KINGSDALE
Shareholder Services

Kingsdale Governance Advantage

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U.S. Market Update: 2016 Glass Lewis Benchmark Guidelines

On November 13, 2015, Glass, Lewis & Co., LLC ("Glass Lewis") released their 2016 Benchmark Guidelines for the U.S. market as part of their annual formal update process.

While not explicitly stated, based on prior experience, these guidelines will **be applied for shareholder meetings held beginning in 2016 unless otherwise noted**.

Glass Lewis instituted five categories of changes relating to its U.S. benchmark guidelines: (i) "overboarding" guidelines have been tightened, (ii) the evaluation of exclusive forum provisions in pre-IPO companies have been revised, (iii) a new framework has been added to assess conflicting management and shareholder proposals, (iv) poor performance as a result of missing director assessment and board refreshment processes may generate negative recommendations, and (v) directors may be held responsible for the failure to identify material social and environmental risks. Glass Lewis has also further elaborated on two items related to compensation without changing its policy application: (i) guidance has been provided to disclosures for transitional and one-off awards; and (ii) methodology of equity plans evaluation has been clarified further.

Details regarding changes in each category with additional Kingsdale commentary can be found below:

1. Director Overboarding

Previously, Glass Lewis recommended that shareholders vote **AGAINST** executive officers of public companies who serve on more than three boards in total and non-executive directors who serve on more than six boards in total.

Glass Lewis revised its guidelines to tighten those thresholds and they will now recommend **AGAINST** public company executive officers who serve on more than two boards in total and non-executive directors who serve on more than five boards in total. A grace period for issuers has been provided and voting recommendations for the 2016 proxy season will rely on the previous thresholds. Beginning in 2017, the new thresholds will be applied.

> ***Kingsdale Commentary***: *Consistent with the proposed updated guidelines of Institutional Shareholder Services Inc. ("ISS"), whereby "overboarding" thresholds are tightened (i.e., the maximum number of allowed boards is reduced), Glass Lewis has adopted a stricter stance in evaluating excessive commitments of directors. Whereas ISS merely scrutinizes CEOs of public companies, Glass Lewis' executive "overboarding" guidelines apply to all executives of public companies. We believe that in 2016, Glass Lewis will still closely monitor director commitments and may add cautionary language (without issuing negative recommendations) in instances where directors serve on an excessive number of boards as per the new thresholds.*

2. Exclusive Forum Provisions

Previously, Glass Lewis recommended that shareholders vote **AGAINST** the Chair of the Nominating/Governance Committee for issuers including exclusive forum provisions in their by-laws or charter in connection with an IPO.

Glass Lewis will no longer automatically vote **AGAINST** the Nominating/Governance Committee Chair, but instead take a case-by-case approach weighing the exclusive forum provision against other factors that may unduly limit shareholder rights (e.g. supermajority vote requirement, classified board, fee shifting by-law). This does not change Glass Lewis' stance for the adoption of exclusive forum provisions outside of spinoff, merger, or IPO situations.

> ***Kingsdale Commentary***: *We believe that the inclusion of the exclusive forum provision alone in pre-IPO charter or by-laws may not generate an* ***AGAINST*** *recommendation on the Chair of the Nominating/Governance Committee. However, subsequent amendments with the inclusion of the exclusive forum provision will be evaluated through Glass Lewis' standard framework. We remind clients that bundled by-laws (without separating the exclusive forum provision in another resolution if put forth) will yield negative recommendations on the Chair of the Governance/Nominating Committee, but the bundled by-law itself would be evaluated on a holistic approach, weighing the effects of all the bundled provisions. Fee-shifting by-laws will continue to be heavily scrutinized by Glass Lewis and the adoption of such in the pre-IPO charter or by-laws will result in an* ***AGAINST*** *recommendation for the entire Governance Committee.*

3. Conflicting Management and Shareholder Proposals

Likely as a result of the Securities and Exchange Commission's ("SEC") recent release of the Staff Legal Bulletin No. 14H on October 22, 2015, which increases the burden of management seeking to prove conflicting proposals exists between management and shareholders (usually for Proxy Access, see our memo on this here), Glass Lewis amended its guidelines to reflect that conflicting management and shareholder proposals will be evaluated based on:

- The nature of the underlying issue;
- The benefit to shareholders from implementation of the proposal;
- The materiality of the differences between the terms of the shareholder proposal and management proposal;
- The appropriateness of the provisions in the context of a company's shareholder base, corporate structure and other relevant circumstances; and
- A company's overall governance profile and, specifically, its responsiveness to shareholders as evidenced by a company's response to previous shareholder proposals and its adoption of progressive shareholder rights provisions.

> ***Kingsdale Commentary****: While Glass Lewis' framework for evaluating Proxy Access remains unchanged, it remains to be seen how Glass Lewis will apply its new framework when two conflicting proposals are on ballot.*

4. Nominating Committee Performance: Director Assessment and Board Refreshment

Previously, Glass Lewis' guidelines did not generate any recommendations based on the lack of periodic director assessment or board refreshment. Glass Lewis has updated its guidelines to recommend

AGAINST the Chair of the Nominating Committee for a subject company's poor performance as a result of the board's failure to ensure directors with relevant experience, either through periodic director assessment or board refreshment, are appointed.

> ***Kingsdale Commentary****: The actual application of this policy remains to be seen, but it appears to be double triggered where lack of periodic director assessment or board refreshment in addition to poor performance (likely in the form of total shareholder returns) is evident. Clients experiencing "poor performance" and looking to avoid negative recommendations on the Chair of the Nominating Committee could consider enhancing disclosures surrounding director assessments and board refreshment. Although not highlighted, we believe long director tenures may be an indicator used by Glass Lewis to identify lack of board refreshment.*

5. Environmental and Social Risk Oversight

Previously, Glass Lewis' guidelines were silent on specific environmental and social risk oversight procedures.

Now, Glass Lewis has codified its position for cases where the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively impact shareholder value. In those cases, Glass Lewis will recommend that shareholders vote **AGAINST** directors responsible for risk oversight in consideration of the nature of the risk and the potential effect(s) on shareholder value.

> ***Kingsdale Commentary****: The key aspect of this policy is the identification and management of material environmental or social risks that* ***did (backward looking) or could (forward looking)*** *negatively affect shareholder value. As such, shareholder value need not be affected, the mere fact that an environmental or social risk could negatively affect shareholder value may trigger this policy. Glass Lewis has not specified which directors will receive negative recommendations. We believe this is assessed on a case-by-case basis depending on which committee or directors are in charge of such risks. The onus may be placed on directors serving on a committee like the environmental, health, or safety committee, broadening Glass Lewis' scope of only traditionally targeting key committees (Audit, Compensation, and Governance/Nominating).*

6. Compensation: Transitional and One-off Awards; Equity-based Compensation Plans

Glass Lewis has further clarified two items relating to compensation: (i) further guidance has been provided with regards to disclosures surrounding transitional and one-off awards and (ii) the evaluation of equity-based compensation plans has been further elaborated.

Glass Lewis clarified that sign-on arrangements at the executive level should be clearly disclosed and accompanied by meaningful explanation of the payments and process by which the amounts are reached. Basis for "make-whole" payments should also be provided. Glass Lewis will also consider target levels of compensation and compensation paid to other executives (including predecessor pay) in evaluating whether or not the payments are appropriate.

For equity-based compensation plans, Glass Lewis further elaborated on the quantitative and qualitative assessments in providing recommendations for equity plans.

> ***Kingsdale Commentary****: We believe Glass Lewis is merely codifying and clarifying their evaluating framework with regards to transitional and one-off awards. The evaluation of transitional and one-off awards will still be completed on a case-by-case basis and additional clarity regarding such payments and the Compensation Committee's decision to arrive at and approve such awards*

would serve to better assist shareholders in understanding such payments. We do not believe there are changes to Glass Lewis' methodology for evaluating equity plans but this update serves to further elaborate on their process.

If you have any questions about this update, please feel free to contact Victor Li or Jackie Cheung directly to discuss.

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