TheCorporateCounsel.net's

Proxy Advisors Handbook

May 2024

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Chapter 13

Proxy Advisors

Table of Contents

1. Who Are the Proxy Advisors 13-5

- ISS & Glass Lewis Are Biggest Proxy Advisors in U.S. 13-5
- ISS Structure & Capabilities 13-5
- Glass Lewis Structure & Capabilities 13-6
- Use of Contract Analysts During Proxy Season 13-6

2. Policy Setting & Availability 13-6

- Nature of Proxy Advisor Policies 13-6
- Proxy Advisors' Voting Advice is "Solicitation" 13-7
- Process for Annual Policy Updates 13-7
- Transparency of ISS Policies 13-8
- Transparency of Glass Lewis Policies 13-9
- Asking Questions About Policies 13-9
- Proxy Advisors Obtain Policy Input From All Investors (Not Just Loudest Ones) 13-9
- ISS Doesn't Always Side With Investors (Even Though They Are Clients) 13-10
- ISS's QualityScore Not Directly Related to Policies 13-10
- Glass Lewis Reports Not Directly Related to Policies 13-10

3. Policy Application 13-11

- Common Reasons for Negative Recommendations Against Directors 13-11
- Lack of Board Diversity 13-12
- Policies on Problematic Governance Structures & Problematic Capital Structures 13-14
- Different Glass Lewis Policies for Companies Recently Taken Public Via SPAC 13-15
- Policies on Shareholder Proposals Typically Factor-Based 13-16
- Policies Determined "Case-by-Case" Doesn't Mean Always Side With Investors 13-16
- ISS and Glass Lewis Have Multi-Factor Approach to Say-on-Climate Proposals 13-16
- ISS and Glass Lewis Focus on Board Accountability for Significant Greenhouse Gas Emitters 13-19
- ISS and Glass Lewis Focus on Company & Controversies for Racial Equity Audit Proposals 13-19
- Gender Pay Gap Proposals 13-20
- Shareholder Access Proposals Are Case-by-Case Determinations 13-21
- Officer Exculpation Proposals Focus on Board Rationale and Scope of Exculpation 13-22
- Director Pay Proposals Are Case-By-Case Determinations 13-22

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– Most Investors Don't Just Copy Proxy Advisor Policies As Their Own................13-23
– Smaller Investors May Outsource Voting Decisions 13-23

4. Proxy Voting Reports 13-24
– What Are "Voting Reports"?...13-24
– Timing of Voting Reports 13-25
– Importance of Voting Reports..13-25
– Companies Can Obtain Their ISS Voting Reports for Free; Must Pay for Glass Lewis Reports 13-25
– ISS Does Not Allow Companies to Review Draft Voting Reports.........................13-26
– Glass Lewis Allows Enrolled Companies 24-48 Hours to Review Data Points (But Not Draft Voting Reports) 13-26
– Proxy Advisors Don't Allow Sharing of Voting Reports.......................................13-26
– Voting Spikes After Voting Reports Released 13-27
– Proxy Advisors Look Beyond Proxy Materials for Company Information 13-27
– Reports Not Started From Scratch; Focus on Changes From Prior Years 13-27
– Proxy Advisors Do Cover 1st Annual Meetings After IPOs 13-28
– Proxy Advisors Do Cover Controlled Companies 13-28

5. Say-on-Pay Analysis 13-28
– "Failed" Say-on-Pay Vote Isn't Majority Vote "Against".......................................13-28
– Beware of Prior-Year Cautionary Support 13-29
– Investors May Immediately Vote Against Compensation Committee....................13-29
– ISS Review Process for Say-on-Pay: Quantitative Screen.....................................13-29
– FPA Screen Does Not Always Change Initial Quantitative Concern Level 13-30
– ISS Won't Always Give Negative Recommendation for Failing Quantitative Test 13-31
– ISS Closely Examines Qualitative Factors When Overall Quantitative Concern Level is "High" or "Medium".. 13-31
– Even "Low Concern" From ISS Can Result in Negative Recommendation...........13-32
– ISS Factors for Qualitative Screens 13-32
– ISS Reports Include GAAP Financial Metrics—But They Don't Affect Vote Recommendation 13-34
– Add EVA Metrics to Proxy Statement if Company Uses Them 13-35
– Glass Lewis Review Process for Say-on-Pay...13-35
– Glass Lewis Pay for Performance Process: Quantitative Assessment 13-35
– Glass Lewis Factors for Qualitative Screen 13-36
– Glass Lewis Policies on Contractual Arrangements..13-37
– Factors Affecting Glass Lewis Assessment of Incentive Plans..............................13-38
– Glass Lewis Reports Include Its Own Supplemental CEO Pay Calculations 13-38
– Proxy Advisors Use Proprietary Methods to Evaluate Say-on-Pay Proposals........13-39
– Consultants Help Understand Proxy Advisor Methods 13-39
– Companies Hiring ISS-Corporate Shouldn't Mention That...................................13-39

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– Negative Say-on-Pay Recommendation Doesn't Necessarily Cause Failed Vote ... 13-40
– Semi-Annual Windows for Peer Group Submissions ... 13-40
– Proxy Advisors Might Regularly Change Your Peer Group ... 13-40
– ISS Peer Groups Rely on "GICS" Classifications ... 13-41
– Glass Lewis Peer Groups Based on Several Factors ... 13-41
– Companies Struggling to Set Peer Groups Can Make Their Case ... 13-42
– Proxy Advisors Don't Require Companies to Use TSR as Performance Metric ... 13-42
– Be Aware of Adjusting Performance Metrics In Mid-Cycle ... 13-43
– Disclosure Practices to Help Make Your Case ... 13-44
– Options Are Performance-Based Depending on How Granted ... 13-45
– Proxy Advisors Rely on "Shareholder Engagement" Proxy Disclosures ... 13-45

6. Director Election Analysis ... 13-45
– Director Elections Always on Ballot for Annual Meetings ... 13-45
– Proxy Advisors Typically Recommend "For" Management Nominees ... 13-46
– Factors Triggering Recommend "Against" or "Withhold" Management Nominees ... 13-46
– Materially Adverse Unilateral Charter/Bylaw Amendments May Trigger ISS Vote "Against" Directors ... 13-47
– "Excessive" Outside Director Pay Means Top 2-3% of Comparable Directors ... 13-48

7. Handling Errors in Voting Reports ... 13-48
– Proxy Advisors Will Issue Corrected Reports for Material Errors ... 13-48
– Alert Top Shareholders Yourself If Recommendation Is Reversed ... 13-49
– Contacting ISS to Verify Data & Report Errors ... 13-49
– Contacting Glass Lewis to Verify Data & Report Errors ... 13-50
– Don't Bother Proxy Advisors With Immaterial Errors ... 13-50
– ISS's Data Verification Site ... 13-51

8. Handling Negative Recommendations ... 13-51
– Sometimes Negative Recommendations Inevitable ... 13-51
– Prepare in Advance and Maximize Proxy Statement Disclosure ... 13-52
– ISS Will Listen If You Want to Reverse Negative Recommendations ... 13-52
– Seek to Overturn Negative Recommendations Right Away ... 13-53
– ISS Won't Change Recommendation Five Business Days Before Annual Meeting ... 13-53
– Change By Company May Require Resolicitation ... 13-54
– Negative Recommendations Shouldn't Stop You From Engaging With Shareholders Directly ... 13-54
– Contact Shareholders as Soon as Possible ... 13-55

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– Responses Can Be Part of Supplemental Materials Filed With the SEC 13-55
– Use Experience to Improve Next Year's Disclosures 13-56
– Don't File Supplemental Materials Slamming Proxy Advisors; Be Proactive Instead 13-56
– Try to Avoid Supplemental Materials Altogether; Make Your Case Once 13-56
– Investors Don't Want to Hear You Complain About Proxy Advisors 13-56
– Glass Lewis Will Distribute "Feedback" on Reports (For A Cost) 13-56

9. Engagement With Proxy Advisors 13-57
– How to Set Up Meetings With Proxy Advisors 13-57
– Glass Lewis Won't Talk to Companies Once Proxy Statement Filed 13-57
– Meeting With ISS During Proxy Season Possible (But Difficult to Schedule) 13-58
– ISS Prefers Remote Meetings to In-Person Meetings 13-58
– Bring Right People to Meetings 13-58
– Don't Let Your Advisor Do All The Talking 13-59
– ISS Wants Directors to Participate in Engagement 13-59
– Inform the Board (or Board Committee) About Engagement Activity 13-59
– Send Your Presentation to Proxy Advisors In Advance of Meeting 13-59
– Know Proxy Advisor's Policies Before You Engage With Them 13-59
– Tell Your Story In Your Proxy Disclosures (Not Just During Meetings) 13-60
– Don't Expect Definitive Answers at Proxy Advisor Meeting 13-60
– Companies Shouldn't Violate Reg FD During Meetings 13-60

10. Common Questions & Our Analysis 13-61
– ISS Director Independence—Former Officer Classification 13-61
– ISS May Continue Recommending Against After Failed Attempt to Remedy 13-62

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1. Who Are the Proxy Advisors

ISS & Glass Lewis Are Biggest Proxy Advisors in U.S.

Most companies are keenly aware of the potential influence that proxy advisors like ISS and Glass Lewis can have on the outcome of proposals submitted to shareholders in their proxy materials. Many institutional investors look to these firms for guidance on how to vote their shares on director nominees, Say-on-Pay and other proposals requiring shareholder approval.

Proxy advisors have publicly available policies that are reviewed and updated annually that are used to guide their voting recommendations to their investor clients. They research and analyze volumes of company data in accordance with these policies to formulate these voting recommendations. The major proxy advisory firms run a volume business—ISS says that it covers approximately 42,000 meetings in 115 countries each year, while Glass Lewis says that it covers more than 30,000 meetings annually across approximately 100 global markets.

Note that this Chapter only deals with U.S. companies. In addition, this Chapter doesn't deal much with the governance or environmental and social ratings services of ISS, which are now called "ISS QualityScore" and "ISS ESG," or the ratings services of other ESG ratings firms such as MSCI. The main thing to know about these is that they're based on public information—so you should not only make sure that your various public disclosures don't conflict with one another (*e.g.,* SEC filings versus website reports), but also that your profile is up to date on outlets like Bloomberg. And if you notice an inaccuracy or if you're making a significant change to your policies, you can reach out to the ratings firms to discuss that.

ISS Structure & Capabilities

Founded almost four decades ago, ISS went public a decade ago and was then taken private a few years later. Since then, it has changed hands a few times. Most recently, the firm announced that Deutsche Börse AG purchased a majority interest in ISS from its then private-equity owner, Genstar Capital.

The U.S. Research team for ISS provides proxy analyses and voting recommendations for the common shareholder meetings of U.S. companies. A voting report is first drafted by a line analyst—and then is subject to review by a senior analyst. Since the U.S. team is organized by sector, the same line analyst typically reviews proxies filed by companies within the same industry—and may also review the same companies year after year.

The Compensation Team includes a half-dozen analysts, all of whom have considerable experience. All potential negative recommendations for Say-on-Pay are reviewed by one or more analysts from this group. Compensation analysts (and most sector analysts) receive focused and continuous training on general compensation concepts and practices, changing regulations, etc.

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Glass Lewis Structure & Capabilities

Founded over two decades ago, Glass Lewis has changed hands a few times and in early 2021, Glass Lewis announced it was acquired by Peloton Capital Management, a private equity firm, and Stephen Smith, a financial services entrepreneur. As of February 2024, Glass Lewis has over 380 employees, half of whom are dedicated to research.

Use of Contract Analysts During Proxy Season

From a cost-benefit analysis, it's not effective for ISS and Glass Lewis to keep numerous proxy analysts on staff throughout the year. So these proxy advisors bring in contract analysts during the proxy season and train them—and then they work under the supervision of more senior analysts. These seasonal analysts often are hired back year after year. Typically, about a dozen seasonal analysts are hired by the U.S. research group for ISS and a few dozen for Glass Lewis overall.

There's close supervision, with limitations on their "publication rights" so that no contract person is allowed to publish a report. They begin by putting the report together—and then it goes through several layers of editing in review by the more senior permanent analysts. So while proxy advisors do use contract help during the proxy season, it's done after significant training and close oversight. For ISS, most of the temporary help is on the data collection side.

2. Policy Setting & Availability

Nature of Proxy Advisor Policies

Proxy advisors provide voting recommendations to their investor clients in accordance with their policies. These policies are updated each year in late fall/early winter. Proxy advisors have an obligation to their clients—to give the best advice that they can and give it in a consistent, rational and defensible way.

The policies deal with items that appear on the ballots of companies for their annual meetings. As a result, the policies address those types of topics—and in the context for which they are on annual meeting ballots (in other words, a voting recommendation only addresses a topic if it's on that company's ballot—so it won't address a governance topic that applies to a company if there isn't something on the ballot that brings that topic up; director elections are always on the ballot but other topics generally are on the ballot only if there is a shareholder proposal about them for that particular year). Often, a topic will appear on a ballot in the form of a shareholder proposal—not a company proposal. Sometimes there's an exception as a handful of policies address areas of poor governance or high risk that may not be found on a proposal.

Proxy advisors also offer semi-customized policies based on potential proxy voting goals. ISS has what it calls "Specialty Policies" that are different from its standard Benchmark Policy: Board-Aligned Policy, Catholic-Faith Based Policy, Climate Policy, Public Fund Policy, Socially

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Responsible Investor (SRI) Policy, Sustainability Policy and Taft-Hartley Policy. Similarly, Glass Lewis also has the following “thematic voting policies”: Catholic, Climate, Corporate Governance Focused, ESG, Investment Manager, Public Pension, Taft-Hartley and Trust Bank. Something to keep in mind with the prevalence of custom policies from proxy advisors is the parallel trend of large institutional investors creating “pass-through” voting programs. As the pass-through voting concept begins to gain steam, proxy advisors such as ISS and Glass Lewis may become even more influential, particularly because the institutional investor pass-through voting program may allow investors to align their votes with an off-the-shelf policy from a proxy advisory firm.

Proxy Advisors’ Voting Advice is “Solicitation”

The SEC adopted rules in 2020 saying that proxy advisors’ voting advice constitutes a “solicitation” subject to the SEC’s proxy rules, but in response to a directive from SEC Chair Gary Gensler, Corp Fin announced that it was considering whether to recommend that the Commission revisit these 2020 rules. In November 2021, the SEC proposed to roll back some of these 2020 rules, and in July 2022, adopted the amendments rescinding certain 2020 rule changes. These 2022 amendments include rescinding the Rule 14a-2(b)(9)(ii) conditions to the proxy advisors’ proxy filing and disclosure exemptions, and removing examples of misleading information regarding proxy voting advice. However, the adopted amendments leave in place the 2020 rules establishing that proxy advisors’ voting advice is generally a “solicitation.”

Since proxy advisors’ voting advice constitutes a solicitation, it is also subject to Rule 14a-9, which prohibits false or misleading statements in proxy solicitations. The 2020 rules added examples in a note to Rule 14a-9 where failure to disclose material information that serves as the basis for a proxy advisory firms’ recommendations (*e.g.,* by explaining their methodology, information sources (and the extent to which they differ from company disclosures)) may be considered false & misleading. The 2022 rules delete these recently-added examples from Note (e) of Rule 14a-9—and the SEC clarified that proxy advisors would not be liable for having differing opinions or using discretion to rely on a particular analysis, methodology or set of information when formulating its recommendations. A proxy advisory firm would still be held liable if its advice contained a material misstatement or omission of fact, including with regard to its methodology, sources of information, or conflicts of interest. *See* Release No. 34-95266. While the 2022 rules are still in effect, there are several cases being litigated around both the 2020 and 2022 SEC rule changes and as of the time of this publishing, they are still unresolved.

Process for Annual Policy Updates

Each year, ISS starts its policy update process by asking investors—as well as companies and other interested parties—to weigh in on a policy survey regarding possible changes. This kicks off sometime in the summer or early fall. ISS might also hold roundtables during this period to get more input. After ISS conducts its annual policy survey, it publishes the results of that survey in the early to mid-fall.

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Then, in the late fall, ISS will release draft policies and request comment over a set period of time, generally over two weeks. ISS doesn't necessarily put all of its upcoming changes to its policies out for comment. For example, there might be policy changes for which it feels that it doesn't need input—or it already has enough input so that it doesn't need new input now.

A month or so after that, ISS issues its final policy updates. Occasionally, ISS will make further policy refinements a few months later if special circumstances warrant—even though that might make it tough for companies to respond in the midst of proxy drafting, etc. Unlike the ISS policies, there isn't necessarily a regular timeframe for when ISS FAQs are updated—but they update those as needed, particularly as they see a lot of questions in a certain area.

Glass Lewis historically has conducted a less formal process for annual voting policy updates, compared to ISS. On its "current policies" page, you can submit feedback on policy guidelines by emailing guidelinescomments@glasslewis.com. You can email Glass Lewis at any time. In 2023, Glass Lewis ran its inaugural Client Policy Survey, which sought feedback from more than 500 institutional investors, corporate issuers, corporate advisors, shareholder advocates and other stakeholders on specific governance, sustainability and executive compensation topics. It released the results in late fall 2023 prior to publishing its voting policies.

Transparency of ISS Policies

ISS has proxy voting guidelines for many markets—they're all posted on the ISS website under the broad categories of "Americas," "Europe, the Middle East & Africa," "Asia-Pacific" and, as mentioned above, "Specialty Policies." In 2023, ISS added a specialty policy titled "Global Board-Aligned Policy." Per ISS, the policy is "designed for clients interested in analyses and recommendations that allow companies to operate within the flexible framework of the laws, regulations and exchange requirements that govern them, while maintaining proper safeguards, including governance structures and practices, that foster and protect long-term value creation for shareholders." In addition, there's an Executive Summary each year that describes new and amended policies.

ISS's detailed voting manual isn't available on its website. The detailed voting manual is made available solely to clients (*e.g.,* institutional investors, proxy solicitors) and it provides a deeper dive with into the background of its policies, such as highlighting academic studies that may undergird a given policy.

ISS does post FAQs that address specific questions about the application of its policies. The FAQs are based on actual questions they have received from companies. The FAQs are divided into compensation & non-compensation topics—and the compensation FAQs are further categorized as Equity Compensation Plan FAQs, Compensation Policies FAQs, and documents explaining its Pay-for-Performance Mechanics and Peer Group methodology.

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Transparency of Glass Lewis Policies

Over the years, Glass Lewis has become more transparent with its policies. Until relatively recently, Glass Lewis wasn't transparent and even a summary of its policies wasn't publicly available. Now, it has a full set of guidelines for each of the markets it covers on GlassLewis.com.

Glass Lewis also has information regarding how it comes up with its pay-for-performance analysis, how it derives peers, how that works with its model and information on its stock plan analysis. Glass Lewis makes its Say-on-Pay analysis available through the platform of its data partner, CGLytics, which is accessible to investors as well as companies. Investors who use Glass Lewis's proxy voting platform can also integrate the CGLytics data into their own custom policies. However, Glass Lewis's own platform is still the exclusive access point for its research reports and voting recommendations.

Asking Questions About Policies

For ISS, companies and advisors can ask questions through the "ISS Help Center"—an online portal available to registered users, which also includes FAQs and other resources. There is no mechanism to ask questions on an anonymous basis other than going through a third-party like a proxy solicitor or compensation consultant.

ISS also has a "Feedback Review Board" to which companies can submit commentary through an online form: http://www.issgovernance.com/contact/feedback-review-board/. The Feedback Review Board deals primarily with research accuracy—it's not the avenue for submitting comments on policies or the annual survey, nor to ask policy questions or lobby vote a change in recommendations. Those communications should go through the ISS Help Center.

In addition, ISS conducts an annual survey each Summer through which stakeholders are invited to submit comments. ISS also maintain two verification portals online as discussed below.

For Glass Lewis, companies can ask questions at info@glasslewis.com or 888.800.7001, or via forms available on Glass Lewis's website. Glass Lewis typically won't engage with companies during the solicitation period, which lasts between the date that a notice of meeting is released (*i.e.,* filing of a preliminary or definitive proxy statement) until the meeting date itself. Glass Lewis has a "report inaccuracies" page on its website—and maintains a data verification portal that allows companies to verify key factual points central to the Glass Lewis analysis for corporate governance matters and other voting items.

Proxy Advisors Obtain Policy Input From All Investors (Not Just Loudest Ones)

One thing that's not true is that only the "activist" investors (*i.e.,* pension funds and unions) provide input into the proxy advisors policies because they have strong views. The reality is that ISS and Glass Lewis listen to all of their clients including major institutional investors who might be quieter—but they still have ongoing discussions with these proxy advisors about policy

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updates. They are actively involved in providing input on policies and telling them what they like and don't like, just in a quieter manner.

ISS Doesn't Always Side With Investors (Even Though They Are Clients)

One myth is that there's no point in talking to ISS about its policies (or answering the ISS survey) because they don't listen to companies, only its investor clients. ISS does indeed take the input that companies provide on policies into account.

ISS's QualityScore Not Directly Related to Policies

For years, ISS has issued corporate governance ratings. The name of this product has changed a few times over the past decade—it currently is called "QualityScore." In 2018, ISS launched an Environmental & Social QualityScore in addition to its existing Corporate Governance QualityScore. The top-line scores are included in ISS's proxy research reports.

These corporate governance and E&S ratings are not the same as voting policies, although they inevitably align with each other somewhat since they both strive to push companies to adopt sound governance practices. So it's possible to achieve a high QualityScore rating and yet still receive a negative voting recommendation—and vice versa. The two are not tied together.

In 2023, ISS also announced the launch of the ISS ESG Cyber Risk Score, which covers the S&P 400, S&P 500, S&P 600 and Russell 3000 companies. For the 2023 proxy season, the Cyber Risk Score will be included to ISS's Benchmark Governance Research and Voting reports for S&P 500 companies, but only for informational purposes.

Glass Lewis Reports Not Directly Related to Policies

Glass Lewis has a variety of reports and reports under their "Governance Hub." They have the issuer-specific data report, or IDR—which is a data-only version of Glass Lewis's report prior to their publication of its proxy paper to its clients, and doesn't include any analysis or voting recommendations. Glass Lewis's analysis and voting recommendations are issued in their Proxy Paper research report, which companies need to purchase to view. The Proxy Paper research reports also include an "ESG Profile," Sustainalytics ESG risk ratings and cyber risk security ratings (from BitSight).

These reports and papers are not the same as their general voting policies, although they inevitably align with each other somewhat since they both strive to push companies to adopt sound governance practices. So it's possible to achieve a high rating and yet still receive a negative voting recommendation—and vice versa. The two are not tied together.

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3. Policy Application

Common Reasons for Negative Recommendations Against Directors

It's not uncommon for proxy advisors to issue a negative recommendation against one or more directors at a company when they are up for election (or re-election). Common sticking points include:

- Lack of independence—not meeting a proxy advisor's independence definitions while serving on a key board committee
- Overboarding—serving on more than a specified number of boards
- Majority vote shareholder proposal—failing to act after a shareholder proposal received a majority vote in the prior year
- Poison pill—adopting a poison pill without shareholder approval
- Poor attendance—failure to disclose director records for board and committee attendance or failure to attend at least 75% of the board and committee meetings (other than "new" directors)
- Adopting a frequency different from the frequency approved by the plurality of shareholders (factor for Glass Lewis)
- "Excessive" non-employee director pay without a "compelling rationale" for two or more consecutive years (ISS)
- Failure to respond to shareholders of more than 20% of shares voting contrary to management recommendations (contributing factor for Glass Lewis)
- Failure to include at least one woman on the board
- Problematic governance structures, pledging arrangements, audit or compensation practices, etc.
- Exclusion of shareholder proposals (Glass Lewis expects companies to include all shareholder proposals except if the SEC has explicitly concurred with a company's argument that it can be excluded)
- Material failure of risk oversight, which includes, but isn't limited to, hedging of company stock by executives and poor risk oversight of environmental and social issues, including climate change
- Failure to disclose remediation plan for a material weakness or if a material weakness has been ongoing for more than one year, failure to disclose an updated remediation plan outlining the company's remediation progress (factor for Glass Lewis)

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- Insufficient or absence of board oversight, response or disclosures concerning an instance where a company has been materially impacted by a cyber-attack (factor for Glass Lewis)
- Inadequate disclosure about shareholder participation rights in virtual shareholder meetings (Glass Lewis)
- Inadequate disclosure of related party transactions (Glass Lewis)

Lack of Board Diversity

Board gender diversity. ISS will generally recommend "against" or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where there are no women on the company's board. ISS will make an exception if there was a woman on the board at the preceding annual meeting and the board makes a firm commitment to return to a gender-diverse status within a year.

For companies in the Russell 3000 index, Glass Lewis will generally recommend against the nominating committee chair if the board is not at least 30% gender diverse. Glass Lewis will also generally recommend voting against all members of the nominating committee of a Russell 3000 company board with no gender diverse directors. For companies outside of the Russell 3000 index, Glass Lewis will recommend voting against the nominating committee chair if there are no gender-diverse directors on the board. "Gender diverse" means women and directors that identify with a gender other than male or female.

Glass Lewis also cautioned that its recommendations may spread to additional nominating committee members depending on the existence of a classified board, or other factors including applicable state laws, the company's size and industry, and the company's overall governance profile.

Additionally, Glass Lewis will carefully review a company's disclosure of its diversity considerations and may refrain from recommending votes against directors when boards have provided a sufficient rationale or plan to address the lack of board diversity, including "a timeline of when the board intends to appoint additional gender diverse directors (generally by the next annual meeting or as soon as reasonably practicable)."

Previously, California's Senate Bill 826 and Assembly Bill 979 imposed certain board diversity requirements on public companies headquartered in California. Since 2022, these laws have been in the appeals process after being held to violate the equal protection clause of the California state constitution. As a result, Glass Lewis will be refraining from providing recommendations pursuant to these state laws—but will continue to monitor compliance with such laws.

Board racial/ethnic diversity. ISS will recommend "against" the chair of the nominating committee (or other directors on a case-by-case basis) at Russell 3000 or S&P 1500 index companies where the board has no apparent racially or ethnically diverse members. ISS will make an exception if there was racial and/or ethnic diversity on the board at the preceding annual

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meeting and the board makes a firm commitment to appoint at least one racial and/or ethnic diverse member within a year.

Glass Lewis will generally recommend voting against the nominating committee chair of a Russell 1000 company with fewer than one director from an "underrepresented community" on the board. Glass Lewis defines "underrepresented community" as an individual who self-identifies as Black, African American, North African, Middle Eastern, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian or Alaskan Native, or who self-identifies as a member of the LGBTQIA+ community. Glass Lewis solely looks at self-identified demographic information as disclosed in proxy statements.

Glass Lewis's recommendations may extend to additional members of the nominating committee if the committee chair isn't standing for election due to a classified board, or based on other factors (similar to its approach on gender diversity).

Similar to Glass Lewis's policy on board gender diversity, Glass Lewis will carefully review a company's disclosure of its diversity considerations and may refrain from recommending votes against directors when boards have provided a sufficient rationale or plan to address the lack of board diversity, including a timeline of when the board intends to appoint additional directors from an underrepresented community (generally by the next annual meeting or as soon as reasonably practicable).

Previously, California's Senate Bill 826 and Assembly Bill 979 imposed certain board diversity requirements on public companies headquartered in California. Since 2022, these laws have been in the appeals process after being held to violate the equal protection clause of the California state constitution. As a result, Glass Lewis will be refraining from providing recommendations pursuant to these state laws—but will continue to monitor compliance with such laws.

Glass Lewis's Approach on Director Diversity and Skill Disclosures

Glass Lewis also reviews disclosure of director diversity and skills in companies' proxy statements. Glass Lewis generally looks at four categories: "(i) the board's current percentage of racial/ethnic diversity; (ii) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity; (iii) whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (aka "Rooney Rule"); and (iv) board skills disclosure." This helps Glass Lewis assess a company's overall governance, and may be a contributing factor in its recommendations when additional board-related concerns have been identified.

If Russell 1000 companies haven't provided any disclosure in any of the above categories, Glass Lewis will generally recommend voting against the chair of the nominating and/or governance committee. Further, when Russell 1000 companies haven't provided any disclosure of individual or aggregate racial/ethnic minority board demographic information, Glass Lewis will generally recommend voting against the chair of the nominating and/or governance committee.

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Glass Lewis will also recommend voting against the governance committee chair of Nasdaq-listed companies if required Nasdaq diversity matrix disclosure isn't provided.

Bear in mind that your goal should be to achieve much more than a majority vote for each director. Some of the larger investors take the position that directors who receive less than 70% of votes will be a target during the next proxy season.

Policies on Problematic Governance Structures & Problematic Capital Structures

For some "problematic" governance structures, ISS has different voting recommendations for companies that held their first annual meeting after February 1, 2015—including those emerging from SPAC transactions, direct listings and IPOs. If these companies (or their boards), prior to or in connection with their public offerings, adopted bylaw or charter provisions implementing (1) a supermajority vote requirement to amend the bylaws or charter, (2) a classified board structure or (3) other "egregious" provisions, ISS will vote against or withhold from directors individually, committee members, or the entire board, except for new nominees, who would be considered on a case-by-case basis. ISS will consider a sunset provision within 7 years of the date of going public as a mitigating factor. Unless such adverse provision is reversed or removed, ISS will vote case-by-case on director nominees in subsequent years.

Previously, ISS's policy on unequal voting rights was limited to newly public companies (*i.e.*, ISS previously grandfathered in older companies with unequal voting rights). As mentioned above, ISS will generally vote against directors individually, committee members, or the entire board (except new nominees that are considered on a case-by-case basis), if a company employs a common stock structure with unequal voting rights—regardless of whether the company is newly public or not. The policy does give a few exceptions, including for newly public companies with a sunset provision of no more than 7 years from the date of going public. In a TheCorporateCounsel.net webcast regarding ISS's forecast for the 2023 proxy season, Marc Goldstein of ISS stated that:

> "[ISS] will be issuing adverse recommendations generally aimed at members of the governance committee and any directors who themselves are beneficiaries of the unequal voting rights structure, *i.e.*, through holding shares with super voting rights. Now, there are some companies where the public shareholders only elect certain directors, not the entire board, so who's on the ballot determines the available targets. That's going to be the intended targeting—members of the governance committee plus the beneficiaries of the system."

Per ISS's FAQ: Procedures & Policies (Non-Compensation), shareholder approval of poor governance provisions at the de-SPAC transaction will not impact ISS's future recommendations on the company. ISS noted that these votes don't necessarily reflect the public company shareholder base due to the redemption/warrant mechanics of the de-SPAC transactions.

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Glass Lewis will generally recommend against the governance committee chair when a company has a multi-class share structure and unequal voting rights without a reasonable sunset provision (also seven years or less).

Glass Lewis generally refrains from making recommendations on the basis of a company's governance standards during the one-year period post-IPO—but it may depend on Glass Lewis's evaluation of whether the governing documents are severely restricting shareholder rights indefinitely. However, in the case of a board that adopts a multi-class share structure in connection with an IPO, spin-off or direct listing within the past year, Glass Lewis will "generally recommend voting against all members of the board who served at the time of the IPO if the board: (i) did not also commit to submitting the multi-class structure to a shareholder vote at the company's first shareholder meeting following the IPO; or (ii) did not provide for a reasonable sunset of the multi-class structure (generally seven years or less)."

It's important to also be mindful of board responsiveness issues related to voting proposals. For companies with multi-class share structures with unequal voting rights, Glass Lewis will examine the level of approval or disapproval attributed to unaffiliated shareholders on a "one share, one vote" basis when determining whether board responsiveness is warranted.

Different Glass Lewis Policies for Companies Recently Taken Public Via SPAC

SPACs are short for "special purpose acquisition company," or a publicly traded company created for the sole purpose of entering into a business combination with an existing (usually private) company. Glass Lewis sees this business combination (aka a "de-SPAC transaction") as a private company's "de-facto IPO"—and quite a few private companies took advantage of the de-SPAC transaction process to go public from 2020 to 2021. Glass Lewis has a section to address governance practices that these companies may have adopted prior to their "de-facto" IPOs where it warns that some cases warrant shareholder action against the board of a company that has completed a business combination with a SPAC within the past year.

In cases where, prior to the combined company becoming publicly traded, the board adopts a multi-class share structure with unequal voting rights or an anti-takeover provision, Glass Lewis generally recommends voting against all members of the board who served at the time of the combined company becoming publicly traded if such board: "(i) did not also submit these restrictive provisions to an advisory shareholder vote at the prior shareholder meeting approving the business combination; (ii) did not also commit to submitting these provisions to a shareholder vote at the company's first shareholder meeting following the company becoming publicly traded; or (iii) did not provide for a reasonable sunset of these provisions."

Unlike operating companies' executives who have their hands full managing an entire business, SPAC executives are primarily involved in identifying acquisition targets for the SPAC. Glass Lewis recognizes this distinction and only recommends voting against a director who serves as a SPAC executive only if he or she serves on more than five public company boards.

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Policies on Shareholder Proposals Typically Factor-Based

For the policies that address shareholder proposal topics, proxy advisors typically recommend on a "case-by-case" basis "for" or "against" proposals based on a list of factors. For those proposal topics addressed by factors, the same type of shareholder proposal at two different companies may result in two opposite recommendations since it's a facts and circumstances analysis.

In addition, for some proposal topics, proxy advisors can apply their policies strictly. In these areas, companies tend to adopt corporate policies that mirror what the proxy advisor expects to avoid a negative recommendation.

Policies Determined "Case-by-Case" Doesn't Mean Always Side With Investors

In the shareholder proposal area, some proxy advisor policies indicate that it's a case-by-case determination. When evaluating a shareholder proposal, proxy advisors focus on the actual proposal and the facts and circumstances at the company—and apply their policies. It's a real case-by-case determination.

For shareholder proposals, proxy advisors historically didn't pay a lot of attention to the identity of the proponent. Instead, they focus on the shareholder proposal's subject matter. And not that it's relevant, but many proposals are submitted by retail investors—not the institutional investors that are the clients of the proxy advisors. In 2023, Glass Lewis stated that it will recommend voting against the governance committee chair if companies don't provide clear disclosure regarding the identity of the shareholder proponent, given the increasing number of shareholder proposals. Certain investors, including the Council of Institutional Investors, have started to request the same, and this may be helpful information especially in the context of anti-ESG proposals that have similar-sounding resolutions as those of ESG proposals.

ISS and Glass Lewis Have Multi-Factor Approach to Say-on-Climate Proposals

The proxy advisors often take a more "case-by-case" approach to environmental and social responsibility proposals, compared to governance proposals, but both ISS and Glass Lewis have codified their approach to certain categories of E&S shareholder proposals. ISS uses its codified framework for analyzing both management-offered and shareholder-offered "Say-on-Climate" proposals—but sticks to its "case-by-case" approach.

For management Say-on-Climate proposals—which are typically proposals asking shareholders to approve a company's climate transition plan—ISS looks at the following (non-exhaustive!) factors to come to a case-by-case recommendation:

- "The extent to which the company's climate related disclosures are in line with TCFD recommendations and meet other market standards;
- Disclosure of its operational and supply chain GHG emissions (Scopes 1, 2, and 3);

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- The completeness and rigor of company's short-, medium-, and long-term targets for reducing operational and supply chain GHG emissions in line with Paris Agreement goals (Scopes 1, 2, and 3 if relevant);
- Whether the company has sought and received third-party approval that its targets are science-based;
- Whether the company has made a commitment to be "net zero" for operational and supply chain emissions (Scopes 1, 2, and 3) by 2050;
- Whether the company discloses a commitment to report on the implementation of its plan in subsequent years;
- Whether the company's climate data has received third-party assurance;
- Disclosure of how the company's lobbying activities and its capital expenditures align with company strategy;
- Whether there are specific industry decarbonization challenges; and
- The company's related commitment, disclosure, and performance compared to its industry peers."

For shareholder Say-on-Climate proposals—which are typically proposals requesting companies to publish their emissions report or to put their transition action plans to a vote—ISS looks at a shorter list of factors to come to a case-by-case recommendation:

- "The completeness and rigor of the company's climate-related disclosure;
- The company's actual GHG emissions performance;
- Whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to its GHG emissions; and
- Whether the proposal's request is unduly burdensome (scope or timeframe) or overly prescriptive."

In contrast, Glass Lewis does not outline factors in evaluating "Say-on-Climate" proposals in its general Benchmark Policy. Instead, Glass Lewis describes its overall approach to environmental (and social) issues which is to evaluate them through the lens of "long-term shareholder value" and "in the context of the financial materiality of the issue to the company's operations" and therefore in context of board oversight of risk. When management and the board have displayed disregard for environmental risks, have engaged in egregious or illegal conduct, or have failed to adequately respond to current or imminent environmental risks that threaten shareholder value, Glass Lewis advises that shareholders should consider holding directors accountable. In addition, or alternatively, depending on the proposals presented, Glass Lewis may also consider recommending voting in favor of relevant shareholder proposals or against other relevant

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management-proposed items, such as the ratification of auditor, a company's accounts and reports, or ratification of management and board acts.

To find Glass Lewis's framework for analyzing both management-offered and shareholder-offered "Say-on-Climate" proposals, look for its "Shareholder Proposals & ESG-Related Issues" guidelines in the Benchmark Policy by Market section of its website.

For management Say-on-Climate proposals seeking approval of climate transition plans, Glass Lewis states that where disclosure regarding the governance of the Say-on-Climate proposal isn't present, Glass Lewis will either recommend that shareholders abstain or vote against the proposal, depending on the quality of the climate transition plan. However, regardless of such disclosure, Glass Lewis evaluates the quality of the climate transition plans on a case-by-case basis. Glass Lewis takes the following factors into account:

- "(i) the request of the resolution (*e.g.,* whether companies are asking shareholders to approve its disclosure or its strategy);
- (ii) the board's role in overseeing the company's climate strategy;
- (iii) the company's industry and size;
- (iv) whether the company's GHG emissions targets and the disclosure of these targets appear reasonable in light of its operations and risk profile; and
- (iv) where the company is on its climate reporting journey (*e.g.,* whether the company has been reporting and engaging with shareholders on climate risk for a number of years or if this is a relatively new initiative)."

Glass Lewis generally recommends against shareholder Say-on-Climate proposals, noting its general belief that a company's business strategy (which shouldn't be separate from the long-term climate strategy) should be set by the board—but will potentially consider the following factors:

- "(i) the request of the resolution;
- (ii) the company's existing climate governance framework, initiatives, and reporting;
- (iii) the company's industry and size; and
- (iv) the company's exposure to climate-related risks."

Regardless of Glass Lewis's concerns, it is supportive of company disclosure regarding climate-related risks and opportunities, and has a separate approach for shareholder requests of climate transition plans (vs. proposals asking to vote on these plans).

With Staff Legal Bulletin No. 14L paving the way for more environmental proposals to potentially land on a ballot, companies will need to pay close attention to climate disclosures going forward. Ultimately, proxy advisors and their clients will be looking through the lens of long-term value creation and risk mitigation. Note some of the factors that might require more

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internal lead time, including time required to lining up appropriate third-party approval, and shaping up disclosure controls to validate climate-related data.

ISS and Glass Lewis Focus on Board Accountability for Significant Greenhouse Gas Emitters

ISS focuses on "significant greenhouse gas emitter" companies, defined as those on the Climate Action 100+ focus group list—which list you can find at https://www.climateaction100.org/whosinvolved/companies/. For these specific companies, ISS generally recommends voting against or withholding from the incumbent chair of the responsible committee (and other directors as appropriate) if a company isn't taking the "minimum steps" to understand, assess and mitigate climate-related risks.

The minimum steps companies need to take are: (1) having detailed disclosure of climate-related risks, such as according to the Task Force on Climate-related Financial Disclosures (TCFD) framework, and (2) appropriate GHG emissions reductions targets. ISS defines "appropriate GHG emissions reductions targets" as medium-term GHG reduction targets or Net Zero by 2050 GHG reduction targets for a company's operations (Scope 1) and electricity use (Scope 2). These GHG targets need to cover the vast majority of the company's direct emissions.

In 2023, Glass Lewis added a policy on board accountability for climate-related issues which was applied to the largest, most significant emitters; however, beginning in 2024, Glass Lewis will apply this policy to companies in the S&P 500 index operating in industries where the Sustainability Accounting Standards Board (SASB) has determined that the companies' GHG emissions represent a financially material risk, as well as companies where Glass Lewis believes emissions or climate impacts, or stakeholder scrutiny thereof, represent an outsized, financially material risk. Companies with such increased risk exposure—for example, the Climate Action 100+ companies—should have clear and comprehensive disclosure in line with the TCFD framework. Glass Lewis also expects these companies' boards to have explicit and clearly defined oversight responsibilities for climate-related issues. If Glass Lewis finds either of these disclosures to be absent or significantly lacking, they may recommend voting against the chair of the committee (or board) charged with oversight of climate-related issues (or if no committee is charged with such oversight, the governance committee chair). Glass Lewis may extend its recommendation to additional members of the responsible committee if the committee chair isn't standing for election or based on other factors.

ISS and Glass Lewis Focus on Company & Controversies for Racial Equity Audit Proposals

ISS is using its codified framework for analyzing shareholder proposals on racial equity and/or civil rights audit guidelines—and similar to its approach on other E&S proposals, ISS is sticking to its "case-by-case" approach. Racial equity audits generally analyze a company's policies, practices and products to combat systemic racism. The factors ISS looks at are listed below—and there seems to be an emphasis on the company's historical actions:

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- "The company's established process or framework for addressing racial inequity and discrimination internally;
- Whether the company adequately discloses workforce diversity and inclusion metrics and goals;
- Whether the company has issued a public statement related to its racial justice efforts in recent years, or has committed to internal policy review;
- Whether the company has engaged with impacted communities, stakeholders, and civil rights experts;
- The company's track record in recent years of racial justice measures and outreach externally; and
- Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to racial inequity or discrimination."

When analyzing these proposals, Glass Lewis states in its "Shareholder Proposals & ESG-Related Issues" guidelines that it will assess: "(i) the nature of the company's operations; (ii) the level of disclosure provided by the company and its peers on its internal and external stakeholder impacts and the steps it is taking to mitigate any attendant risks; and (iii) any relevant controversies, fines, or lawsuits." After taking these factors into account, Glass Lewis will generally recommend in favor of "well-crafted" proposals when it believes that doing so could help the company identify and mitigate potentially significant risks.

<u>Gender Pay Gap Proposals</u>

ISS and Glass-Lewis typically take a case-by-case approach in determining their voting recommendations.

ISS considers the company's current policies and disclosure related to diversity and inclusion policies and practices and its compensation philosophy and fair and equitable compensation practices; whether the company has been subject to recent controversy, litigation or regulatory action related to gender, race or ethnicity pay gap issues; the company's disclosure regarding gender, race, or ethnicity pay gap policies or initiatives compared to its industry peers; and local laws regarding categorization of race and/or ethnicity and definitions of ethnic and/or racial minorities.

Glass Lewis states in its "Shareholder Proposals & ESG-Related Issues" guidelines that it reviews proposals requesting a company reports on efforts being made to ensure pay parity on a case-by-case basis and will consider:

(i) The company's industry;

(ii) The company's current efforts and disclosure with regard to gender pay equity;

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(iii) Practices and disclosure provided by a company's peers concerning gender pay equity; and

(iv) Any legal and regulatory actions at the company.

Glass Lewis will consider supporting well-crafted shareholder resolutions requesting more disclosure on the issue of gender pay equity in instances where the company has not adequately addressed the issue and there is some evidence to suggest that such inattention could present a risk to the company's operations and/or shareholders.

Glass Lewis considers proposals requesting a company disclose its median gender pay ratio on a case-by-case basis but where a company has provided sufficient information concerning its diversity initiatives as well as information concerning how it ensures women and men are paid equally for equal work, it will typically recommend voting against the proposal.

Shareholder Access Proposals Are Case-by-Case Determinations

The two mechanisms for shareholders to access companies outside of the regular meeting calendar are written consent and special meetings. A lot of companies don't have either—and if you don't have either one, you're vulnerable to a proposal. ISS believes there should be a mechanism for shareholders to access the management team in between annual meetings for egregious time-sensitive situations that just can't wait for the annual meeting.

For proposals seeking a right for written consent, ISS takes a case-by-case approach even though it seems like a right that all shareholders should have. Sometimes companies do have extenuating circumstances, such as the company doesn't have a strong fortress of takeover defenses already or it's got a significant shareholder. For that type of exception, ISS might recommend against a proposal.

Note that when this type of proposal first came out, a group of companies got together and decided that they need to explain this to the proxy advisors. They were able to convince ISS that written consents are a fairly complicated concept when you sit down and look at how they work in practice. So this is a good example of how ISS does indeed take corporate input into account.

ISS will generally recommend a vote for management or shareholder proposals that provide shareholders with the ability to call special meetings and recommend a vote against management or shareholder proposals to restrict or prohibit shareholders' ability to call special meetings.

Glass Lewis is generally supportive of shareholders' right to act by written consent. However, Glass Lewis believes that special meetings are preferable to actions by written consent, so if a company has a special meeting threshold of 15% or below and has reasonable proxy access provisions, Glass Lewis will generally recommend against the written consent proposal. If the company already has a written consent provision, Glass Lewis will also generally recommend in favor of lowering the written consent ownership threshold if the company has no special meeting provision, or has a 15%+ ownership threshold for a special meeting. Glass Lewis will generally

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recommend against a proposal to lower the ownership threshold for a written consent if the company has a 15% or lower special meeting threshold.

Officer Exculpation Proposals Focus on Board Rationale and Scope of Exculpation

In August 2022, amendments to Delaware General Corporation Law's Section 102(b)(7) allowed companies to adopt a charter provision to eliminate or limit the personal liability of certain executive officers for fiduciary duty of care breaches. Such exculpation provisions don't apply, among others, to derivative actions or to any claims for fiduciary duty of loyalty breaches.

Glass Lewis will evaluate these officer exculpation provisions on a case-by-case basis, but will generally recommend voting against such proposals unless the board provides a "compelling rationale" and the provisions are "reasonable." While there were no examples given of either a "compelling rationale" or "reasonable provisions" directly in its 2023 policy, Glass Lewis shared in a webcast that an example of a compelling rationale would be confirmed difficulty in hiring or keeping executives—not that it *may* be more difficult. Exculpation provisions aligned with Delaware law would be reasonable.

ISS stated that it will vote case-by-case on officer exculpations, considering the stated rationale and the extent to which each proposal would:

- "Eliminate directors' and officers' liability for monetary damages for violating the duty of care.
- Eliminate directors' and officers' liability for monetary damages for violating the duty of loyalty.
- Expand coverage beyond just legal expenses to liability for acts that are more serious violations of fiduciary obligation than mere carelessness.
- Expand the scope of indemnification to provide for mandatory indemnification of company officials in connection with acts that previously the company was permitted to provide indemnification for, at the discretion of the company's board (*i.e.,* "permissive indemnification"), but that previously the company was not required to indemnify."

ISS expressed concern with other state laws (*i.e.,* Nevada) and noted that provisions to extend exculpation to violations of the duty of loyalty won't generally be supported, even if permitted under state law.

Director Pay Proposals Are Case-By-Case Determinations

ISS takes a case-by-case approach to management proposals that seek ratification of non-employee director compensation. Its recommendation is based on whether it supports the equity plan under which director grants are made (if that's also on the ballot)—and these qualitative factors:

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- How director pay compares to peers
- Presence of problematic pay practices relating to director compensation
- Director stock ownership guidelines and holding requirements;
- Equity award vesting schedules;
- Mix of cash & equity-based compensation
- Meaningful limits on director compensation

Most Investors Don't Just Copy Proxy Advisor Policies As Their Own

Institutional investors have a fiduciary obligation to vote for what they believe ultimately is going to be the best interests of their beneficiaries. This is based upon an ERISA interpretive position taken by the Department of Labor and an SEC rule that requires registered investment advisers to have policies reasonably designed to ensure voting in the best interests of clients—including policies to address conflicts of interest. In turn, many investors rely on proxy advisors by hiring them to provide guidance about how they should vote.

The level of reliance depends on the investor. Most of the larger investors—and some smaller investors too—have corporate governance departments and their own policies and guidelines. So they have the resources to make their own full evaluation of each proposal. For them, they only look at proxy advisor policies—in many cases, both ISS and Glass Lewis—as one source of many sources of information during their evaluation. Since these tend to be the larger investors, the vast majority of assets out there use their own policies.

Even if they rely on a proxy advisor for voting recommendations, investment advisors who vote on behalf of clients have to demonstrate that they're making voting determinations in the client's best interest and in accordance with the investment advisor's own voting policies & procedures—and they have to be on the lookout for factual errors and methodological weaknesses in the proxy advisor's analysis. Investment advisors should also consider the effectiveness of the proxy advisor's policies and procedures for gathering current and accurate information relevant to matters included in its research reports and on which it makes voting recommendations.

Smaller Investors May Outsource Voting Decisions

Some investors don't have a dedicated proxy/governance group, so they rely on proxy advisory policies as a "default," also called "robo-voting." But even those investors will typically have a mechanism where the portfolio manager can override a proxy advisor recommendation if that's in the best interest of their investment. These leanly staffed investors include mere index funds or smaller public pensions managing only $1-2 billion that tend to outsource many of their functions, including their investment managing function.

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For those that outsource, many of those investment managers may be buying in the same company—and if they let those investment managers make all those voting decisions, they could potentially be canceling each other's votes out. In those situations, they retain the discretion on those votes and then tend to follow a proxy advisor recommendation because it's more aligned with their own perspectives.

So it's not uncommon for the same investment firm to have different policies if different funds have different strategies. It can be difficult to figure out because you're held by this entity—but it's actually this fund within this entity. So it's not just a blanket policy, but it's a particular policy.

One of the biggest criticisms of fully outsourced voting decisions has been a perceived increase in "robo-voting"—that is, where the investment adviser utilizes a proxy advisory firm's electronic vote management system that "pre-populates" the adviser's ballots with suggested voting recommendations or for voting execution services. Companies may be able to estimate the number of shares voted this way based on how many voted in line with an ISS or Glass Lewis recommendation in the 24-hour period after the recommendation is issued.

In 2014, the SEC's Division of Investment Management and Division of Corporation Finance issued Staff Legal Bulletin #20, which clarifies that investment advisers are required to vote in accordance with their clients' wishes—and that they must establish policies and procedures to do so. This may include retaining proxy advisors that have proper resources and robust policies and procedures regarding conflicts of interest—and that provide voting recommendations based on accurate information. Under SLB #20, investment advisors should investigate any material factual errors made by proxy advisors that affect voting recommendations.

4. Proxy Voting Reports

What Are "Voting Reports"?

"Voting reports" are the vehicles through which proxy advisors provide recommendations for each meeting agenda item—along with analysis for each item—to their investor clients. Voting reports also are referred to as "proxy research."

The reports vary in length depending on the complexity and number of matters on a company's ballot. On the cover, ISS lists whether its recommendation is "For" or "Against" the items covered in the report. The reports average about 10-15 pages in length, with the first few pages spent on background information on the company before it gets into an item-by-item analysis of ballot proposals. A negative recommendation tends to result in longer analysis for that agenda item as the proxy advisor endeavors to supports its position.

For ISS, each report passes through at least two analysts—and data (excluding third-party data) is reviewed separately as well. The U.S. Research team for ISS is organized among six industry sectors and several topic specialty teams, including Compensation, M&A, and E&S. A voting

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report is first drafted by a line analyst—and then is subject to review by a senior analyst. Since the U.S. team is organized by sector, the same line analyst typically reviews proxies filed by companies within the same industry—and may also review the same companies year after year.

For Glass Lewis, there are multiple layers of editing and input, with at least three sets of eyes on each Russell 3000 company's report, including at least two layers of editing.

Note the voting reports of proxy advisors are exempt from the filing and disclosure requirements of the SEC's proxy rules as highlighted in Staff Legal Bulletin #20.

Timing of Voting Reports

During the height of the proxy season (April—June), ISS reports are typically delivered 13-18 days before the shareholder meeting—*i.e.,* about 2-4 weeks after definitive proxy materials are filed. Outside of that timeframe, ISS aims to deliver reports about a month ahead of time. Other factors that affect the timing include the complexity of the proxy & agenda items, contentiousness of the issues and any engagement required. Voting reports for proxy contests are also usually delivered closer to the meeting because there may be significant late developments. ISS doesn't review preliminary proxy materials.

Glass Lewis aims to deliver reports an average of three weeks before a meeting.

Importance of Voting Reports

There is an ongoing debate about the influence of proxy advisors. However, there definitely is some influence, particularly because the circumstances leading to a negative proxy advisor recommendation would likely lead an investor to reach that same conclusion on its own. However, it's possible to have an agenda item pass despite a negative recommendation—as well as an agenda item fail even though proxy advisors blessed it.

There is no denying that a favorable recommendation is a good goal to have. A favorable recommendation may well lead many investors to not even bother to read your proxy statement—and a negative one can lead to intense scrutiny.

Companies Can Obtain Their ISS Voting Reports for Free; Must Pay for Glass Lewis Reports

Voting reports are not publicly available—they are only available for purchase with an exception that ISS provides a final voting report to any company it covers if they sign up to receive them.

In comparison, Glass Lewis provides final voting reports only if they are purchased (and they are pricey—up to $6,000).

Typically, only investors and consultants who help companies (*i.e.,* proxy solicitors, compensation consultants and some law firms) buy voting reports.

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Note that leaks to the media about recommendations—particularly negative ones—do happen on occasion, particularly for high profile companies or situations.

ISS Does Not Allow Companies to Review Draft Voting Reports

Companies can correct errors in their ISS proxy voting reports—they just can't do that before their voting report is released to ISS clients.

ISS doesn't allow companies to review draft voting reports, and it's rare for ISS to change its voting recommendation based on company comments.

Two notes about ISS not related to its voting reports. First, Russell 3000 companies are able to review QualityScore data before ISS releases governance ratings for them (though through a view of individual data points rather than through a draft report). Second, all U.S. companies (or companies subject to U.S. policy) can review data that ISS has collected related to equity plans that will be on the ballot for shareholder approval.

Glass Lewis Allows Enrolled Companies 24-48 Hours to Review Data Points (But Not Draft Voting Reports)

Glass Lewis doesn't provide draft voting recommendations or analysis. Companies that pre-register with Glass Lewis get a chance to review key data points that affect Glass Lewis's analysis of corporate governance, equity plans and Say-on-Pay. Registration is free and the report is typically available 16-28 calendar days before the shareholder meeting. When it's available for viewing, a company will have one or two calendar days to comment on factual inaccuracies or omissions.

This "Issuer Data Report" doesn't include analysis or voting recommendations—those are issued in the final "Proxy Paper Research Report" which can only be purchased from Glass Lewis after it's issued.

Proxy Advisors Don't Allow Sharing of Voting Reports

Glass Lewis allows proxy solicitors, compensation consultants & other advisors to inform their clients about its recommendations—but they aren't allowed to share the actual report. Companies that don't have an advisor who subscribes to the reports are unable to have any insight into their reports without buying them.

For ISS, a company can access the voting reports issued by ISS about it—without charge—by accessing ISS's "Governance Analytics" platform subject to the following conditions:

(i) Reports are only for the company's internal use by employees of the company, and

(ii) The company is expressly prohibited from sharing the reports, profiles or login credentials with any external parties (including any external advisors retained by the

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company such as a law firm, proxy solicitor or compensation consultant) or sharing the user ID and password to the platform with any external parties.

Voting Spikes After Voting Reports Released

Most investors use Broadridge's ProxyEdge platform to vote electronically—and nearly all institutional investors vote (as required by their fiduciary duties, confirmed by an ERISA interpretive position taken by the Department of Labor).

Some investors even hire proxy advisors to create customized policies—these policies often are closely aligned with the proxy advisor policies. For investors with customized policies, the proxy advisors actually vote on their behalf according to the instructions for customization they have received (absent an instruction to the contrary from a client).

Thus, after voting reports are released by ISS and Glass Lewis, heavier voting commences. Investors who use a proxy advisor's electronic vote management system to pre-populate votes on an electronic voting platform and/or submit an investor's votes (*i.e.*, robo-voting) are required to design their policies and procedures for voting, including through automated voting platforms, so that they exercise their voting authority in the client's best interest.

Proxy Advisors Look Beyond Proxy Materials for Company Information

Although the proxy statement is the primary document considered by proxy advisors when drafting their reports and deciding upon a recommendation, it's not the only thing that they look at. They try to look at all the 8-Ks filed since the last annual meeting, as well as anything in the press and certain parts of the 10-K and 10-Qs. In addition, third-party sources are sometimes used. Proxy advisors don't base their recommendations merely on executive summaries.

Bear in mind that one of the reasons that investors hire proxy advisors is that they perform the job of gathering data. So proxy advisors make sure that their reports reflect all the salient information that they think is important for investors to know before making their voting decisions.

Proxy advisors also extract information for their own benchmarks as part of their review process.

Reports Not Started From Scratch; Focus on Changes From Prior Years

Proxy advisors don't start each year's report for a company from scratch. They have collected a bevy of information gleaned over many years. They tend to look at what's changed year-to-year, such as board membership, tenure, etc.

This is why proxy disclosure can be important to help proxy advisors find information. For example, an executive summary about executive compensation can be helpful to highlight those differences from prior years, particularly changes that were done in response to shareholder outreach.

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Proxy Advisors Do Cover 1st Annual Meetings After IPOs

ISS treats a company that has recently gone public like any other company—there are no allowances for the transition from privately-held to public company. However, ISS does have different voting recommendations for companies that held their first annual meeting after February 1, 2015 (*see* "Policies on Problematic Governance Structures & Problematic Capital Structures" above). For some things, like for burn rates, ISS looks three years back—and if a company doesn't have the information, then that part of the policy just doesn't apply. And if a pre-IPO company adopts a new equity plan or amended the charter or bylaws in ways that ISS believes are adverse to shareholder interests, ISS will take a hard look at that—and likely penalize the company.

In comparison, Glass Lewis makes some allowances for IPOs in the first year, recognizing it may take some time to get up-to-speed and meet the more traditional governance standards. To some extent, the range of allowances depends on the company. For example, if it's an additional listing in the U.S. and they're already listed somewhere else, Glass Lewis already will have started its coverage before the U.S. listing. Glass Lewis also has policies that apply to companies newly taken public via a SPAC, which include evaluating whether a company has adopted overly restricted governing documents while it was privately held. For ISS's policy on problematic governance structures for companies that held their first public annual shareholders meeting after February 1, 2015, ISS includes companies that emerged from SPAC transactions.

Proxy Advisors Do Cover Controlled Companies

ISS and Glass Lewis do publish reports on some controlled companies—and that includes a compensation analysis. Even if the voting outcome is controlled by a small group of shareholders, other shareholders may be interested in the analysis. That's especially true if there is a current or threatened proxy fight.

5. Say-on-Pay Analysis

"Failed" Say-on-Pay Vote Isn't Majority Vote "Against"

ISS and Glass Lewis have the position that boards need to be responsive to Say-on-Pay votes that receive less than 70% and 80% support, respectively. This means that your goal isn't to just receive a majority vote on your nonbinding Say-on-Pay—you need to do better than that. If a company receives a low vote and isn't sufficiently responsive, ISS and Glass Lewis may recommend against reelection of the compensation committee members—or the entire board—the following year. Increasingly, low Say-on-Pay support can also be a red flag to activists who closely monitor shareholder dissatisfaction at potential targets.

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Beware of Prior-Year Cautionary Support

One reason why a strong “Say-on-Pay” vote can be deceptively alluring is that a positive recommendation from the proxy advisor firms, including ISS, will oftentimes result in the same “for” vote by shareholders, regardless of whether their recommendation is enthusiastic or cautionary. But one year’s cautionary support can easily lead to the following year’s negative recommendation, especially if TSR (or other metrics utilized by the proxy advisor firms) is tepid.

Read the cautionary recommendation with care and, if there is any substantive validity to them, consider making changes to the company’s compensation program. Minimally, consider the following year’s disclosure and consider revising it to address directly the concerns mentioned in the cautionary report.

Investors May Immediately Vote Against Compensation Committee

Most investors express their displeasure with executive compensation through the Say-on-Pay vote, and then vote against members of the compensation committee in the following year if the committee or the board wasn’t responsive to shareholder concerns. However, there are instances in which compensation committee members will get “against” votes in the same year that the company fails Say-on-Pay (for example, that is the CalPERS policy). That’s another reason why it’s important to thoroughly understand investors’ voting policies.

ISS Review Process for Say-on-Pay: Quantitative Screen

The Say-on-Pay analysis for ISS includes a full review of the CD&A to identify any areas of concern. Russell 3000 E Index companies first undergo a quantitative screen, which is used to identify long-term disconnects between pay and performance and determine ISS’s initial concern level. ISS’s quantitative pay-for-performance screen uses four measures to assess alignment: three relative measures where a company’s CEO pay magnitude and the degree of pay-for-performance alignment are evaluated in reference to a group of comparable companies, and one absolute measure, where alignment is evaluated independently of other companies’ pay or performance. The four measures are:

- Relative Degree of Alignment (RDA): This relative measure compares the CEO’s relative pay rank versus the company’s relative TSR (or Total Shareholder Return) performance—using the ISS-selected peer group. ISS looks at average CEO pay and annualized TSR over a three-year period.
- Multiple of Median (MOM): This relative measure expresses the prior year’s CEO pay as a multiple of the median CEO pay of the ISS peer group for the most recently available annual period. ISS also includes a three-year multiple of the median CEO pay for informational purposes only.

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- Pay-TSR Alignment (PTA): This absolute measure compares the trends of the CEO's annual pay and the change in the value of an investment in the company over the prior five-year period.
- Financial-Performance Assessment (FPA): This relative measure compares the percentile ranks of a company's CEO pay and financial performance across four non-GAAP Economic Value-Added (EVA) financial metrics versus the ISS peer group over the prior three-year period.

If the quantitative screen suggests a misalignment between pay and performance, ISS conducts an in-depth qualitative review. This step reviews the full picture of the company's pay decisions and practices. Some of the factors considered are: the ratio of performance-based pay, financial and operational performance, whether realized pay reflects a commitment to a pay-for-performance philosophy, peer group benchmarking practices, the circumstances and arrangements for executive transitions, the company's responsiveness to past Say-on-Pay votes, and other special circumstances (such as special one-time awards).

FPA Screen Does Not Always Change Initial Quantitative Concern Level

ISS's quantitative screen produces two concern results: (1) an "Initial Quantitative Concern" level, and (2) an "Overall Quantitative Concern" level. The Initial Quantitative Concern level is determined by three primary screening measures: Relative Degree of Alignment (RDA), Multiple of Median (MOM) and Pay-TSR Alignment (PTA). The second "Overall Quantitative Concern" level is the final concern level for ISS's quantitative screen, which may or may not be impacted by Financial-Performance Assessment (FPA) results. And keep in mind that ISS's current FPA screen generally only consists of four equally-weighted ISS EVA metrics, measured over a three-year period (or potentially two)—whereas companies often make other adjustments when it comes to incentive plan payouts. Disclosure is important, so that shareholders can appreciate the business rationale for these adjustments when making their voting decisions.

The FPA potentially modifies a company's Overall Quantitative Concern level—by increasing/decreasing the Initial Quantitative Concern level upon a poor/strong FPA result—in one of four ways:

> "i. From a Low to Medium, for a company with an Initial Quantitative Concern level that is a Low concern but bordering the Medium concern threshold under any of the three primary screens (RDA, MOM, PTA).
>
> ii. From a Medium to Low, for a company with an Initial Quantitative Concern level that is a Medium concern under any of the three primary screens.
>
> iii. From a Medium to High, for a company with only one individual Medium concern (and two Low concerns) under the three primary screens.

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iv. From a High to Medium, for a company with only one individual High concern (and two Low concerns) under the three primary screens."

Below is ISS's handy chart from its "U.S. Pay-for-Performance Mechanics" policy document showing the "Eligible for FPA Adjustment" thresholds indicating RDA, MOM and PTA results that are deemed to be bordering the "medium" concern threshold (which makes such companies eligible for their Overall Quantitative Concern to be modified from a "low" to a "medium" concern depending on the FPA):

Quantitative Concern Thresholds (beginning for meetings Feb. 1, 2024)			
Measure	Eligible for FPA Adjustment	Medium Concern	High Concern
Relative Degree of Alignment	-39	-50	-60
Multiple of Median (Non-S&P 500)	1.82x	2.33x	3.33x
Multiple of Media (S&P 500 only)	1.69x	2.00x	3.00x
Pay-TSR Alignment	-25%	-30%	-45%

ISS expects that not many companies subject to the quantitative screen will have the overall quantitative concern level modified by the FPA. So in most cases, the secondary FPA screen doesn't have a big impact—and the overall quantitative concern level is the same as the initial quantitative concern level.

ISS Won't Always Give Negative Recommendation for Failing Quantitative Test

ISS uses a quantitative screening process to filter proxy statements and figure out "which ones do we really have to do a deep dive on and read literally every word?" It's the first step in ISS's pay-for-performance evaluation—a far cry from the recommendation itself.

As mentioned above, there are four measures that ISS uses in its quantitative assessment. One of these is an absolute test—it looks at CEO pay relative to the trend in your company's TSR over the last five years. Three are relative tests—comparing your pay & performance to peers. ISS recognizes that these relative tests aren't perfect due to variations in fiscal years, etc.—but remember that this quantitative step is just a screening process. These tests determine ISS's overall quantitative concern level. ISS has three levels of concern out of that: high, low, and medium.

ISS Closely Examines Qualitative Factors When Overall Quantitative Concern Level is "High" or "Medium"

If your company gets a "low" concern level after the initial and/or overall screen, you know you're probably not going to get the deep dive. But if you get a "high" or "medium" concern in the quantitative screens—that's when ISS takes a closer look at your proxy statement.

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ISS depends on these quantitative tests to discern if there's a long-term disconnect between pay and performance. If it looks like there might be a disconnect, they'll dig deeper. That's where the qualitative step comes in, which assesses many factors. They're looking for one of two things. Either something that explains why misalignment may be occurring. Or conversely, some factors that may mitigate the apparent disconnect.

Because of the qualitative step, being a "high" concern doesn't always result in a negative recommendation. So even if you flunk the numbers test, you still have a chance of not getting a negative recommendation at all, which is why there's such an emphasis on explaining things in the proxy statement—because at that point, ISS will take a careful look at the reasons for failing that quantitative test. In addition, the proxy is also a communication tool for your shareholders—who may vote favorably despite an "against" recommendation. Your disclosure should demonstrate that you have a robust pay process—and clearly link pay outcomes to long-term company performance.

Even "Low Concern" From ISS Can Result in Negative Recommendation

A "low" concern from ISS doesn't preclude a negative recommendation. Many practitioners mistakenly believe that everything is just about pay-for-performance. It certainly has taken center stage since Say-on-Pay, but there are other factors. For example, a company receiving significant opposition during the prior year to its Say-on-Pay but still didn't engage with shareholders (at least according to its proxy statement). And ISS also conducts a high-level qualitative review of the compensation disclosure of all companies, including the policies & practices disclosed in the CD&A, regardless of their score on the quantitative screen.

ISS Factors for Qualitative Screens

ISS doesn't identify all of the qualitative factors that it considers for its pay-for-performance analysis. ISS Compensation Policies FAQ states that the following are some of the key factors ISS typically considers in conducting a qualitative review of the pay-for-performance analysis:

- "The ratio of performance- to time-based incentive awards;
- The overall ratio of performance-based compensation to fixed or discretionary pay;
- The transparency and clarity of disclosure;
- The complexity of the pay program;
- Any risks associated with the pay program design;
- The emphasis of objective and transparent metrics;
- The rigor of performance goals;
- The application of compensation committee discretion;

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- The magnitude of pay opportunities;
- The company's peer group benchmarking practices;
- Financial/operational results, both absolute and relative to peers, including clear disclosure in the proxy of any adjustments made for incentive plan purposes;
- Special circumstances such as CEO and executive turnovers or unusual grant practices (*e.g.,* bi-annual awards, special one-time grants);
- Recent pay program changes and/or any forward-looking commitments;
- Realizable and realized pay compared to granted pay; and
- Any other factors deemed relevant."

ISS primarily reviews the company's proxy statement for its qualitative review—and states that if the information isn't fully disclosed in the proxy statement, the company may not receive mitigating weight in the pay-for-performance analysis.

Here's some more context around some practices that could lead to a negative recommendation (and remember that your shareholders may look at different and/or additional factors when deciding how to vote):

- **Making discretionary awards outside of plans.** Retention grants, replacement grants & make-whole awards are problematic—particularly if they're essentially re-grants of previously forfeited awards or used to replace foregone performance-based awards. Discretion, or any adjustments, can be appropriately applied, even upward discretion, if specifically linked to tangible business events that benefited shareholders. To minimize criticism from proxy advisors and shareholders, address any unusual or off-cycle awards head-on in the proxy statement and during shareholder engagements.
- **"Front-loaded" awards.** ISS closely scrutinizes large "front-loaded" equity awards that are intended to cover multiple years of equity incentive compensation. They're particularly unlikely to support grants that cover pay for more than 3 years or that accelerate in full upon a termination or change in control—instead, ISS prefers that awards vest pro-rata based on the elapsed portion of the performance period & actual performance achieved.

  In addition, ISS wants the proxy statement to clearly describe the award's metrics & payout opportunities (goals should be rigorous), explain the rationale for the unusual grant practice, and state that the board won't award additional equity incentives during the time period the award is intended to cover. Violations of future commitments without a compelling rationale may result in adverse recommendations for board members.

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- **Incentive plan construction.** Questions may arise around a program that relies exclusively on subjective components, has an ineffective mix of time-and performance-based awards (*i.e.,* provides excessive fixed pay elements that aren't tied to performance), or uses performance periods that are too short.

- **Rigor of performance goals.** The situations that generate the most concern include setting goals below last year's actual or target performance without explanation, use of time-based awards, goals that always achieve maximum payouts or a company's failure to disclose goals at all even after the award cycle is completed. In recent years, this is the qualitative factor that most commonly contributed to negative recommendations—even though it overlaps with the concerns that the quantitative tests are intended to address.

- **Peer group and benchmarking practices.** Some companies continue to select aspirational peer sets where the median company is significantly larger, or benchmark above the median without explanation.

- **Employment agreements.** There's been a lot of change in this area, but some perennial issues that arise and always garner attention include large severance multipliers, guaranteed multi-year awards, inducement grants, replacement awards, retirement grants and separation benefits such as "single-trigger" severance, excessive severance, and tax gross-ups.

- **Risk-Mitigating Factors.** The existence of meaningful stock ownership guidelines and clawback policies may garner more favorable treatment in Say-on-Pay voting (but note ISS assesses the specific scope of clawback policies for purposes of the Equity Plan ScoreCard).

- **Other Problematic Pay Practices.** ISS may recommend a "no" vote if the company has repriced or replaced options or SARs without prior shareholder approval, has provided extraordinary perks or tax gross-ups, has made severance payments when termination is not clearly disclosed as involuntary, or uses liberal "change in control" and "good reason" definitions in plans and agreements.

- **Inadequate Disclosure.** ISS's FAQs say that completeness of disclosure is an important pay-for-performance consideration. For example, companies that are eligible to provide scaled disclosure under SEC rules still need to provide enough information to allow ISS to assess the board's compensation philosophy and practices.

ISS Reports Include GAAP Financial Metrics—But They Don't Affect Vote Recommendation

In addition to the measures that ISS uses in its quantitative screen, ISS research reports show a company's return on invested capital, return on assets, return on equity, EBITDA growth and cash flow from operations growth. Most of these are GAAP-based financial metrics that had

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been part of ISS's secondary "Financial Performance Assessment" before it moved to its EVA-based model—and ISS clients still use them as a point of comparison.

Add EVA Metrics to Proxy Statement if Company Uses Them

Here's disclosure advice from a 2018 Davis Polk/Semler Brossy memo:

> Companies typically use their proxy statement disclosure to describe their pay-for-performance philosophy. Unless a company has already been using EVA as part of how it has granted compensation or measured performance, we would recommend that companies continue to describe the fundamentals of their compensation program. That said, to the extent that a company could demonstrate strong financial and operational performance in EVA-based metrics, it might wish to emphasize those points.
>
> Proactive disclosure of which aspects of a company's business model and strategy make it different from peers can also be helpful. This discussion helps explain why the company uses the metrics it does and not other common metrics, as well as provide context for why results may vary from peers (for example, frequent or significant M&A or effecting a turnaround). This additional context would be helpful considering the EVA measures are more prominent in ISS's evaluations.

Glass Lewis Review Process for Say-on-Pay

Glass Lewis reviews Say-on-Pay proposals on a qualitative and quantitative basis, and focuses on several key issues: overall design and structure of the executive compensation program, including the selection and challenging nature of performance metrics; implementation and effectiveness of the program, including pay mix and use of performance metrics in determining pay levels; quality and content of disclosure; amounts paid; and the link between pay and performance.
To analyze the link between pay and performance, Glass Lewis takes both a qualitative and quantitative approach. For the qualitative report, they examine the design and implementation of compensation programs including reviewing the balance between performance-based and time-based variable incentive plans. In addition, they examine the appropriateness and the balance of the performance metrics used. For the quantitative aspect, they examine company performance and amounts paid to executives compared to a Glass Lewis proprietary peer group using a proprietary pay-for-performance model.

Glass Lewis Pay for Performance Process: Quantitative Assessment

For its quantitative assessment, Glass Lewis grades companies on an "A" to "F" scale, where a grade of "C" or above represents adequate alignment between pay-for-performance. Its model looks at compensation of all NEOs and stock and business performance over a weighted three-year period.

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Glass Lewis defines "compensation" as the sum of all cash and equity compensation paid to the five most highly paid NEOs, net of severance and director fees and excluding any changes in pension value. For most companies, Glass Lewis measures performance by looking at five metrics:

- Return on Assets (ROA)
- Return on Equity (ROE)
- Total Shareholder Return (TSR)
- EPS Growth
- Change in Operating Cash Flow

In conducting its assessment, Glass Lewis looks at ROA and ROE for the year under review. For the other three metrics, Glass Lewis uses a weighted average of the year under review plus the previous two years—but the weightings depend on the company's industry and aren't disclosed.

Glass Lewis then assigns a grade. A good grade ("A" – "C") means that the company's percentile rank within its peer group for compensation is less than or aligned with its percentile rank within its peer group for performance. A grade of "D" or "F" means that the company's percentile rank within its peer group for compensation is more than its percentile rank within its peer group for performance.

Glass Lewis Factors for Qualitative Screen

Glass Lewis assesses pay holistically—so it won't automatically recommend a vote "against" a Say-on-Pay proposal if a company gets a low quantitative grade, and even a company with an "A" grade isn't guaranteed a positive recommendation. To make its recommendation, Glass Lewis considers its quantitative grade along with qualitative tests that evaluate both the structure—and disclosure—of pay programs.

The qualitative assessment rates the structure of company compensation programs as follows:

- "Good"— little to no concerns
- "Fair"—some concerns
- "Poor"—significant deviation(s) from best practices or contains one or more egregious compensation practices

The qualitative assessment rates disclosure as follows:

- "Good"—a thorough discussion of all compensation elements
- "Fair"—an adequate discussion of all or most compensation elements
- "Poor"—an incomplete or absent discussion of compensation

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Here are some practices that could lead Glass Lewis to issue a negative Say-on-Pay recommendation, either individually or weighted together or with a low quantitative grade:

- “Inappropriate or outsized self-selected peer groups and/or benchmarking issues such as compensation targets set well above the median without adequate justification;
- Egregious or excessive bonuses, equity awards or severance payments, including golden handshakes and golden parachutes;
- Insufficient response to low shareholder support;
- Problematic contractual payments, such as guaranteed bonuses;
- Insufficiently challenging performance targets and/or high potential payout opportunities;
- Performance targets lowered without justification;
- Discretionary bonuses paid when short- or long-term incentive plan targets were not met;
- High executive pay relative to peers that is not justified by outstanding company performance; and
- The terms of the long-term incentive plans are inappropriate.”

Glass Lewis will also consider “supplemental quantitative factors” (*e.g.*, analyses of realized pay levels and the “compensation actually paid” data mandated by the SEC’s 2022 final rule regarding pay versus performance) and other “qualitative factors” (*e.g.*, an effective overall incentive structure or significant forthcoming enhancements) to recommend in favor of a proposal even when it has identified a disconnect between pay and performance.

Glass Lewis Policies on Contractual Arrangements

The following specific design features may be triggers for negative Say-on-Pay voting recommendations from Glass Lewis:

- Excessively broad change-in-control triggers, which may include single-trigger and modified single-trigger provisions providing for payouts absent termination of employment. If your disclosure doesn’t specifically state that the change-in-control arrangement is double-trigger, Glass Lewis will assume it isn’t
- Inappropriate severance entitlements, which will be assessed relative to the executive’s target compensation, other executive packages and the executive’s predecessor package
- Lack of robust disclosure or excessive sign-on arrangements
- Guaranteed bonuses

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- Amended contracts that maintain poor pay practices, so when you amend a contract, Glass Lewis expects that you will clean-up any problematic pay practices embedded in the contract
- Inclusion of new excise tax gross-ups in specific change-in-control transitions

Factors Affecting Glass Lewis Assessment of Incentive Plans

Glass Lewis also takes into consideration how a company's short-term and long-term incentive plans are structured. Glass Lewis expects clearly disclosed justifications to accompany any significant changes to a company's short-term incentive plan structure, as well as any instances in which performance goals have been lowered from the previous year. Glass Lewis raises concerns if less than half of an executive's long-term incentive awards are subject to performance-based vesting conditions. Where non-GAAP or bespoke metrics are used, Glass Lewis wants clear reconciliations between these figures and GAAP figures from audited financial statements. When compensation is tied to E&S metrics, Glass Lewis will focus on whether the E&S incentives are being tied to company strategy and pre-determined, quantitative targets that are transparently disclosed, rather than requiring or expressly encouraging E&S metrics. Additionally, Glass Lewis includes instances of retroactively prorated performance periods in its description of the application of upward discretion. For long-term plans, Glass Lewis defines inappropriate performance-based award allocation as a criterion which may, in the presence of other major concerns, contribute to a negative recommendation. Additionally, for any decision to significantly roll back performance-based award allocation, Glass Lewis will review it as a regression of best practices, that outside of exceptional circumstances, may lead to a negative recommendation. Glass Lewis also expects clearly disclosed explanations to accompany long-term incentive equity granting practices, as well as any significant structural program changes or any use of upward discretion.

Glass Lewis Reports Include Its Own Supplemental CEO Pay Calculations

In addition to showing the amounts of CEO pay that are disclosed in company proxy statements, Glass Lewis's Say-on-Pay analysis also includes two other pay calculations that may differ from the company's Summary Compensation Table disclosure. Neither of these figures is used in the proxy advisor's pay-for-performance model.

One figure is realizable pay. The other figure is a breakdown of CEO compensation granted but not necessarily earned for the year in review, presented in the "CEO Compensation Breakdown Table." This table excludes changes in pension value and non-qualified deferred compensation earnings.

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Proxy Advisors Use Proprietary Methods to Evaluate Say-on-Pay Proposals

Both ISS and Glass Lewis use proprietary methods to evaluate Say-on-Pay proposals. These methods use both quantitative and qualitative metrics. For the quantitative analysis, ISS has its own model—Glass Lewis relies on CGLytics.

These metrics are explained in materials posted on their websites—but they are complex. For example, it is not uncommon for a proxy advisor's model to come up with a "total" compensation number that is different than what a company discloses in its proxy statement.

Consultants Help Understand Proxy Advisor Methods

There is a cottage industry of consultants who help make sense of proxy advisor methodology. These include proxy solicitors, compensation consultants and law firms. ISS has a unit that is separate from its core business that also provides this type of corporate consulting service—but is fully separate from ISS. This is ISS-Corporate.

ISS-Corporate has a service where it will analyze a company's proposals ahead of drafting the proxy statement. Although some companies hire ISS-Corporate to help them if they have a new compensation plan on the ballot (particularly if they have a large institutional base), it is doubtful that this type of service helps for Say-on-Pay because that type of proposal is more holistic. In comparison, shareholder approval of new compensation plans primarily involves an objective, quantitative approach related to the estimated cost of the plan and the presence or absence of certain provisions, which lends itself more to help from ISS-Corporate.

Glass Lewis is affiliated with Glass Lewis Corporate, LLC—and the latter advises companies on modeling out their equity compensation plans against the Glass Lewis model. Similar to ISS, Glass Lewis has a strict separation between Glass Lewis Corporate advisors and the Glass Lewis research analysts, so hiring Glass Lewis Corporate won't guarantee any particular Glass Lewis recommendation.

No consultant can guarantee that their assistance in designing a pay program will help avoid a negative recommendation from a proxy advisor.

Companies Hiring ISS-Corporate Shouldn't Mention That

ISS and ISS-Corporate are two separate entities with an ethical wall. ISS has investors for clients. ISS-Corporate has companies for clients. The relationship between these two has been criticized due to the potential for conflicts of interest.

ISS-Corporate has fine print in its consulting contract that you aren't allowed to mention that you hired them—and the ISS voting FAQs also make clear that you shouldn't mention any past, present or expected contact with ISS-Corporate. So you shouldn't mention that you hired them if you engage with ISS on a policy issue. If you do mention it, the first thing ISS has to do is tell its

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compliance folks that that happened—and that raises a lot of scrutiny on the engagement and complicates things.

Also note that the contract between ISS-Corporate and companies states that there's no guarantee of any particular ISS recommendation. You should be hiring ISS-Corporate to help your decision-making and understanding where not only ISS, but also where investors may be coming from.

Negative Say-on-Pay Recommendation Doesn't Necessarily Cause Failed Vote

Over the years, proxy advisors have given hundreds of negative recommendations— and many of these votes still passed. Most of those situations involved some form of shareholder engagement. It's also important to note that some companies, particularly smaller companies, have a shareholder base that doesn't follow ISS or Glass Lewis recommendations (*e.g.*, their shareholder base might be more retail heavy). Moreover, many of the larger institutional investors have their own voting policies which they'll follow.

Semi-Annual Windows for Peer Group Submissions

ISS and Glass Lewis consider a company's self-selected compensation peer group to be one of the key inputs in developing the peer group that they use to evaluate pay-for-performance. If you believe that it may be helpful to provide ISS and Glass Lewis with the compensation peer group that was used in your executive compensation deliberations for your last completed fiscal year, you can use this process to ensure that each firm has an up-to-date list of your peer group companies in advance of the filing of your proxy statement for the company's next upcoming annual meeting. Companies that haven't made any changes to their previously disclosed peer groups, or don't want to provide this information in advance, aren't required to participate. If you don't submit new info, the peers from your last proxy statement filing will automatically be factored into ISS's and Glass Lewis's peer group construction process. Note that updating your peer group with ISS and Glass Lewis won't guarantee that they'll make any changes to the companies they include based on their proprietary methodologies, but it's worth making sure they have accurate and updated information just in case.

The process is relatively simple for both ISS and Glass Lewis. For ISS, peer submissions flow through ISS Corporate Solutions' ("ICS") Governance Analytics platform. For Glass Lewis, you can submit updated compensation peer groups via https://www.glasslewis.com/submit-peers/ during an open submission window.

Proxy Advisors Might Regularly Change Your Peer Group

For years, companies complained about how peer groups were concocted by proxy advisors. Probably the most frequent criticism was that companies were using peer groups that were very different from what proxy advisors were using. Partly, that's because proxy advisors are using peer groups to compare pay among companies that are of similar size and in a similar industry—

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whereas companies are using them to benchmark pay to whatever management and the board believe is appropriate to attract and retain talent. So the purpose is not exactly the same, and there's no perfect peer group due to fiscal year timing discrepancies and other anomalies. But the proxy advisors still listened to companies' concerns and the process has evolved.

In its FAQ re: peer groups, ISS states that it doesn't require companies to "make any special public disclosure of their updated peer group information at the time it is submitted to ISS." However, ISS does expect that the submitted list of peer companies matches the benchmarking peers disclosed in the company's proxy statement—and if the peer lists don't match up, ISS may look more closely during its pay-for-performance analysis, and may also, in its discretion, "remove a company from a future peer submission process."

ISS Peer Groups Rely on "GICS" Classifications

ISS uses the "Global Industry Classification System" in determining peer groups (which impact its pay-for-performance assessment as well as things like its director pay evaluation, Equity Plan Scorecard and Environmental & Social Quality Score). Note, this isn't the same thing as the four-digit "Standard Industrial Classification" (SIC) code that the SEC uses to classify companies and that shows up on Edgar and registration statements. The GICS is an industry group classification system developed by MSCI and S&P that's primarily used for creating financial market indices.

The ISS peer group will typically contain between 12 and 24 companies, based on the GICS classification of the company, the GICS classifications of the company's disclosed benchmarking peers, and size constraints for both revenue (or assets for some financial companies) and market capitalization. ISS tries to construct a peer group in which the company's size is close to the median of the group.

When choosing peers, ISS also prioritizes potential peers within the subject's "first-degree" peer group (the companies that are either in the subject's own peer group, or that have chosen the subject as a peer), and companies with numerous connections (by choosing as a peer or being chosen as a peer) to these first-degree peers. ISS maintains a "FAQ: Peer Group Selection Methodology" that describe the methodology in more detail.

In theory, the ISS peer group classification shouldn't drive pay arrangements, since it's not something that directly influences company performance and the ISS pay-for-performance assessment considers many factors. But it's still useful to know what companies will be used as data points for the relative quantitative screens.

Glass Lewis Peer Groups Based on Several Factors

Glass Lewis's pay-for-performance assessment includes an enhanced peer group methodology, proprietary to Glass Lewis, which leverages the global compensation data and analytics tools of its partner, Diligent.

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Glass Lewis states its peer group analysis begins with a company's self-disclosed peers, then includes investor views on both industry-based and country-based peers, in addition to the company's peers-of-peers. Glass Lewis's methodology then scrutinizes this larger pool of potential peers by introducing additional screens based on corporate revenue, market capitalization and assets; weightings for peers based on the source and frequency of confirmation; and peer rankings based on a strength-of-connection approach that considers all potential peers, not just those resulting from the network effects of corporate disclosures.

Glass Lewis includes its peer group analysis as part of its qualitative Say-on-Pay assessment. A minority of companies that receive a low grade based on the quantitative test are still able to receive a favorable recommendation if they compare well to peers, provide thorough disclosure, and don't maintain problematic pay practices.

Glass Lewis also recognizes that a peer group is only as good as how it's used. Glass Lewis grades companies quantitatively on an "A" to "F" scale. And of those F's, some still receive a favorable recommendation because of the qualitative assessment—and part of that qualitative assessment is the peer group.

Companies Struggling to Set Peer Groups Can Make Their Case

Some companies struggle to find the right peer group. And if they think that a proxy advisor is off the mark, they can engage with the proxy advisor to explain the rationale for the peer group that they use. To do so, you should be able to make your argument by pointing to proxy statement disclosures that explain why you're choosing the peers that you choose. When disclosing the peers in the proxy statement, you may also consider disclosing the stock ticker next to the peer company's name to ensure proxy advisors and investors are in fact looking at the same peers.

Proxy Advisors Don't Require Companies to Use TSR as Performance Metric

This is one of the biggest myths about the way proxy advisors analyze companies during a pay-per-performance quantitative analysis.

For Glass Lewis, TSR is just one of five performance metrics that they use—and they're all equally related. Other than TSR, Glass Lewis looks at EPS growth, changes in cash flow, ROA, and ROE. They recognize that not every single one of these metrics makes sense for some companies.

If a company says they've done well on the performance metrics that really matter to them—and that's how research analysts are judging us on and that our peers are using—that's a fair point that proxy advisors will likely listen to. Use your proxy disclosures to explain why you've chosen those performance metrics, why they make sense and how they've been in use for years. If it's a new transition, explain in your disclosure why that's more effective than what was used before.

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For ISS, they focus on TSR for half of its quantitative screens, mainly because that's what clients are focused on. Other performance metrics come into play in its quantitative and qualitative analyses. So if the company operationally is doing really well, that's going to figure into the recommendation.

But even though ISS focuses on TSR a lot, it's not an "all or nothing" proposition. You can do something that is operationally driven with a TSR overlay modifier or other things that incorporate TSR. And ISS says that its selection or weighting of any financial metric in the pay-for-performance analysis shouldn't be interpreted as a suggestion that a particular metric—or combination of metrics—should be used to form a company's compensation program. In our experience, it's actually not uncommon for there to be a disconnect between ISS and company metrics.

Be Aware of Adjusting Performance Metrics In Mid-Cycle

TSR is transparent—that's why a lot of investors like it as a metric. Companies normally don't change their performance goals in the middle of the cycle. But increasingly, companies are making adjustments to the results—that effectively changes the goals. And maybe that's legitimate, but that's something for you to explain, to be consistent about and to have some rationale behind.

Here are related disclosure tips:

Use of Discretion:

- Explain the necessity for discretion in compensation program implementation and award granting
- Explain how discretion is used and if it has been used positively (*i.e.,* to increase awards) and/or negatively (*i.e.*, to reduce awards)
- Provide examples where discretion was used, or if it has not been used, disclose that

One-off awards:

- Explain the purpose for the one-off awards particularly if the recipient is still eligible for awards under existing plans
- Discuss the effectiveness of one-off awards if they are granted for work seemingly within the normal responsibilities of the recipient (*i.e.,* explain that the recipient is not being rewarded twice for meeting the same goals or for doing the same work)
- Provide information about the historical usage of one-off awards and how they have been effective

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- Explain if the one-off awards were granted at the discretion of the board following the performance period
- Describe if the one-off awards were granted prior to the performance period and if they had clear, measurable and overlapping performance goals

Incentive awards for below median performance:

- If awards vest for below median performance, explain how and why the awards are still earned and continue to provide incentives
- Describe if the awards replaced time vesting awards that had no performance aspects (and therefore vested irrespective of performance)

Disclosure Practices to Help Make Your Case

Companies should understand the kind of information that proxy advisors are basing their evaluations on—so they can make sure that the story that they want to tell is prominently in the proxy statement, so it's definitely not going to get missed. Other pointers include:

- Provide executive summaries that highlight the key elements of each proxy statement section and recent changes or elements that are particularly important—this ensures that shareholders don't miss the information.
- Integrate salient aspects of incentive plans in one place in the CD&A (rather than dispersed in different sections of the discussion). Investors value some key information about short- and long-term incentive plans:
    - Rationale for use of specific award types, and how related performance metrics incentivize value creation
    - What are the specific target, minimum and maximum awards levels, and the specific goals associated with each level?
    - How did you determine the goals set for the plan and how do they relate to previous years' goals and results?
    - What were the results and awards generated based on specific results?
    - What mitigating elements are used to ensure that the pay programs do not incentivize excessive risk-taking?
- Use plain English wherever possible, and avoid extensive details about the programs that are not germane to the above.

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Options Are Performance-Based Depending on How Granted

When it comes to stock options, it's the wrong question to ask whether they are performance-based. Options can be granted based on the performance of that executive, so is that performance-based or not? It's performance-based depending on the way options are granted. Are there performance targets? How many were granted? What is the period over which they are invested? Are there any holding periods after that? How do they fit into the overall program? Are they being reloaded every year? Are options just one component that are equity-based that fit into the overall compensation program?

Proxy advisors believe that the best way to evaluate options is to look at the entire compensation program—and see how that all works together.

Proxy Advisors Rely on "Shareholder Engagement" Proxy Disclosures

Proxy advisors do care if you talk to your shareholders—and they like to see disclosure in your proxy about how you talk to your shareholders, what the shareholders then said, and how you then responded. This is particularly important if your Say-on-Pay received below 70-80% support (for ISS and Glass Lewis respectively) as proxy advisors believe this shows significant opposition.

So if your Say-on-Pay received <70% support last year, ISS strongly considers the company's response to that vote, with particular focus on your engagement with shareholders and actions taken as a result. You will need to disclose how you engaged with shareholders in response to your significant opposition as proxy advisors need that explanation of what you did in response—particularly if you decided to keep some compensation design elements that were criticized. Make sure you're hitting all the elements of disclosure that ISS wants to see in your proxy statement; they do want some details.

For Glass Lewis, if your Say-on-Pay vote received <80% support last year, Glass Lewis expects your level of responsiveness to correspond with the level of shareholder opposition, determined using both the size of opposition as well as the persistence of shareholder discontent over time. They expect that your disclosure will discuss engagement with large shareholders and any changes to your compensation program that directly address shareholder concerns. Glass Lewis is looking for robust disclosure and if it doesn't think that the disclosure is robust, it may vote against your upcoming Say-on-Pay vote.

6. Director Election Analysis

Director Elections Always on Ballot for Annual Meetings

For annual shareholder meetings, director nominees are always up for election, whether they are incumbents up for re-election or new nominees put forth by the board's nominating committee. And this is true regardless if the company has a classified board—in this case, there will at least

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be some nominees up for election. As a result, a proxy advisor's voting report will always cover this matter for an annual meeting.

Proxy Advisors Typically Recommend "For" Management Nominees

In the absence of a proxy contest, proxy advisors typically will recommend in favor of the nominees set forth by the company with some exceptions detailed below.

Factors Triggering Recommend "Against" or "Withhold" Management Nominees

There are circumstances where a proxy advisor will recommend "against" or "withhold" one or more management nominees including:

- Tripping over the proxy advisor's independence definitions (which sometimes differ from the definitions used by the stock exchange listing standards)
- Directors serving on one of the three key board committees who are not independent
- Adopting controversial bylaws or other problematic provisions prior to, or in connection with, the company going public (for example, continued classified board or super-majority voting provisions after the IPO)
- Doing nothing after a shareholder proposal received majority support the prior year
- Adopting a poison pill without obtaining shareholder approval
- A director who has served more than one year and who doesn't attend at least 75% of the board/committee meetings (which is disclosed in that year's proxy statement)
- Being overboarded by serving on more than a specified number of boards
- Crisis circumstances, which trigger troubles with regulators
- Adopting controversial bylaws that are deemed to infringe on shareholder rights without obtaining shareholder approval
- Doing nothing after a low Say-on-Pay vote in the prior year
- Omitting a Say-on-Pay or say-on-frequency vote from the ballot when one would otherwise be expected, without providing an explanation
- Adopting a frequency for Say-on-Pay different from the frequency approved by the plurality of shareholders (factor for Glass Lewis)
- "Excessive" non-employee director pay without a "compelling rationale" for two or more consecutive years (ISS)
- Failure to address when any agenda item receives more than 20% unfavorable votes from shareholders (contributing factor for Glass Lewis)

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- Failure to include at least one woman or a director from an underrepresented community on the board
- Problematic governance structures, multi-class share structures with unequal voting rights, unilaterally adopted charter or bylaw amendments that materially diminish shareholder rights, pledging arrangements, audit or compensation practices, etc.
- Exclusion of shareholder proposals (Glass Lewis expects companies to include all shareholder proposals except if the SEC has explicitly concurred with a company's argument that it can be excluded)
- Material failure of risk oversight, which includes, but isn't limited to, hedging of company stock by executives and poor risk oversight of environmental and social issues, including climate change

Materially Adverse Unilateral Charter/Bylaw Amendments May Trigger ISS Vote "Against" Directors

ISS will recommend voting against appropriate committee members or the entire board of directors if a unilaterally adopted charter or bylaw amendment is deemed "materially adverse" to shareholder rights. Per ISS's FAQ: Procedures & Policies (Non-Compensation), examples of this include:

- "Authorized capital increases that do not meet ISS's Capital Structure Framework;
- Board classification to establish staggered director elections;
- Director qualification bylaws that disqualify shareholders' nominees or directors who could receive third-party compensation;
- Adoption of mandatory shareholder arbitration provisions;
- Fee-shifting bylaws that require a suing shareholder to bear all costs of a legal action that is not 100 percent successful;
- Increasing the vote requirement for shareholders to amend charter/bylaws;
- Adopting a plurality vote standard in uncontested director elections, or a majority vote standard in contested director elections;
- Imposing advance notice periods greater than the 90-120 day window or imposing undue restrictions on the ability to nominate candidates;
- Removing or restricting the right of shareholders to call a special meeting (raising thresholds, restricting agenda items); and
- Removing or materially restricting the shareholder's right to act in lieu of a meeting via written consent."

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"Excessive" Outside Director Pay Means Top 2-3% of Comparable Directors

ISS's FAQs explain its methodology to identify director pay outliers. ISS first applies a quantitative screen, and will conduct a qualitative evaluation of the company's disclosure to determine whether concerns are adequately mitigated.

The quantitative screen looks at pay totals for directors in the same two-digit GICS group and within the same index grouping—*i.e.,* S&P 500, combined S&P 400 and S&P 600, remainder of Russell 3000, and Russell 3000-Extended.

ISS separately groups non-executive chairs and lead independent directors together for purposes of this analysis. Since those positions often receive a premium, directors in those categories will be compared to others within the same category of leadership (still considering index and sector).

Typical mitigating factors include:

- Onboarding grants for new directors that are clearly identified to be one-time awards
- Special payments for transactions or special circumstances
- Payments made for specialized scientific expertise
- Narrow distributions of non-employee director pay, where there isn't a pronounced difference between the top 2-3% and the median

ISS analyzes consulting payments on a case-by-case basis. Payments to reward directors for general performance typically don't constitute a "compelling rationale."

7. Handling Errors in Voting Reports

Proxy Advisors Will Issue Corrected Reports for Material Errors

A common question is "what happens when there is an error in a proxy advisor report?" One of the myths is there's an error in a report—but there's no point in talking to them about it since they're not going to fix it since the report's already issued. The reality is that proxy advisors have tried pretty hard to have a communication channel for companies to tell them about errors in part because Staff Legal Bulletin #20 encourages it.

In 2014, the SEC's Division of Investment Management and Division of Corporation Finance issued Staff Legal Bulletin #20, partly to tackle a perception that proxy advisors are not responsive to errors by placing an onus on investment advisors to conduct due diligence to ensure any proxy advisors they hire have robust policies and procedures to deal with materially inaccurate voting reports.

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There's a range of potential types of errors, some significant—some not. Some are merely a matter of interpretation—differences in opinion—and not really errors. And some "errors" are really updates as developments occur at a company. Some might be changes not reflected in a company's disclosures—so they are just additional data points not reflected in a SEC filing so the proxy advisors weren't aware of them.

If there is a significant error, proxy advisors try to issue a revised report out within 24 to 48 hours—and they've done pretty well sticking close to that, particularly for material errors. Proxy advisors don't want to bombard their clients with revised reports for insignificant items—so they issue revised reports only if the information seems like it might be material. In other words, ISS won't bother sending an alert to call attention to the correction of a factual error unless it believes that the correction could impact the vote.

If ISS issues a revised report, it's in the form of a short update that focuses on just the correction—not the entire report with the correction included. If Glass Lewis issues a revised report, it reissues the entire report and explains the nature of its revisions in a note on the front page.

Alert Top Shareholders Yourself If Recommendation Is Reversed

Even though the proxy advisors alert investors to a corrective report, companies should not rely on investors seeing that if it's expected to be a tight vote. Investors are busy during proxy season and might miss the announcement that a revised report is out. Companies should make the effort to alert their top shareholders on their own that a recommendation has been reversed. Companies do this in a few ways, including posting a letter or alert on their website, filing an 8-K, and filing the information as additional soliciting material.

Contacting ISS to Verify Data & Report Errors

Even though the name(s) of the ISS analyst who wrote a particular report is listed on each report, ISS typically prefers that corrections and questions be directed to a central online portal—the "ISS Help Center"—because the analysts are too busy during the proxy season to field them. Companies should specifically point out the mistake and refer to the page in the proxy statement or other disclosure where the information is located. ISS also believes that it can better handle these centrally because its policies are well-developed and transparent, rather than subjective to individual analyst interpretation. However, it is fine to point out to the analyst named on the report too (or in lieu of the Help Center).

Of course, those that deal with ISS often—such as proxy solicitors, compensation consultants and some of the larger companies—often have relationships with the analysts on the U.S. Research team that enable them to better navigate this process.

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Over the proxy season, ISS closely tracks any errors that are reported, as well as internal errors that are found. ISS has separate data verification sites for its governance ratings (i.e., QualityScore) and for equity plan approvals.

In ISS's FAQ: Procedures & Policies (Non-Compensation), ISS states that it reviews all proxy and exempt solicitation filings on EDGAR between the time ISS publishes its research report and the date of the shareholder meeting. Form 8-Ks (other than those with only Items 2.02, 7.01 and 9.01) are also reviewed. If there's relevant information in the Form 10-Q, ISS recommends that companies inform ISS of this through the ISS Help Center, as 10-Qs aren't generally part of the review.

Relatedly, CSR or other environmental/social reports posted on the company's website aren't part of the proxy team's review for the research report, unless there's a proposal on the ballot or a vote-no campaign relating to the topic. As a result, companies who want to have the CSR report incorporated into ISS's E&S ratings in the proxy voting report should "1) use their Governance Analytics account to submit data verification updates to their Environmental and Social QualityScore data; and/or 2) submit a link to the new E&S-related report to the ISS Help Center. (Use the "Provide a link to Public Disclosure" tile, and under the Disclosure category on the next screen, please specify "E&S or CSR report" to speed delivery to the proper teams)." This should be done at least a month prior to the proxy statement filing.

Contacting Glass Lewis to Verify Data & Report Errors

Glass Lewis maintains an Issuer Data Report (IDR) program—which allows companies to see a data-only version of their Glass Lewis Proxy Paper prior to Glass Lewis completing its analysis and voting recommendations. Enrolled companies receive their IDR approximately 3-4 weeks prior to their shareholder meeting and have 24-48 hours to review and provide factual corrections along with supporting public documentation. Companies need to follow the instructions contained in the IDR to mark up the PDF and return it to Glass Lewis.

This service is free of charge, but companies must register for it on the Glass Lewis website.

There's also a mechanism on Glass Lewis's website to report errors. Glass Lewis does this to fix them—and because they want to track the errors so they know at the end of the season how many they have and the nature of the errors (for example, Glass Lewis may need to bolster its oversight in a particular area for all companies or an entire industry). Companies can use this "report inaccuracies" website regardless of whether they have subscribed to the IDR program.

Don't Bother Proxy Advisors With Immaterial Errors

Some companies subscribe to the belief that it's better not to try to make voting reports perfect. They leave well enough alone if they spot immaterial errors in them. They recognize that the proxy advisors aren't perfect and that they're too busy during proxy season to deal with a minor clean-up. So they pick their battles and only go to bat for the significant errors that might force a

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proxy advisor to reverse a recommendation. That said, regardless of changes to the proxy advisors' reports and/or voting recommendations, it may be worthwhile to communicate directly with shareholders about any factual errors in the reports.

ISS's Data Verification Site

In 2022, ISS launched a new data verification site to cover over 400 governance and compensation datapoints, including those relating to stock plans, director details and executive pay figures. You have to register (email contactus@isscorporatesolutions.com if you haven't registered before) but there's no charge to take a look at your data. The portal access will be via Governance Analytics, which is managed by ISS Corporate Solutions.

Since ISS spells out what they're looking for in its guidance in this area, you might want to consider that guidance as you're drafting your plan approval disclosure. You might want to ensure your disclosure lines up nicely—so they have all your information and it's easy to digest as that should reduce the likelihood of an error.

Bear in mind that there will be a tight timeframe to take a look at ISS's data verification site because they can't release that to you until you file your proxy statement—and then they've got to issue a report 1-2 weeks later. The data verification window is only provided if the proxy statement is filed at least 40 days prior to the shareholder meeting. Companies will get an email notification when its 48-hour data verification window opens (between the proxy statement filing but prior to ISS's proxy research report publication). So it's a very short window. After the meeting ends, the data verification site is re-opened so companies can provide updates throughout the year.

This platform won't impact ISS's Governance QualityScore and Environmental & Social QualityScore data verification platforms—but data verified through the new portal will be reflected in those QualityScore corporate profiles.

8. Handling Negative Recommendations

Sometimes Negative Recommendations Inevitable

Since companies act in what they believe are the best interests of shareholders—according to their own fiduciary duties—they sometimes will take actions that run afoul of proxy advisor policies and wind up with a negative recommendation. That means that companies need to have a process in place to address negative recommendations—and it needs to include not just reacting to a recommendation once it has been received, but also identifying potential issues in advance to either head off a negative recommendation or position the company to most effectively mitigate its effect on investors and their voting decisions.

It's important that companies be aware of a negative recommendation as soon as they can since they might have to engage in damage control—ranging from campaigning with investors to

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explain why the company's position is different than a proxy advisor's position to fixing a possible error by a proxy advisor.

Prepare in Advance and Maximize Proxy Statement Disclosure

ISS and Glass Lewis publicize their policy positions well in advance of the proxy season, so in most cases you should be aware of a potential negative recommendation long before you file your proxy statement. That gives you an opportunity to address potential problem areas in a particular proposal and/or to engage with shareholders and provide them with insight into the board's thinking on a potentially problematic issue. Along those lines, the potential for a negative recommendation should be communicated to management and the board of directors. Some companies prioritize proxy advisor recommendations, and the prospect of receiving one may result in the board's decision to make substantive changes designed to head off a negative recommendation. Even if your company's board is unlikely to be swayed by the prospect of a negative recommendation, it is important that the recommendation does not come as a surprise. Sometimes, it may also be possible to engage directly with the proxy advisors on potential areas of concern during the off-season in addition to shareholder engagement.

Proactive efforts to address areas of concern in your proxy statement may—at least on some topics—help fend off a negative recommendation. More importantly, your proxy disclosure can build on your engagement efforts with shareholders and put forth the board's case for the proposal and what has been done to address concerns raised in the engagement process. That can go a long way toward mitigating the effect of a negative recommendation.

ISS Will Listen If You Want to Reverse Negative Recommendations

It is hard to get ISS to change a recommendation once made. However, ISS will consider if they made an error or they had incomplete information when it made its recommendation. To fix an error, companies must ensure the information that proves it's an error is publicly available (often in a proxy statement or additional soliciting material) and in some cases, verifiable.

And in some non-error cases, ISS might reverse a negative recommendation if the company sufficiently addresses a concern that ISS raised. However, ISS won't reverse a recommendation just based on a conversation with you. Any kind of update or change that a company makes as part of its argument to ISS needs to be publicly filed so that all shareholders can benefit from it. Frequently, that means an 8-K filing and a supplement to the proxy statement.

In addition, ISS won't commit to a change in position until that public filing is made so they can actually review and evaluate it. This can cause tension as some companies don't want to file until they know for sure that ISS will make the reversal. On very rare occasion, ISS may review draft disclosures and hint at what they might do, but ISS can't and won't disclose or guarantee a vote recommendation (or change in vote recommendation) in advance of the public filing.

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Seek to Overturn Negative Recommendations Right Away

Absent extraordinary circumstances, ISS won't change a voting recommendation within five business days of an annual meeting. So you need to make your filing and alert ISS quickly if you're trying to reverse a recommendation.

If new information is provided within five business days of a meeting, ISS might issue an "informational alert" to institutional investor clients—even if there's no change to the voting recommendation. ISS does this if it considers the information material to its voting analysis.

Aside from correcting material errors that led to the negative recommendation, in rare cases, companies may be able to convince ISS to change its recommendation if it makes a desired change or commits to make the change in the near future.

If an agreement with ISS is reached, companies will be required to publicly disclose the change or promise for future change in a SEC filing right away. This SEC filing could come in the form of a Form 8-K or additional soliciting material (or both), depending on what is being disclosed. ISS will not issue a report with the reversed recommendation until this SEC filing is made.

Because Glass Lewis doesn't engage during the proxy season, they historically would overturn a negative recommendation only in the case of material errors. To correct errors with Glass Lewis, companies need to follow the instructions contained in the Issuer Data Report to mark up the PDF and return it to Glass Lewis. Glass Lewis also maintains a "report inaccuracies" website where companies that have not subscribed to the IDR service can report errors. Like ISS, Glass Lewis requires any corrections to be based on publicly available information. Glass Lewis clients receive the company's unedited statement along with a re-issued report and an indication of whether the company's feedback caused Glass Lewis to revise its report in any respect, and versions of Glass Lewis research published prior to company feedback are removed.

ISS Won't Change Recommendation Five Business Days Before Annual Meeting

Due to voting deadlines and to ensure that votes are properly counted at a meeting, ISS generally will not issue a change to a vote recommendation closer than 5 business days before the meeting.

This means that if a company is filing additional information with the SEC (or issuing a press release for non-SEC filers), ISS must be informed of this filing at least 5 business days before the meeting. For example, for a Thursday meeting, ISS will need to know of the filing no closer to the meeting than 5 p.m. eastern the Thursday before (assuming no holiday during that week.)

Any new information received closer than 5 business days before the meeting will be mentioned by ISS in an informational alert if it is deemed to be material to the analysis, even if there is no change to its voting recommendations. While rare, ISS may issue an alert to change a vote recommendation closer than 5 business days before the meeting only under extraordinary circumstances.

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Change By Company May Require Resolicitation

If a company agrees to a change in order to convince ISS to reverse a negative recommendation, it must be careful if that changes the substance of a proposal or plan that is to be approved by shareholders—because shareholders may need to be resolicited.

The analysis includes consideration of whether shareholders have sufficient information to vote on the proposal that is consistent with the information in the proxy statement and proxy card that they was originally delivered. A resolicitation can be quite expensive—and may include a postponement of the shareholders meeting date.

Negative Recommendations Shouldn't Stop You From Engaging With Shareholders Directly

There are many cases when proxy advisors will recommend one way on a proposal—but actual voting results fall the opposite way. So a negative proxy advisor recommendations does not necessarily mean the proposal will fail. There are many situations in which proxy advisors will recommend against a proposal, but shareholders will nevertheless support it. The key to retaining shareholder support despite a negative recommendation often is effective shareholder engagement.

If you are on the bandwagon with year-round engagement, you shouldn't get too caught by surprise if things are going against you. And chances are, if things are going against you in the engagement, things probably will go against you in the proxy advisor reports once they are issued. Even if you're caught completely off guard, you should reach out to your top shareholders and have a dialogue with them—and articulate as best as possible why the proxy advisor was wrong. Scheduling may be a challenge, but it is usually possible to arrange some sort of dialogue with your key investors. Note that if that is the first time your company is reaching out to them, you may be fighting an uphill battle. Year-round engagement with your major shareholders should give you a sense well in advance that obtaining shareholder approval for a particular proposal or director nominee may be a challenge. More importantly, that engagement may provide you with insights into the specific concerns of your key shareholders under their own policies—which may or may not be the same as those that prompted a negative recommendation from ISS or Glass Lewis.

To make your arguments with investors, don't focus on why you disagree with the proxy advisors. Most investors are insulted with that approach, particularly if they have their own policies.

Instead, you should focus on your own circumstances and explain why the company did what it did. Focus on the investor's policies as they may well differ from those of the proxy advisor—and you may be able to make a cogent argument based on that difference (for example, if the issue is overboarding, Fidelity focuses more on attendance than on actual overboarding).

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Contact Shareholders as Soon as Possible

If there's a negative recommendation, don't delay your direct outreach to shareholders. You want to have time to respond to any shareholder feedback and give your shareholders time to consider your response. During these outreach efforts, it's best to focus on the merits of management's proposals rather than why the company believes the proxy advisors' recommendations are wrong.

Depending on the topic, consider assembling a cross-functional management team, including colleagues from investor relations, legal and senior management—and possibly one or more directors (*e.g.*, from the compensation or governance committee)—to participate in these engagement efforts. Involving directors can reassure shareholders that there are governance processes in place to address any concerns. These meetings aren't typically attended by compensation consultants and outside counsel, but those external advisors can and should assist in the background. Make sure participants understand the issues involved and are able to address the company's position and respond to questions in the meeting.

Responses Can Be Part of Supplemental Materials Filed With the SEC

Companies are allowed to file additional soliciting material with the SEC once they receive a negative recommendation in an effort to respond. Companies aren't obligated to deliver these supplemental materials to all shareholders as long as they do not alter the terms of proposals or include material new information—they can deliver them to a subset of investors or not deliver them at all (which means the content is publicly available so that the company can use them as talking points in conversations, etc.).

There is no prescribed format for these supplemental materials. They typically are short 1-2 page documents, often in the form of a letter. The letter can come from the board or management, and even occasionally from a company's compensation consultant.

The goal is to build your case in these materials. So you want to focus on your argument and not overly restate the background already disclosed in your proxy statement. Supplemental filings are best used to draw attention to company-specific factors that the company believes may not have been adequately considered, to highlight positive aspects of management recommendations that may have been overlooked in the proxy statement and to frame future discussions with shareholders.

One decision point is whether to even bother mentioning the negative recommendation in the supplemental materials. Doing so helps bring focus to your arguments. But doing so also makes the materials seem defensive—as well as makes it seem that the proxy advisor's position is more important than the positions of your shareholders. Remember that the proxy advisor voting reports are not publicly available—so although there may be leaks, the news of a negative recommendation isn't always in the public domain.

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Use Experience to Improve Next Year's Disclosures

It's hard to find a silver lining in a negative recommendation—but if one exists, it's that it can help you recognize sticking points so that you can improve disclosure & outreach the following year. Your next proxy statement should discuss those outreach efforts—*e.g.,* number of shareholders contacted, the percentage of outstanding shares they represent, topics discussed—and any changes adopted in response to the shareholder vote and other shareholder feedback throughout the year. And you can also discuss those efforts with the proxy advisors in advance of your next shareholder meeting.

Don't File Supplemental Materials Slamming Proxy Advisors; Be Proactive Instead

For the first few years under Say-on-Pay, companies filed supplemental letters with the SEC if they received a negative proxy advisor recommendation, particularly if they received one from both ISS and Glass Lewis. Those supplemental materials initially addressed all of the flaws with ISS and Glass Lewis and their methodology—but that approach didn't prove to be effective with shareholders. So most supplemental materials have now evolved into more positive filings that explain the company's story.

Try to Avoid Supplemental Materials Altogether; Make Your Case Once

The number of supplemental filings have dwindled overall—as companies have more frequently incorporated the content that would be in their proxy statement disclosures. Investors are too busy during proxy season to keep track of multiple filings where you make a case.

Often you know going in—based on conversations with investors and because you can run some proxy advisor modeling in advance—that you're going to flunk with the proxy advisors. And that's when you should really spend time explaining why your governance practices are properly structured in your proxy disclosures the first time around.

Investors Don't Want to Hear You Complain About Proxy Advisors

Since your Top 25 investors are likely going to have their own policies, avoid haranguing about Glass Lewis or ISS when you engage them. They're really not interested—and in fact, they might be insulted because they have their own policies.

The bottom line is that they want you to understand where they're coming from. Focus on what your investors want to hear; not on what you want to complain about.

Glass Lewis Will Distribute "Feedback" on Reports (For A Cost)

Glass Lewis allows companies and shareholder proponents to express how their opinion differs from what's in Glass Lewis's research. You don't have to be a Glass Lewis client to use this service, but you have to purchase the relevant annual meeting report (at a cost ranging from $750

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to $6,000, depending on size of the company) and pay a $2,000 fee for the distribution of the "Report Feedback Statement" (RFS).

Only publicly available and legally vetted information should be shared in the Report Feedback Statement. And because the feedback can't contain any new information, there should be no need to file additional soliciting material. At the same time, it would be worthwhile for companies to confirm there is nothing in the RFS that requires filing under Rule 14a-6, so you don't run into additional problems later. Glass Lewis has FAQs and an "Etiquette Guide" that explain the process in more detail.

9. Engagement With Proxy Advisors

How to Set Up Meetings With Proxy Advisors

ISS stated in an interview in 2024 that the best way to schedule a meeting is to reach out through their online portal ("ISS Help Center"), which you can at https://issgovernance.service-now.com/csp. ISS requests that you also submit a detailed proposed agenda so that the team can determine which analysts should take part and enable those analysts to prepare in advance. At minimum, your submission should include:

- A detailed agenda for the engagement
- A list of the company's participants
- Your preferred dates/times

Glass Lewis identifies a director of engagement on its website—that's the person you should contact to organize a meeting and plan meeting logistics (*i.e.,* the agenda and participants).

Both proxy advisors will want a complete list of company participants in advance.

Glass Lewis Won't Talk to Companies Once Proxy Statement Filed

Glass Lewis typically won't engage with companies during the solicitation period, which is between the date a notice of meeting is released (*i.e.,* filing of a preliminary or definitive proxy statement) and the meeting date itself. So once a company has filed its proxy, Glass Lewis is in self-imposed blackout mode and will refrain from conversation with companies—with an exception if it reaches out to a company to ask a clarifying question. There are exceptions for material errors in a Glass Lewis report.

The reason for the policy is that Glass Lewis finds the discussions outside the proxy season more constructive as there's more time to both prepare and for companies to react. It also enables Glass Lewis to avoid feeling they're in a position of somehow negotiating on behalf of its clients about its recommendation or a change to a company's program.

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Glass Lewis does hold "Proxy Talks" during the proxy season, which are conference calls that they moderate, during which investors can submit questions. These allow companies and shareholder proponents—on two separate calls—to make their case. Proxy Talks are also held for proxy contests, with dissidents on one call and management on another. Proxy Talks facilitate engagement with its investor clients listening in—so Glass Lewis isn't acting as a filter.

Meeting With ISS During Proxy Season Possible (But Difficult to Schedule)

ISS prefers to engage outside of the proxy season (*i.e.,* August–February). Telephonic meetings during the proxy season are possible—but are best done only if there is a disagreement over a recommendation.

Sometimes ISS will instigate an engagement if they have questions after reviewing a proxy statement. If there is a contentious situation involving two parties—such as a proxy contest—ISS will likely engage both parties. The same goes for contentious "vote no" campaigns.

Sometimes a company will want to talk to ISS just before it files its proxy—and ISS likely will suggest they file first and talk afterwards as the conversation might be more constructive after filing.

ISS Prefers Remote Meetings to In-Person Meetings

Even outside the proxy season, most meetings with ISS are mostly held over Zoom, Teams or Webex rather than in-person. However, there are times when an in-person meeting may make more sense. If a company has gotten a very low vote or failed a Say-on-Pay and they feel they really want to sit across the table or bring directors, ISS will try to accommodate that. But it's costly for the company, so ISS encourages remote engagement—they believe it's just as effective as an in-person meeting. During the annual meeting season, in-person meetings are typically limited to contentious issues, including contested mergers, proxy contests or other special situations, while engagement on other topics is handled remotely.

On the other hand, you get a little bit more out of the personal interaction—and a little bit more color commentary—when you're meeting with ISS in its headquarters in Rockville, Maryland.

ISS prioritizes engagements with companies that have substantive governance issues. For example, low support for Say-on-Pay or director elections, majority-supported shareholder proposals, ISS recommendations against management proposals at the prior meeting, or companies undergoing major transitions.

Bring Right People to Meetings

Although the circumstances will dictate who should attend the meeting, typical attendees include the corporate secretary and general counsel. Sometimes, the head of human resources or investor relations is involved. Or the CEO or CFO could be involved—or even a director.

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Don't bring someone if they have no knowledge of the circumstances—as too many cooks can spoil the meeting.

Sometimes it's appropriate to bring a compensation consultant, proxy solicitor or other advisor to a meeting—but that only works if they participate in a supportive role. The proxy advisors want to hear what the company has to say—not what the advisor thinks.

Don't Let Your Advisor Do All The Talking

Don't let your lawyer, proxy solicitor or compensation consultant do all the talking. Their role should be to assist your presentation; not dominate it. You need to prove that you know the issues—and that you have the solutions.

ISS Wants Directors to Participate in Engagement

Although it's not absolutely necessary, ISS prefers that one or more board members participate in engagement. The reason for this is that ISS is focused on hearing about the company's long-term focus & strategy.

In addition—if the topic is executive compensation—ISS deems it inappropriate to discuss that topic while the executive is present and would ask the person to recuse themselves. ISS prefers that a compensation committee member handle that discussion. Make sure that you bring a director who's knowledgeable about the issues so that they have credibility.

Inform the Board (or Board Committee) About Engagement Activity

If a company does engage with a proxy advisor, it is wise to report back to the full board—or at least the board committee tasked with shareholder engagement (typically the corporate governance committee)—about how it went. A few boards have created "Shareholder Liaison Committees"—but not many, which could be a good thing as too many board committees is unnecessary.

Send Your Presentation to Proxy Advisors In Advance of Meeting

You should send a presentation to the proxy advisor in advance of a meeting, so that the meeting will be less of a prepared dialogue—and a bit more give and take. This advice works for both telephonic and in-person meetings. The presentation should synthesize what you have (or expect to have) in your public disclosure—but can be crafted to appeal to the advisor's policies.

Know Proxy Advisor's Policies Before You Engage With Them

Companies who approach proxy advisors should understand how their policies actually work before they seek a meeting. Unfortunately, many don't. Do your homework.

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Tell Your Story In Your Proxy Disclosures (Not Just During Meetings)

Proxy advisors like to get color from companies during engagements—but they ultimately will base their recommendations based on what they see in the company's disclosures at the time of the meeting. A persuasive proxy statement is particularly important if unique company or industry factors have led the company to make decisions that would be disfavored under general voting policies. The proxy statement can anticipate concerns and provide some context to mitigate them—although it may not change voting recommendations.

Don't Expect Definitive Answers at Proxy Advisor Meeting

Ensure that your board and senior team don't expect a resolution to come out of a meeting with a proxy advisor. That won't happen. The most you will get is some general feedback, such as "yes we've seen that a lot" or "no, we find that it doesn't help."

You'll get some direction on what it is that you're thinking of doing—and that is important if you've had a failed vote or it's an important vote coming up.

Success in these meetings is defined as getting the most color commentary that you can—possibly a sense of what disclosures or explanations would be helpful to add to your proxy materials. So don't fill it up with your side doing all the talking. That's why you should email them your presentation way in advance—so you can get right to the nitty gritty and not waste everyone's time with the background.

Another point is to not come to the meeting asking the proxy advisor what it is that they want to hear. Don't expect the proxy advisor to pipe up and explain what its issue is. You should have done your homework and know what your issues are—and you should be spending your time during the meeting explaining your solution to fix those issues.

Increasingly, proxy advisors are also interested in hearing about investor feedback that the company has received during engagement efforts—and what the company is doing to address any concerns. Remember that the proxy advisors' engagement goal is to strengthen their reports and analysis.

Companies Shouldn't Violate Reg FD During Meetings

Due to concerns under Regulation FD, companies should be careful not to divulge confidential information. Also note that there is a very broad definition of "solicitation" under the proxy rules.

While many practitioners have gotten comfortable that most governance modifications aren't considered "material"—and thus don't pose Regulation FD concerns—proxy advisors will only take publicly-available information into account for their voting recommendations. In addition, the bigger concern is that in the midst of a conversation about governance, a question is asked about financial performance. Spokespersons must be well versed in how Reg FD is applied in practice, so they don't slip and inadvertently say something they shouldn't have.

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Remember that a confidentiality agreement does not have to be in writing to be valid under Regulation FD; an "express" oral agreement will suffice. Of course, a company is better able to prove that another party agreed to keep the information confidential if there is a written document. In addition, a written agreement can better define the scope of permitted uses, which reduces the likelihood of subsequent disputes. Proxy advisors won't sign a confidentiality agreement as they specifically tell companies not to share material, nonpublic information. And ISS's FAQs expressly state that they accept no obligation of confidentiality with respect to matters discussed during their engagements.

So, if you accidentally disclose confidential information, the best thing to try to do is create a contemporaneous written record of any oral agreement to maintain confidentiality. This provides some written evidence in the event the information is improperly used for insider trading.

10. Common Questions & Our Analysis

ISS Director Independence—Former Officer Classification

Question: ISS director independence standard 2.3 indicates that a former CEO isn't considered "independent", and standard 1.1 excludes from independence any "current officer" (using the Section 16 definition of officer).

Do you know whether the ISS standard 2.3 exclusion covers only the CEO and not the president for a company that splits those roles? I am guessing that the answer to this is obvious—they only said CEO and they mean only CEO—but because those roles often go together, I'm wondering whether it's "understood" that this would apply to the president as well.

Also, I would think that the Vice Chairman wouldn't be considered an "officer" for purposes of the ISS determination of independence (as long as the Vice Chairman doesn't perform any significant policy-making functions).

Answer: When it comes to other officers—CEO is likely to mean CEO, particularly since the footnotes to ISS's classification system says it will generally follow the Section 16 approach when it comes to identifying "officers," and then restates the familiar litany of officers, which includes the president. We would remain cautious about their classification of a Vice Chair, particularly if that person's non-policy making role isn't self-evident from disclosure in the proxy statement.

Note that while there's not a permanent disqualification from being considered independent for former officers other than the CEO, these people won't be eligible for consideration as independent directors by ISS for at least 5 years.

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ISS May Continue Recommending Against After Failed Attempt to Remedy

Question: If ISS's policy on a topic (whether on supermajority provisions or a dual-class structure, for example) is to recommend a vote against the relevant directors, and a company proposes amendments to eliminate the problematic provision but fails to meet the required shareholder approval requirement, would ISS keep recommending against the directors in future years despite the company's failed efforts?

Answer: Yes, ISS generally does continue to recommend against the directors every year. This is particularly true when a company tries to eliminate the dual-class structure but fails—given insider shareholders with a lot of voting power can vote against it.

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