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The Global CEO Advisory Firm

Teneo Insights:
Corporate Governance Update

December 2018

November was a busy month for corporate governance, including: (i) newly proposed legislation on proxy advisory firms; (ii) SEC proxy voting roundtable held on November 15th; and (iii) updated ISS and Glass Lewis proxy policies announced in November. See our September client insight on proxy advisor regulatory reform for related background as well (September client insight).

Additional Proposed Proxy Advisor Legislation

On November 14, 2018, a bi-partisan group of U.S. Senators introduced Senate Bill S. 3614 (the "Corporate Governance Fairness Act") that would require proxy advisory firms to register as investment advisers under the Investment Advisers Act of 1940. This bill is intended to "protect investors, improve corporate governance, and hold proxy advisory firms accountable." The bill's sponsors include U.S. Senators Jack Reed (D-RI), David Perdue (R-GA), Doug Jones (D-AL), Thom Tillis (R-NC), Heidi Heitkamp (D-ND), and John Kennedy (R-LA). The bill has been referred to the Senate Banking, Housing, and Urban Affairs Committee.

In addition to requiring proxy advisory firms to register as investment advisers under the Investment Advisers Act of 1940, the Corporate Governance Fairness Act would also require the SEC periodically examine proxy advisory firm records. This review would focus on proxy advisory firm conflicts of interest policies as well as any material errors and omissions contained in proxy research reports. The SEC would also be required to consult with all relevant stakeholders and report back periodically (initially within two years) to the Senate Banking Committee and the House Financial Services Committee with recommendations for any additional investor protections so that investors have the tools to make informed investment decisions and exercise their rights as shareholders. Please see Appendix A for a summary of the bill.

The latest Senate bill may not become law during the current Congressional session, but it arguably puts additional pressure on the SEC to take further action following its November 15th roundtable on proxy issues (described below). If enacted, the Corporate Governance Fairness Act could provide the SEC with more influence over how proxy advisory firms should be regulated in the future.

SEC Roundtable on the Proxy Process

Three separate proxy-related roundtables were conducted on November 15th at the SEC. A description of each roundtable is included below. The SEC has stated it will utilize what was learned at the November 15 roundtables for future consideration.

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Proxy voting mechanics and technology ("proxy plumbing"): This panel discussion included issues related to end-to-end vote confirmation, chain-of-custody issues, universal proxy cards in contested director elections, blockchain technology, NOBO/OBO rules, and the roles of the various voting intermediaries. Participants exhibited general agreement that vote confirmation is critical, and that blockchain technology could enable traceable shares and vote confirmation without compromising investor privacy. Some commentators noted that the SEC may want to put more focus on developing ways for companies to communicate with beneficial owners and solving problems related to "proxy plumbing" than on, for example, universal proxy cards.

Shareholder proposals and shareholder engagement: This panel discussion included shareholder engagement, the number of shareholder proposals that companies receive, the submission thresholds for shareholder proponents, and the re-submission thresholds for failed shareholder proposals. Participants generally agreed that both shareholders and companies have benefitted from an increase in engagement over the past few years. Several investors noted that shareholder proposals facilitated productive engagement and that the shareholder proposal process is working well. Some corporate representatives advocated for the SEC to raise submission and/or resubmission thresholds, require more proof of ownership by proponents, and re-examine certain no-action decisions.

Proxy advisory firms: The heads of the two largest advisors, ISS and Glass Lewis, stated that most of their clients do not automatically vote with ISS or Glass Lewis (so-called "robo-voting"). Instead, they explained, most investors use the firms' research as inputs into their own voting decisions as well as to facilitate the administrative execution of their votes. ISS and Glass Lewis also described the procedures in place to help address potential, material conflicts of interest. Various investors added that the services provided by Glass Lewis and ISS allowed them to focus their resources on more contentious voting issues. Despite expectations, most panelists did not express urgency about the need for proxy advisor regulation.

Shortly after the roundtable, SEC Chairman Jay Clayton noted that proxy advisor regulation, the shareholder proposal process, and "proxy plumbing" issues are all rulemaking priorities for the SEC in 2019.

ISS Policy Updates

ISS released 2019 voting policy updates on November 19th; a summary of key changes for U.S. companies is below:

Board Diversity: ISS may oppose the chair of the nominating committee when there are no women on the company's board (effective on Feb. 1, 2020). Mitigating factors will include (i) proxy disclosure indicating a commitment to appoint at least one female to the board in near term; and (ii) the presence of a female on the board at the preceding annual meeting. Glass Lewis already has a similar policy on this issue.

Board Accountability: ISS will consider opposing directors (members of the governance committee or the full board) when companies obtain no-action relief for shareholder proposals by sponsoring proposals to ratify existing charter or bylaw provisions. Mitigating factors will include (i) the presence of a shareholder proposal addressing the same issue on the same ballot; (ii) the board's rationale for seeking ratification;

(iii) disclosure of actions to be taken by the board should the ratification proposal fail; (iv) disclosure of shareholder engagement regarding the board's ratification request; and (v) the level of impairment to shareholders' rights caused by the existing provision.

Social and Environmental Issues: ISS updated its policy on social and environmental shareholder proposals to explicitly state that ISS will consider significant controversies, fines, penalties or litigation when evaluating such proposals. In this case, ISS has codified what it has already been doing. What has not been defined is what ISS considers a "significant" controversy, fine, penalty or litigation. Historically, the bar has been low – in at least one case, an ISS analyst was inclined to support a shareholder proposal based on a single lawsuit that few other than the company and shareholder proponent were aware of.

Glass Lewis Policy Updates

Glass Lewis also issued policy updates on November 1st:

Conflicting and Excluded Proposals: Glass Lewis has codified its policy regarding conflicting special meeting shareholder proposals: (i) when a company's ballot includes both a management and shareholder proposal requesting different thresholds to call a special meeting, Glass Lewis will normally support the proposal with the lower threshold; (ii) if there are conflicting proposals and there is currently no special meeting right, Glass Lewis may recommend that clients support the shareholder proposal and abstain from voting on the board's proposal; and (iii) if a company excludes a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis may recommend against the ratification proposal and members of the nominating and governance committees. Glass Lewis will also note instances where the SEC has allowed companies to exclude shareholder proposals, which may result in recommendations against members of the governance committee.

Environmental and Social: Glass Lewis will begin generally recommending (i) in favor of employee diversity reporting; (ii) against directors who have failed to oversee risks related to environmental or social issues; and (iii) consider the Sustainability Accounting Standards Board framework in determining the financial materiality of shareholder proposals.

Virtual-only Shareholder Meetings: As previously announced, Glass Lewis will recommend against members of the nominating/governance committee if the company holds a virtual-only shareholder meeting and does not ensure that shareholders are afforded the same rights and opportunities to participate as an in-person shareholder meeting.

Appendix A

The Corporate Governance Fairness Act (S. 3614)

- Requires all proxy advisory firms with greater than $5 million in annual revenue to register as investment advisers under the Investment Advisers Act of 1940;

- Requires the SEC to periodically examine the records of proxy advisory firms, which must include a review of whether the proxy advisory firms knowingly made false statements or omitted to state any material fact to its clients, as well as the firm's conflicts of interest policies;

- Requires the SEC to consult with all relevant stakeholders and report back periodically (initially within two years after passage of the Act and at least every five years thereafter) to the Senate Banking Committee and the House Financial Services Committee with recommendations for any additional investor protections beyond continued access to proxy advisory firms so that investors have the tools to make informed investment decisions and exercise their rights as shareholders.