative level of achievement with respect to target for each metric even if the targets themselves are not disclosed.

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

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

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

## LONG-TERM INCENTIVES

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

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

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

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

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

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

## DISCRETION

Remuneration committees should retain a reasonable level of discretion to ensure that pay outcomes are justified and linked to performance, and that the implementation of the remuneration policy remains appropriate, including with reference to performance metrics and specific targets. The scope of potential discretionary powers, and any exercise of such discretion made during the year, should be clearly disclosed and justified.

## REMUNERATION RELATIVE TO STAKEHOLDER EXPERIENCE

Glass Lewis believes that remuneration outcomes should remain appropriate to a company's specific situation and the experiences of its shareholders and employees, even where formulaic targets have been met. More specifically, we generally expect remuneration committees to consider exercising downward discretion where:

- A company has suffered an exceptional negative event that has had a material negative impact on shareholder value;
  - For example, we generally expect a remuneration committee to consider reducing an annual bonus payout and/or the size of an LTI grant following a significant decline in share price. Further, we expect downward adjustments to the outcomes of awards linked to share price performance where windfall gains have been received; or

- A company's decisions regarding working conditions have had a material negative impact on employees;
  - For example, we generally expect substantial workforce layoffs, furloughs, short-time working arrangements, salary freezes etc. to be reflected in executives' remuneration outcomes.

In cases of substantial misalignment between executive pay outcomes and the experience of shareholders or employees in the past fiscal year, we may recommend that shareholders vote against a company's remuneration report solely on this basis.

Furthermore, we believe that forward-looking decisions regarding executive remuneration should also take into account a company's shareholders and employees. For example, we may raise concern with a company's remuneration policy where there is evidence that executive fixed pay and/or total opportunity increases are substantially outpacing employee salary increases.

## REMUNERATION RELATIVE TO PEERS

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

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

## REMUNERATION RELATIVE TO OWNERSHIP STRUCTURE

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

## EXECUTIVE REMUNERATION AT FINANCIAL INSTITUTIONS

Following the global financial crisis, the European Union has directed significant attention to the reform of remuneration policies at financial institutions in order to mitigate risk to relevant stakeholders. Notably, the European Union introduced directives amending the existing Capital Requirements Directive in 2010 ("CRDIII"), 2013 ("CRD IV") and 2019 ("CRD V") in order to harmonise the supervision of remuneration practices at financial institutions across the EU.<sup>39</sup> The amendments introduced with CRDIII established a requirement that

<sup>39</sup> Directives 2010/76/EU, 2013/36/EU, and 2019/878 of the European Parliament and of the Council of 24 November 2010, 26 June 2013, and 20 May 2019, respectively, amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.

national supervisory authorities directly oversee financial institutions' remuneration policies and practices in order to "promote sound and effective risk management."<sup>40</sup> The more notable provisions from the Capital Requirements Directives that apply to executive remuneration policies of affected firms<sup>41</sup> are the following:<sup>42</sup>

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

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

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

41 While all financial and credit institutions are affected by the Capital Requirements Directives, a "proportionality rule" prevents all requirements from being strictly applied to smaller companies or to companies or individuals with less direct risk exposure. CRD V defines such institutions as having a value of assets of which is on average and on an individual basis equal to or less than €5 billion over the previous four years, and staff members whose annual variable remuneration does not exceed €50,000 and does not represent more than one third of the staff member's total annual remuneration.

42 Annex V, Article 11(23.1) of CRDIII.

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

44 For variable remuneration that is "particularly high," at least 60% must be deferred. Material risk takers are defined as staff members whose remuneration is equal to or greater than €500,000 and equal to or greater than the average remuneration awarded to senior management.

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

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

47 Section 4.2.4 of the CEBS Guidelines on Remuneration Policies and Practices.

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

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

## AUTHORITIES TO INCREASE VARIABLE REMUNERATION

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

## EQUITY-BASED REMUNERATION PLAN PROPOSALS

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

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

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

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

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

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

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

## OPTION REPRICING

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

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

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

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

- Officers and directors do not participate in the programme;
- 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 programmes; and
- Management and the board make a cogent case for needing to motivate and retain existing employees, such as being in a competitive employment market.

## SEVERANCE PAYMENTS

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

## REMUNERATION OF NON-EXECUTIVE DIRECTORS

In accordance with SRD II, the remuneration of non-executive directors should be included in the remuneration policies and reports that are presented for a shareholder vote. In some European countries, companies may elect to seek approval of the remuneration policy for non-executive directors separately from the policy for executive directors. Further, in some European countries, the remuneration policy for non-executive directors is commonly outlined in a company's statutes and any amendments require shareholder approval.

In general, Glass Lewis believes that the quantum of non-executive fees should be broadly comparable to

a company's country and industry peers and should take into account the time commitment required for a director to satisfactorily discharge their duties to shareholders. Accordingly, we believe the board should provide rationale for any substantial proposed increases to the fees of non-executive directors. We believe that shareholders are best served when non-executive directors receive fixed remuneration only -- payable solely in cash, or partially in equity awards that are not subject to any performance conditions or a director's continued service on the board.

In line with best practice in Europe, we generally recommend voting against proposals which foresee stock option grants and performance-based equity grants for non-executive directors. In our view, performance-related awards for non-executive directors -- particularly those granted on the same terms as awards to executive directors -- may threaten to compromise the objectivity and independence of directors. To the extent that the payment of variable remuneration continues to be generally accepted market practice in a country, we may accept limited performance-based awards to non-executive directors, so long as such awards are based on clearly-defined, multi-year performance criteria and geared toward the long-term sustainable development of the company. We may also accept the granting of stock options to the non-executive directors of companies in a development phase with limited cash resources.

# Governance Structure, Capital Management and the Shareholder Franchise

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## AMENDMENTS TO THE ARTICLES OF ASSOCIATION

Glass Lewis evaluates proposed amendments to a company's articles of association on a case-by-case basis. In general, we will recommend voting for article amendments that are unlikely to have a material negative impact on shareholders' interests. Accordingly, we generally recommend voting for proposed technical amendments to a company's articles of association, such as editorial amendments or the necessary reflection of changes to corporate law.

We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from reviewing each amendment on its own merit. In such cases, we will analyse each proposed change on an individual basis and will recommend voting for the proposal only when, on balance, we believe the amendments are in the best interests of shareholders. Material concerns with a single proposed amendment may lead to a recommendation that shareholders oppose all proposed amendments where these are bundled into a single proposal.

## RATIFICATION OF BOARD, MANAGEMENT AND AUDITORS' ACTS

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

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

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

- The report of the independent auditor notes a material weakness, serious restatement, or failure to comply with accounting norms;
- In cases where there is ongoing legal action against or concerning members of the board, management or auditing firm and we believe the postponement of ratification or the individual ratification of directors (if possible) would better serve the interests of shareholders;
- The board has failed to address material shareholder concerns in the past year, such as providing an adequate response to the dissent of minority shareholders to a proposal at the previous general meeting, as outlined in the "Board Responsiveness" section of these guidelines;
- When the actions of the board or management (or their failure to act) have resulted in a material negative impact on shareholders' interests;
- Where other substantial oversight, governance, human capital management and ESG concerns exist for which we believe shareholders should hold the board or management accountable; or
- When we have serious concerns regarding the actions of the board and none of its members is up for election, we may recommend voting against the ratification of board acts, depending on the materiality of the concerns.

In cases where we believe that ongoing investigations or proceedings may cast significant doubt on the performance of a corporate body in the past fiscal year, but that the potential outcome of such investigations or proceedings is unclear at the time of convocation of the general meeting, we believe that companies should propose that a decision on ratification be postponed until a future general meeting. If shareholders are not provided with this opportunity, we will generally recommend that shareholders abstain from voting on such ratification proposals; in cases where abstain votes are neither counted as valid votes cast nor displayed in the minutes of general meetings, we will generally recommend that shareholders vote against ratification proposals under the aforementioned circumstances. In all other cases outlined above, we will typically recommend that shareholders vote against the ratification proposal.

## RELATED PARTY TRANSACTIONS

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

## DIRECTOR INSURANCE AND INDEMNIFICATION

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

## ANTI-TAKEOVER DEVICES (POISON PILLS)

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

<sup>49</sup> Directive 2017/828 amending the Shareholder Rights Directive sets minimum standards for the independent review and disclosure and approval of material related party transactions. Some EU member states require shareholders to approve such transactions, absent another satisfactory means of approval by an independent supervisory body.

## ISSUANCE OF SHARES/WARRANTS

In some markets, shareholders must explicitly approve any authority to issue shares or warrants that may be used as a takeover defence. Given our strong opposition to anti-takeover devices, we generally recommend that shareholders vote against these proposals. In extraordinary circumstances, we may recommend shareholders vote for proposals that are limited in timing and scope to accomplish a particular objective such as the closing of an important merger. We will also take into account any exceptional justification provided by the board, including contextual factors such as a severe drop in stock price due to a widespread industry or market downturn.

## SHARE REPURCHASE PLANS

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

## CAPS ON VOTING RIGHTS

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

## RESTRICTIONS ON SHARE REGISTRATION

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

## OWNERSHIP REPORTING REQUIREMENTS

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

## SUPERMAJORITY VOTE REQUIREMENTS

Glass Lewis believes that supermajority vote requirements act as impediments to shareholder action on ballot items that are critical to shareholder interests. One key example is in the takeover context, where supermajority vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business. While we recognise that supermajority voting requirements are imposed by national law for approval of certain proposals in most European markets, we will recommend voting against any proposal seeking to extend supermajority voting requirements to decisions where a supermajority requirement is

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

not stipulated by law and such provisions are not clearly designed to protect the interests of minority shareholders.

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

## VIRTUAL SHAREHOLDER MEETINGS

Most European countries have yet to formally legislate to allow for companies to hold virtual shareholder meetings, or requirements exist that shareholders first approve changes to a company's statutes. However, the spread of COVID-19 led to European legislators passing temporary provisions to allow companies to hold general meetings in a format that limits the ability of shareholders to attend in person. It is expected that most European countries will continue to allow for meetings with reduced attendance for the 2021 proxy season and that broader legislative reform regarding the format of shareholder meetings will follow.

Glass Lewis unequivocally supports companies facilitating the virtual participation of shareholders in general meetings. We believe that virtual meeting technology can be a useful complement to a traditional, in-person shareholder meeting by expanding participation of shareholders who are unable to attend a shareholder meeting in person (i.e. a "hybrid meeting"). However, we also believe that virtual-only shareholder meetings can curb the ability of a company's shareholders to participate in the meeting and meaningfully communicate with company management and directors.

## MEETING FORMAT AND CONVOCATION

Where companies are convening a meeting at which in-person attendance of shareholders is limited, we expect companies to set and disclose clear procedures at the time of convocation regarding:

- i) When, where, and how shareholders will have an opportunity to ask questions related to the subjects normally discussed at the annual meeting, including a timeline for submitting questions, types of appropriate questions, and rules for how questions and comments will be recognised and disclosed to shareholders;
- ii) In particular where there are restrictions on the ability of shareholders to question the board during the meeting - the manner in which appropriate questions received during the meeting will be addressed by the board; this should include a commitment that questions which meet the board's guidelines are answered in a format that is accessible by all shareholders, such as on the company's AGM or investor relations website;
- iii) The procedure and requirements to participate in the meeting and access the meeting platform; and
- iv) Technical support that is available to shareholders prior to and during the meeting.

In egregious cases where inadequate disclosure of the aforementioned has been provided to shareholders at the time of convocation, we will generally recommend that shareholders hold the board or relevant directors accountable. Depending on a company's governance structure, country of incorporation, and the agenda of the meeting, this may lead to recommendations that shareholders vote against members of the governance committee (or equivalent; if up for re-election); the chair of the board (if up for re-election); and/or other agenda items concerning board composition and performance as applicable (e.g. ratification of board acts).

We will always take into account emerging local laws, best practices, and disclosure standards when assessing a company's performance on this issue.

## AMENDMENTS TO ARTICLES

In some jurisdictions, companies are required to seek prior shareholder approval and amend their statutes in order to hold a meeting with a virtual element or to allow for directors and executives to attend general meetings virtually.

The following is a summary of our views on common proposed amendments and the conditions under which we would generally recommend that shareholders support such amendments:

### Amendments to Allow for Virtual-Only Meetings

As outlined above, we believe that virtual-only meetings can lead to a reduction in shareholder rights unless clear procedures regarding the ability for shareholders to participate in the meeting are disclosed at the time of convocation. As such, we expect, at a minimum, companies proposing to amend their statutes to allow for virtual-only meetings to include the following commitments in the proposed amendments or in the supporting documents:

- i) The procedure and requirements to participate in a virtual-only meeting will be disclosed at the time of convocation; and
- ii) There will be a formal process in place for shareholders to submit questions to the board, which will be answered in a format that is accessible to all shareholders.

In cases where the proposed amendments specify that the virtual meeting format would only be used in exceptional circumstances, Glass Lewis will generally recommend that shareholders support such amendments in order to provide flexibility to companies to navigate potential restrictions in holding in-person meetings. However, we expect companies proposing such amendments to include a commitment that the exceptional circumstance for the convocation of a virtual-only meeting be disclosed at the time of convocation.

### Amendments to Allow for Hybrid Meetings

Glass Lewis will generally support proposed amendments that would allow for companies to hold hybrid meetings. Nevertheless, we believe that shareholders would benefit from the inclusion of commitments regarding the participation of virtual attendees, as outlined above.

### Amendments to Allow for Virtual Attendance of Directors and Executives

Glass Lewis believes that, under normal circumstances, the virtual attendance of directors and top-tier executives at traditional in-person or hybrid general meetings may serve to reduce accountability to shareholders and risks perpetuating the perception that companies are utilising emerging technologies to avoid uncomfortable conversations.

As such, we will generally recommend that shareholders oppose amendments to statutes that would allow for the virtual participation of directors and executives in general meetings of shareholders unless:

- i) Virtual participation of directors and executives is explicitly limited to virtual-only meetings; or
- ii) Where the amendment would also allow for the virtual participation of directors and executives in traditional or hybrid meetings, this is only permissible in exceptional circumstances and subject to prior approval by the board or meeting chair.

## SHAREHOLDER LOYALTY INITIATIVES

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

## RIGHT OF SHAREHOLDERS TO CALL A SPECIAL MEETING

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

## ROUTINE ITEMS

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

## TRANSACTION OF OTHER BUSINESS

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

## AUTHORITY TO CARRY OUT FORMALITIES

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

## MEETING PROCEDURES

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

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

# Capital Management

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## INCREASES IN CAPITAL

Glass Lewis believes that adequate capital stock is important to a company's operation. European companies are authorised to increase share capital through several methods, which may or may not involve new share issues. In most jurisdictions, companies may request pre-authorisation from shareholders to issue new shares, or securities convertible into shares, under certain predefined conditions for a certain period of time. Companies may also seek approval of a share issue intended for a specific purpose.

## GENERAL AUTHORITIES TO ISSUE SHARES AND/OR CONVERTIBLE SECURITIES

A general authority to issue shares, or to issue securities convertible into shares, is the most common way for European companies to seek shareholder approval for capital increases. Such authorities provide companies with flexibility to issue equity at short notice without having to convene an extraordinary general meeting. Under this form of authorisation, companies are not required to detail a specific purpose or transaction for which the authority would be used, but are generally required to set and disclose at least i) the maximum amount of shares that may be issued; ii) the expiry date of the authority; iii) general conditions under which the authority may be utilised (including whether new shares may be issued during an actual or perceived takeover event); and iv) the extent to which new shares/convertible securities may be issued without preemptive rights.

While we believe that adequate authorisation to allow management to make quick decisions and effectively operate the business is critical, we also believe that companies should not be provided with a blank cheque in the form of a large pool of unallocated shares available for any purpose.

### With or Without Preemptive Rights<sup>52</sup>

In our view, a company's general authorisations to issue shares and/or convertible securities should not cumulatively exceed 100% of its total issued share capital, of which the ability to issue shares and/or convertible securities without preemptive rights should not cumulatively exceed 10-20% of its total issued share capital, depending on established market best practice.

Where a company is seeking approval of multiple authorities at the same meeting, or has outstanding general issuance authorities that are not expiring or being replaced by the proposed authority, we believe it is incumbent on the company to clearly disclose the extent to which all current and proposed authorities may be cumulatively utilised to issue new shares and/or convertible securities with and/or without preemptive rights. Where multiple authorities exist, best practice in Europe foresees the inclusion by a company of an explicit cap on maximum potential issuances with and without preemptive rights that applies across all current and proposed authorities.

Where sufficient information is available, we will exclude outstanding authorities from the recommended limits outlined above to the extent that they have expired or already been utilised, or where an explicit cap limits their potential future usage. Further, where sufficient information is available, we will also generally exclude existing or proposed authorities to issue new shares for a specific purpose (e.g. a capital authority to service a specific disclosed transaction) or which are reserved for servicing equity programmes.

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

## Usage as a Takeover Defence

Glass Lewis believes that provisions that are intended to prevent or thwart a potential takeover of a company are not conducive to good corporate governance and can reduce management accountability by substantially limiting returns for shareholders. As such, we generally recommend that shareholders vote against general authorities to issue shares and/or convertible securities where this authority may be used as a takeover defence.

In the case of companies that have a provision in their articles of association to allow for the usage of a capital authority during an actual or perceived takeover event, we believe that shareholders can reasonably expect clear disclosure on the existence of this provision in the terms of any proposed capital authorities.

## Servicing Equity Programmes

In general, we recommend voting for authorities intended to conditionally service potential future obligations under existing director/employee equity or share purchase programmes. Where a company is seeking to renew an authority to issue new shares under a specific plan that is itself also being renewed, we will evaluate the proposal in line with the specified plan terms; please refer to the “Equity-based Remuneration Plan Proposals” section of these guidelines for further information.

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

## SPECIFIC AUTHORITIES TO ISSUE SHARES AND/OR CONVERTIBLE SECURITIES

While not as common as general authorities, companies incorporated in most European jurisdictions may also seek shareholder approval of a direct issuance of shares and/or convertible securities for a specific purpose or transaction.

## Mergers, Acquisitions, Refinancing, and Recapitalisation

Proposed capital authorities to finance a merger or specific acquisition, or which seek to refinance or recapitalise a company, often exceed our recommended limits on maximum issuances with and/or without preemptive rights.

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

When a company seeks shareholder approval of a specific issuance of shares without preemptive rights that exceeds 20% of its issued share capital, we will examine the proposal on a case-by-case basis to weigh the merits of the proposed plan against the dilutive effect to shareholders from the proposed share issuance.

## Private Placements

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

## Capitalisation of Reserves, Profits, or Issue Premiums

The successive or simultaneous capitalisation (i.e., incorporation) of reserves, retained earnings or paid-

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

## PREFERENCE SHARES AND ADDITIONAL SHARE CLASSES

We view authorities that seek to, or would allow for, issuances of preference shares, the creation of a new class of shares, or the disproportionate increase of one class of shares vis-a-vis other share classes, on a case-by-case basis with a focus on the rights of current shareholders.

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

Where companies with multiple share classes are seeking approval of a general authority to issue shares, we believe that shareholders can reasonably expect clear disclosure regarding the proportionality in which new shares may be issued across these share classes.

## AUTHORITIES TO MEET CAPITAL ADEQUACY REQUIREMENTS

We often make exceptions to the thresholds for general or specific authorities to issue shares with or without preemptive rights outlined above when a company explains that the capital increase is intended to meet capital adequacy requirements applicable to financial institutions established at international,<sup>53</sup> regional,<sup>54</sup> and/or national level.

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

## 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 favour of such proposals.

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

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

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

## **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 remuneration 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 favour 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 defence.

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

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

# Environmental, Social & Governance Initiatives

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Glass Lewis believes it is important for companies to effectively oversee and manage material environmental, social and governance (“ESG”) issues. We believe shareholders should seek to promote governance structures that protect shareholders, support effective ESG oversight and reporting, and encourage director accountability. It is our belief that companies’ management of governance and shareholder rights-related issues are often indicative of their management of other issues, including those that are environmental and social in nature. Accordingly, Glass Lewis places a significant emphasis on promoting transparency, robust governance structures and companies’ responsiveness to and engagement with shareholders.

We believe that part of the board’s role is to ensure that management conducts a complete risk analysis of company operations, including those that have environmental and social implications. We believe that directors should monitor management’s performance in mitigating environmental and social risks in order to eliminate or minimise the risks to a company and its shareholders. Companies face significant financial, legal and reputational risks resulting from poor ESG-related practices, or negligent oversight thereof. Therefore, in cases where the board or management has neglected to take action on pressing issues that could negatively impact shareholder value, we believe shareholders should take necessary action in order to effect changes that will safeguard their financial interests.

To that end, Glass Lewis generally supports shareholder resolutions that seek to enhance companies’ governance structures, as we believe that, in most cases, this enhancement benefits shareholders. With respect to shareholder resolutions related to environmental and social issues, we evaluate each on a case-by-case basis and in the context of financial materiality. We believe that all companies face risks associated with ESG issues. However, we recognise that these risks manifest themselves differently at each company as a result of its unique operations, workforce, structure, and geography, among other factors. With a view to these risks, Glass Lewis will generally recommend in favour of resolutions that we believe will promote more and better disclosure of relevant risk factors where such disclosure is lacking or inadequate or that will otherwise serve the best long-term interests of shareholders. Further, when we believe that a company has not adequately managed environmental or social issues to the detriment of shareholders, Glass Lewis will note our concerns and may recommend that shareholders vote to signal these concerns on any applicable management or shareholder proposal. This could include a vote against the ratification of board or management acts in the prior year, where applicable, or the re-election of directors.

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

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