

United Kingdom



**GLASS LEWIS**

2023 Policy Guidelines

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# About Glass Lewis

Glass Lewis is the world's choice for governance solutions. We enable institutional investors and publicly listed companies to make sustainable decisions based on research and data. We cover 30,000+ meetings each year, across approximately 100 global markets. Our team has been providing in-depth analysis of companies since 2003, relying solely on publicly available information to inform its policies, research, and voting recommendations.

Our customers include the majority of the world's largest pension plans, mutual funds, and asset managers, collectively managing over \$40 trillion in assets. We have teams located across the United States, Europe, and Asia-Pacific giving us global reach with a local perspective on the important governance issues.

Investors around the world depend on Glass Lewis' [Viewpoint](#) platform to manage their proxy voting, policy implementation, recordkeeping, and reporting. Our industry leading [Proxy Paper](#) product provides comprehensive environmental, social, and governance research and voting recommendations weeks ahead of voting deadlines. Public companies can also use our innovative [Report Feedback Statement](#) to deliver their opinion on our proxy research directly to the voting decision makers at every investor client in time for voting decisions to be made or changed.

The research team engages extensively with public companies, investors, regulators, and other industry stakeholders to gain relevant context into the realities surrounding companies, sectors, and the market in general. This enables us to provide the most comprehensive and pragmatic insights to our customers.

## Join the Conversation

Glass Lewis is committed to ongoing engagement with all market participants.

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# Guidelines Introduction

## Corporate Governance Background

Corporate governance guidelines in the UK are based primarily on the UK Corporate Governance Code (the UK Code). The UK Code is maintained by the Financial Reporting Council (FRC) and was last updated in 2018.

As a guideline for boards to discharge their duties to companies and their shareholders, the UK Code sets out principles and provisions of good practice in relation to board leadership, effectiveness and accountability; remuneration; and relations with shareholders. It operates on a “comply or explain” basis, whereby a thorough and acceptable explanation for a deviation from the UK Code’s provisions may be provided in lieu of compliance. The most recent revisions to the UK Code have attempted to clarify what constitutes a “meaningful explanation” in lieu of compliance, encouraging non-boilerplate disclosure from board committees and board leaders in communicating their roles and processes to shareholders. Under the two-tiered listing regime overseen by the Financial Conduct Authority (FCA), the revised UK Code applies to all companies with a “Premium”, rather than “Standard”, listing of equity shares on the London Stock Exchange (LSE), regardless of their corporate domicile.

For its part, Glass Lewis will continue to take a holistic view of the operation and composition of the board and the prevailing culture at the company, rather than applying a mechanistic reading thereof. This approach is sure to be aided by the greater transparency and enhanced disclosure for which the UK Code advocates and which we welcome.

Best practices in the UK are also heavily influenced by the Investment Association, a trade body for the UK asset management industry. Glass Lewis will therefore review companies’ adherence to the Investment Association’s principles alongside those of the UK Code. Further, we will consider the requirements of the UK Listing Rules as maintained by the FCA.

The Companies Act (the “Act”) provides the legislative framework for regulation. The Act was last revised in 2006, with full compliance required by October 2009.

In addition, Glass Lewis’ UK policy guidelines incorporate global corporate governance best practices and are reviewed annually to ensure they remain current with market practice, regulations, governance codes, and the evolving standards of best practices for UK corporate governance.

## Market and Regulatory Updates

### Diversity

The area of diversity has seen two major developments this year: the update to the UK’s Financial Conduct Authority (FCA) Listing Rules and the publication of the inaugural [FTSE Women Leaders Review](#) in February 2022.

In April 2022, following a consultation on proposals to promote diversity and inclusion on public company boards, the FCA [announced](#) new diversity targets and associated disclosure requirements for UK companies. The

updated rules increase the expectations for gender representation for all Main Market listed companies on the London Stock Exchange and expand the field to cover leadership positions and other forms of diversity, for companies with reporting periods starting on or after April 1, 2022.

The targets are as follows:

- At least 40% of the board are women;
- At least one of the senior board positions (Chair, Chief Executive Officer (CEO), Senior Independent Director (SID) or Chief Financial Officer (CFO)) is a woman; and
- At least one member of the board is from a minority ethnic background (which is defined by reference to categories recommended by the Office for National Statistics (ONS)) excluding those listed, by the ONS, as coming from a White ethnic background).

In addition, public companies will be required to include a statement in their annual financial report setting out whether they have met specific board diversity targets, and to publish standardized numerical data on the sex or gender identity and ethnic diversity of their board, senior board positions (Chair, CEO, SID and CFO) and executive management.

The revised Listing Rules also expand existing reporting requirements to cover the diversity policies of key board committees and to indicate that reporting on board and board committee diversity policies could consider wider diversity characteristics.

Furthermore, the FTSE Women Leaders Review's voluntary targets are largely identical to those of the FCA, albeit just for FTSE 350 companies and to be achieved by the end of 2025.

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

## Capital Management

On October 12, 2021, HM Treasury launched the UK Secondary Capital Raising Review (Review) to look into improving further capital raising processes for publicly traded companies in the UK. On July 12, 2022, the outcome of the [Review](#) was published and, it called for, among other things, an increase in the general thresholds established by the Pre-emption Group.

On November 4, 2022, the Pre-emption Group updated its Statement of Principles in order to implement the recommendations of the Review. The limit for general authorities to issue shares without preemptive rights has been increased, subject to certain disclosure recommendations, from 5% to 10%. Further, the additional authority to issue shares without preemptive rights limited to use in connection with an acquisition or specified capital investment, was also increased from 5% to 10%. An additional 2% leeway has been given on each authority in cases where the additional 2% is limited to a follow-on offer intended to involve retail and other investors otherwise excluded from the issuance. The Pre-emption Group calls for further consideration to be made for companies that might be described, and disclose themselves, as 'capital hungry'.

Please refer to the "General Authority to Issue Shares Without Preemptive Rights" section of these guidelines for further information.

## Summary of Changes for 2023

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

### External Commitments

We have amended and extended the "External Commitments" section of these guidelines to outline cases where we believe a director may be potentially overcommitted and to better clarify how our policies are applied. Specifically, we will consider a director to have a potentially excessive commitment level when they:

- Serve as an executive officer of any public company while serving on more than one additional external public company board; or
- Serve as a non-executive director on more than five public company boards in total.

We will continue to count non-executive board chair positions at UK companies as two board seats given the increased time commitment generally associated with these roles.

Please refer to the "External Commitments" section of these guidelines for further information.

### Director Accountability for Climate-related Issues

In a new section of these guidelines, we have outlined our view that climate risk is a material risk for all companies and that companies, particularly those whose greenhouse gas (GHG) emissions represent a financially material risk, should provide clear and comprehensive disclosure of their risks, including how they are being mitigated and overseen.

Where companies with increased climate risk exposure have not provided thorough Task Force on Climate-related Financial Disclosures (TCFD)-aligned climate-related disclosure and/or have not explicitly and clearly defined board oversight responsibilities for climate-related issues, we may recommend voting against a responsible member of the board or other relevant agenda item(s).

Please refer to the "Director Accountability for Climate-related Issues" section of these guidelines for further information.

## Clarifying Amendments

The following clarifications of our existing policies are included this year:

### Employee Representatives

We have updated the "Independence" section of the guidelines to better clarify our interpretation of an employee representative serving on the board of directors. In addition, we have updated the guidelines to clarify that employee representatives are not included for the purposes of calculating ?



Please refer to the “Independence” section of these guidelines for further information.

## Cyber Risk Oversight

In a new section of these guidelines, we have outlined our belief that cyber risk is material for all companies and that a company’s stakeholders would benefit from clear disclosure regarding the role of the board in overseeing issues related to cybersecurity. Further we have clarified that, while we will generally not make recommendations on the basis of a company’s oversight or disclosure concerning cyber-related issues, we may recommend against appropriate directors in instances where cyber-attacks have caused material risk to shareholders and we find the company’s disclosure or oversight to be insufficient.

Please refer to the “Cyber Risk Oversight” section of these guidelines for further information.

## Pensions

We have updated this section of the guidelines to clarify that we generally expect pension provisions for executive directors, both those newly appointed and incumbent executives, to be in line with those available to the majority of the wider workforce by the end of 2022, absent a cogent rationale.

Please refer to the “Pensions” section of these guidelines for further information.

## Combined Incentive Plans

We have introduced a new section into these guidelines to better clarify our assessment of combined incentive plans, or omnibus plans, in executive remuneration policies. Specifically, we have clarified our belief that omnibus plans should generally have a minimum vesting period of three years, at least part of the award should be in the form of equity or equity-based instruments, that quantitative underpin/gateway conditions should apply to deferred awards, and there should be some strategic rationale provided for the plan. Further, where a company is amending its incentive structure to adopt a combined incentive plan while removing existing variable incentive plans, we have clarified that we generally expect a substantial reduction in the total target and maximum award opportunity, appropriately reflecting the reduction in the risk profile of the plan.

Please refer to the “Combined Incentive Plans” section of these guidelines for further information.

## Linking Executive Pay to Environmental and Social Criteria

We have clarified our belief that shareholders of companies that have not included explicit environmental or social indicators in their incentive plans would benefit from additional disclosure on how the company’s executive pay strategy is otherwise aligned with its sustainability strategy.

Please refer to the “Linking Executive Pay to Environmental and Social Criteria” section of these guidelines for further information.

## Remuneration Committee Discretion

We have expanded this section of these guidelines to codify our views on certain exercise of remuneration committee discretion on incentive payouts. Glass Lewis recognises the importance of the remuneration committee’s judicious and responsible exercise of discretion over incentive pay outcomes to account for significant events that would otherwise be excluded from performance results of selected metrics of incentive programmes. We believe that companies should provide thorough discussion of how such events were considered in the committee’s decisions to exercise discretion or refrain from applying discretion over incentive pay outcomes.

Please refer to the “Remuneration Committee Discretion” section of these guidelines for further information.

## Specific Authority to Issue Shares

We have updated this section of the guidelines to clarify the approach Glass Lewis takes when analysing proposals to issue shares for a specific purpose outside of routine authorities normally seen proposed on an annual basis. That being, Glass Lewis takes a case-by-case basis in such instances, considering the total number of shares to be issued and the dilutive impact on shareholders; the issuance price and discount/premium; and the intended uses of proceeds from the issuance in the context of the company’s financial position and business strategy.

Please refer to the “Specific Authorities to Issue Shares” section of these guidelines for further information.

# A Board of Directors that Serves the Interest of Shareholders

## Election of Directors

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favour of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for skilled boards with a proven record of protecting shareholders and delivering value over the medium- and long-term. We believe the boards that are best able to protect and enhance the interests of shareholders are independent, have directors with diverse backgrounds, have records of positive performance, and have members with a breadth and depth of experience.

The UK Code recommends that all directors at premium listed companies stand for election annually. Glass Lewis supports annual director elections as a means of increasing director accountability to shareholders. While we expect the vast majority of companies to comply with this provision, we recognise that some firms may have valid reasons to maintain a staggered electoral system in either the short- or long-term. We will not automatically recommend shareholders penalise boards that do not put all directors up for election annually; however, we believe any firms opting to deviate from this provision must provide a clear and reasonable explanation. Glass Lewis may recommend voting against one or more directors at boards that provide unsatisfactory or unjustifiable explanations for such a compliance failure, as well as with those that have significant performance or governance problems that shareholders are unable to address with their votes as a result of a staggered board election process.

If we find that a board's explanation for non-compliance is lacking, or there are significant director concerns that shareholders are unable to address due to staggered director elections, we may recommend that shareholders vote against the board chair.<sup>1</sup> However, we will continue to approach this issue on a case-by-case basis and with regard to the company's overall governance practices.

We note that shareholders may elect to "withhold" their votes or "abstain" from voting on a proposal, rather than casting their votes as either "for" or "against" the measure. Whereas an "against" vote is binding, an "abstain" is not a vote in law and allows shareholders to express reservations about a proposal without unseating the director.<sup>2</sup>

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<sup>1</sup> If the chair is not standing for election or is an executive director, we will recommend voting against the senior independent director.

<sup>2</sup> Although proposals in the UK commonly receive at least some "abstain" votes, we typically only recommend this option to shareholders in rare circumstances, such as when insufficient information is available to provide an analysis or an "against" vote seems unjustified or inappropriate.

## Independence

The independence of directors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of a director, we will take into consideration, where appropriate, whether that director has a track record showing they are able and willing to make objective decisions. Ultimately, our determination of a director's independence takes into account applicable listing requirements, as well as their professional history.

We review each individual on the board and examine their relationships with the company, the company's executives and other board members. The purpose of this analysis is to determine whether pre-existing personal, familial or financial relationships (apart from director fees) are likely to impact the decisions of that board member. We believe the existence of such relationships can make it difficult for a board member to put the concerns of shareholders above either their own interests or those of a related party.

To that end, we classify directors in four categories based on the type of relationships they have with the company:<sup>3</sup>

**Independent Director** — A director is independent if they have no material financial, familial<sup>4</sup> or other current relationships with the company,<sup>5</sup> its executives, its independent auditor or other board members, except for service on the board and standard fees paid for that service. Employment relationships with the company within five years, or business relationships/transactions that have existed within the three years prior to our analysis, are usually considered to be “current” for the purposes of this test.

In our view, a director who is currently serving in an interim management position is considered an insider, while a director who previously served in an interim management position for less than one year and is no longer serving in such a capacity may be considered independent. However, a director who previously served in an interim management position for more than one year and is no longer serving in this capacity is considered an affiliated director for five years following their return to non-executive status.

In addition, we apply heightened scrutiny to non-executive directors who have served on the board for more than nine years,<sup>6</sup> as we believe length of service may affect director independence. In such cases, we will assess the director's independence in light of the board's overall tenure and composition, as well

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<sup>3</sup> If a company does not disclose the independence status of a director, we will look for the presence of any relationships that may preclude independence, but in the absence thereof, will classify the director as a “non-executive” director of the company and treat them as independent for the purposes of our analysis.

<sup>4</sup> “Familial” as used herein includes a person's spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces and nephews, including in-laws, and anyone (other than domestic employees) who shares such person's home.

<sup>5</sup> “Company” includes any parent or subsidiary in a consolidated group with the company or any entity that merged with, was acquired by, or acquired the company.

<sup>6</sup> Provision 10 of the UK Code identifies tenures of more than nine years as being likely to impair a non-executive director's independence.

as any other relevant factors. Further, we expect the company to provide an assurance as to the director's continued independence.

**Non-executive Chair** — We will classify a chair as non-executive if they were independent upon appointment and, outside of the role of chair,<sup>7</sup> continue to meet the independence standards outlined above.

**Affiliated Director** — A director is affiliated if they have a material financial, familial or other relationship with the company, its independent auditor or its executives, but are not an employee of the company.<sup>8</sup>

A director will normally be considered affiliated if they:

- are a non-executive chair who was not independent on appointment or has a relationship with the company that falls into one of the categories below;
- have served as a director for more than nine years, unless their continued independence is confirmed by the board;
- have served as an employee of the company in the past five years;
- they are a significant shareholder or represent one (defined as holding 10% or more of the company's share capital);<sup>9</sup>
- have — or have had within the last three years — a material business relationship with the company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- have close family ties with any of the company's advisers, directors or senior employees;
- participate in the company's share option or performance-related pay scheme(s);
- are a member of the company's pension scheme;<sup>10</sup> or
- hold cross-directorships or have significant links with other directors through their involvement in other companies or bodies.

Definition of "**material**" — A material relationship is one in which the value exceeds:

- £50,000 (£25,000 for companies outside the FTSE 350), or where no amount is disclosed, for directors who personally receive remuneration for a service they have agreed to perform for the company, outside of their service as a director. This threshold also applies to directors who are the majority or principal owner of a firm that receives such payments;

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<sup>7</sup> Provision 9 of the UK Code states that the board chair should be independent upon appointment. Thereafter, the test of independence is generally accepted as being inappropriate given the significant time commitment required of the role at many UK companies.

<sup>8</sup> If a company classifies one of its non-employee directors as non-independent, Glass Lewis will classify that director as an affiliate.

<sup>9</sup> The UK Listing Rules define a "substantial shareholder" as "any person who is entitled to exercise, or to control the exercise of 10% or more of the votes able to be cast on all or substantially all matters at general meetings of the company."

<sup>10</sup> Provision 10 of the UK Code.

- £100,000 (£50,000 for companies outside the FTSE 350), or where no amount is disclosed, for those directors employed by a professional services firm such as a law firm, investment bank or consulting firm where the firm is paid for services but not the individual directly. This limit also applies to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, and any commercial and real estate dealings between the company and the director or the director's firm;
- 1% of either company's consolidated gross revenue for other business relationships (e.g., where the director is an executive of a firm that provides or receives services or products to or from the company).

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

**Employee Representatives** - An employee representative serves as a director to represent employees' interests. Employee representatives are nominated by employees.

## Voting Recommendations on the Basis of Independence

Glass Lewis believes that a board will most effectively perform the oversight necessary to protect the interests of shareholders if it is significantly independent. In line with the UK Code, we generally expect that at least half the board, excluding the chair<sup>11</sup> and any employee representative, should be independent.<sup>12</sup> In the event that more than half of the members, not including the chair, are affiliated or inside directors, we typically recommend shareholders vote against one or more of the non-independent directors in order to satisfy this guideline.

We are firmly committed to the belief that only independent directors should serve on a company's audit and remuneration committees.<sup>13</sup> A notable exception to this rule is the board chair, who may serve as a member of — but not chair — the remuneration committee, provided that they were independent upon appointment.<sup>14</sup> We also believe that the nomination committee should be majority independent.<sup>15</sup>

We typically recommend that shareholders vote against any affiliated or inside director serving on the audit or remuneration committee. Where the nomination committee is not majority independent, we recommend shareholders vote against one or more of the non-independent directors in order to satisfy this guideline.

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<sup>11</sup> When the chair is an insider or is considered an affiliate due to any reason other than their position as chair, we will include them in the count of total number of inside/affiliated directors on the board.

<sup>12</sup> Provision 11 of the UK Code.

<sup>13</sup> Provisions 24 and 32 of the UK Code.

<sup>14</sup> Provision 32 of the UK Code.

<sup>15</sup> Provision 17 of the UK Code.

## Separation of the Roles of Chair and Chief Executive

Glass Lewis believes that separating the roles of corporate officers and the board chair is typically a better governance structure than a combined executive/chair position. This belief is consistent with the UK Code, which recommends that the roles of chair and chief executive should not be exercised by the same individual. The UK Code also states that a chair should be independent upon appointment, and that a former chief executive should not go on to be the chair of the same company.<sup>16</sup>

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

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

We believe that the roles of chief executive and chair should be separated; however, we do not automatically recommend that shareholders vote against executives who chair the board. We strongly support the appointment of a senior independent director with the authority to set the agenda for board meetings and lead sessions outside the presence of an executive chair.<sup>17</sup> If the board has an executive chair but also has a senior independent director, we will refrain from recommending shareholders vote against the nomination committee chair solely for this reason. In the event that the board has an executive chair but lacks a senior independent director, we will recommend that shareholders vote against the nomination committee chair.

Nevertheless, in the first year after a former executive takes up the role of chair, or of an executive chair's appointment, we may recommend that shareholders vote against the nomination committee chair, or senior independent director, as appropriate, if the board does not provide adequate justification for the appointment, in line with provision 9 of the UK Code.

## Performance

The most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. We look at the performance of these individuals in their capacity as board members and executives of the company, as well as their performance in different positions at other firms.

## Voting Recommendations on the Basis of Performance

We are generally sceptical of directors who have a track record of poor performance in fulfilling their responsibilities to shareholders at any company where they have held a non-executive or executive position. We

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<sup>16</sup> Provision 9 of the UK Code.

<sup>17</sup> Provision 12 of the UK Code.

typically recommend voting against the election of directors who have held key roles on boards or as executives at companies with a track record of:

- poor audit or accounting-related practices;
- poor nomination practices;
- poor remuneration practices;
- poor risk management practices; or
- other indicators of poor performance, mismanagement or actions against the interests of shareholders, such as failing to take reasonable steps to address significant and reasonable shareholder concerns.

Also, we will usually recommend shareholders vote against directors who fail to attend at least 75% of the board meetings and/or key committee meetings and do not provide an acceptable explanation for such poor attendance. However, we do not apply this 75% attendance threshold for first-year directors.

We typically expect UK boards to have audit, remuneration and nomination committees, although other types of committees, such as risk and governance committees, are also common. We hold the chair or the relevant committee members accountable to the performance standards outlined below.

## Board Evaluation and Refreshment

Glass Lewis strongly supports routine director evaluation, including independent external reviews,<sup>18</sup> and periodic board refreshment to foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Further, we believe the board should evaluate the need for changes to board composition based on an analysis of skills and experience necessary for the company, as well as the results of the director evaluations. When necessary, shareholders can address concerns regarding proper board composition through director elections.

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

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

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<sup>18</sup> At least every three years for FTSE 350 companies in line with Provision 21 of the UK Code.



## Director Tenure

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

Nonetheless, we will generally recommend against the chair of the nomination committee where the tenure of the chair of the board exceeds nine years and a defined succession plan and definitive timeline for retirement has not been disclosed.

## Board Committees

### The Role of a Committee Chair

Glass Lewis believes that a designated committee chair maintains primary responsibility for the actions of their respective committee. As such, many of our committee-specific voting recommendations are against the applicable committee chair rather than the entire committee (depending on the seriousness of the issue). In cases where the committee chair is not up for election due to a staggered board, and where we have identified substantial or multiple concerns, we will generally recommend voting against a long-serving committee member that is up for election, on a case-by-case basis.

In our view, companies should provide clear disclosure of which director is charged with overseeing each committee. In cases where we would ordinarily recommend voting against a committee chair but the chair is not specified, we apply the following general rules, which apply throughout our guidelines:

- If there is no committee chair, we recommend voting against the longest-serving committee member or, if the longest-serving committee member cannot be determined, the longest-serving board member serving on the committee (i.e., in either case, the "senior director"); and
- If there is no committee chair, but multiple senior directors serving on the committee, we recommend voting against both (or all) such senior directors.

### Audit Committee Performance

Audit committees play an integral role in overseeing the financial reporting process because "while all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control."<sup>19</sup>

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<sup>19</sup> Guidance on Audit Committees. Financial Reporting Council. April 2016.

Under the UK Code, the audit committee is required to report on the process by which it has assessed the effectiveness of the external audit, and any significant issues that were considered in relation to the financial statements. If non-audit services are provided, the committee should explain how the auditor's objectivity and independence are safeguarded.

In addition, only the audit committee (rather than management) should manage the appointment of an external auditor and be responsible for negotiating and agreeing audit fees. Further, the audit committee is responsible for tendering audit work not less than every ten years.<sup>20</sup>

When assessing an audit committee's performance, we are aware that such a committee: (i) does not prepare financial statements; (ii) is not responsible for making the key judgments and assumptions that affect financial statements; and (iii) does not audit the financial results. Rather, the audit committee monitors and oversees the processes and procedures performed by management and the auditors.

For an audit committee to function effectively, it should be independent and objective. In addition, each member should have a good understanding of the objectives and priorities of the organisation and of their role as an audit committee member.<sup>21</sup> We believe that companies should clearly outline the skills and experience of the members of the audit committee, and that shareholders should be wary of audit committees that lack expertise in finance and accounting or in any other equivalent or similar areas of expertise.

Glass Lewis generally assesses audit committees based on the decisions they make with respect to their monitoring role, and the level of disclosure provided to shareholders. Companies should provide shareholders with reasonable assurance that financial statements are materially free from errors through: (i) the quality and integrity of the statements and earnings reports; (ii) the completeness of disclosures necessary for investors to make informed decisions; and (iii) the effectiveness of the company's internal controls. The independence of the external auditors and the results of their work provide useful information by which to assess the audit committee.

When evaluating the decisions and actions of the audit committee, we typically defer to the judgement of its members; however, we usually recommend voting against the following members under these circumstances:

- The audit committee chair when non-audit fees are greater than audit and audit-related fees paid to the auditor for more than one year in a row (in which case we will also recommend against the authority to appoint the auditor and set its fees). For the purposes of this test, we consider audit-related fees to be those that are pursuant to legislation or for the audit of pension schemes, for example. Further, we are mindful of fees for one-time corporate finance transactions and due diligence work related to IPOs, mergers, acquisitions or disposals, and we may grant one-time exceptions when these fees make up a significant portion of the year's non-audit work.
- An audit committee member who has potentially excessive external commitments.
- The audit committee chair if the auditor's selection has not been put up for shareholder approval to fulfil its duty to shareholders.

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<sup>20</sup> Competition & Markets Authority Statutory Audit Services for Large Companies Market Investigation Order 2014.

<sup>21</sup> "Good practice principles for Audit and Risk Assurance Committees". HM Treasury's Audit and risk assurance committee handbook. March 2016.

- The audit committee chair when the company fails to disclose the fees paid to the auditor or a breakdown thereof (in which case we will also recommend against the authority to set the auditor's fees).
- The audit committee chair if the committee does not have at least one member who has a demonstrable financial background sufficient to understand the financial issues unique to public companies, likely to be demonstrated through recent and relevant accounting or auditing experience.<sup>22</sup>
- The audit committee chair if the committee has failed to tender the audit work in the past ten years and has failed to disclose sufficient rationale for not having done so.
- The audit committee chair if the committee has failed to hold a minimum of three meeting during the year under review.<sup>23</sup>
- All members of an audit committee that re-appointed an auditor that we no longer consider to be independent for reasons unrelated to fee proportions.
- All members of an audit committee who served during a time when accounting fraud occurred in the company.
- All members of an audit committee who served during a time when the company failed to report or to have its auditors report material weaknesses in internal controls.
- All members of an audit committee who served during a time when financial statements had to be restated due to negligence or fraud.
- All members of an audit committee if the company repeatedly fails to file its financial reports in a timely fashion.
- All members of an audit committee if the company's non-audit fees included fees for tax services for senior executives of the company, or if such fees involved services related to corporate tax avoidance or tax shelter schemes.

Additionally, we believe that a committee with responsibilities as crucial as those of the audit committee requires a minimum of three members — or two for smaller companies — to adequately perform its functions. This guideline is supported by provision 24 of the UK Code. We will generally recommend shareholders abstain from voting on the re-election of the audit committee chair if the committee has fewer than the recommended number of members.

## Remuneration Committee Performance

Remuneration committees have a critical role in determining the remuneration of executives. They are responsible for implementing policies that are aligned with strategy and agreed risk appetite, reward success fairly and avoid paying more than is necessary.

The remuneration process begins with employment agreements, including the establishment of terms relating to base salary, pension contributions, service contracts and severance arrangements. When establishing the terms of an employment agreement, it is important that such provisions reflect both the size of the company and current market practice. The remuneration committee is also generally responsible for approving variable,

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<sup>22</sup> Provision 24 of the UK Code; DTR 7.1.1A of the FCA's Disclosure Guidance and Transparency Rules.

<sup>23</sup> Guidance on Audit Committees. The Financial Reporting Council. April 2016.

performance-based remuneration, including annual cash bonuses and awards granted under long-term equity-based incentive plans. In every case, we believe overall remuneration levels should be reflective of the company's size, relevant peer group and recent performance. Furthermore, the remuneration committee should keep wider workforce remuneration and the company's culture under review when setting the executive remuneration policy.<sup>24</sup>

If a company's remuneration levels and practices significantly diverge from best practice and do not appear to reflect performance, we generally expect the remuneration committee to provide a thorough and convincing explanation for such a divergence. Glass Lewis also believes remuneration committees should regularly review a company's remuneration policies to ensure their continued effectiveness, as well as to respond to shareholder concerns if there is a relatively low level of support for the firm's remuneration proposals.

In evaluating a remuneration committee's performance, we also consider the overall structure and transparency of a company's remuneration practices, as disclosed in the remuneration report.

When assessing the decisions and actions of the remuneration committee, we typically defer to the judgement of its members; however, we may recommend voting against the following committee members under these circumstances:

- The chair and/or all members of the remuneration committee if executive pay is excessive relative to the financial performance of the company.
- The chair and/or all members of the remuneration committee (who served during the relevant time period) if the board entered into excessive employment contracts and/or severance agreements with senior executives.
- The chair and/or all members of the remuneration committee if performance goals for incentive-based pay were inappropriately changed or lowered after an executive failed to meet the original goals or success became unlikely, or if performance-based remuneration was paid despite a failure to achieve the goals. At a minimum, we expect the board to provide a thorough and convincing explanation for the lowering or removal of any performance condition.
- The chair and/or all members of the remuneration committee if excessive employee perquisites and benefits were allowed.
- The chair of the remuneration committee when there are substantial concerns with the remuneration policy presented for shareholder approval and/or the pay practices outlined in the remuneration report. We may recommend votes against the re-election of all remuneration committee members when a company's policies and practices are particularly egregious -- especially in cases where these concerns have existed over multiple years.
- The chair and/or all members of the remuneration committee if we believe the pay policies described in the remuneration report are highly divergent from best practices or are otherwise not aligned with the interests of shareholders.
- The chair and/or all members of the remuneration committee when the committee failed to address shareholder concerns following majority shareholder rejection of the say-on-pay proposal in the previous year; and/or the say-on-pay proposal was approved but there was a significant shareholder vote (i.e., greater than 20% of votes cast) against the proposal in the prior year, and there is no evidence

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<sup>24</sup> Provision 33 of the UK Code.

that the board responded accordingly to the vote including actively engaging with shareholders on this issue.

- The chair and/or all members of the remuneration committee when the remuneration report fails to disclose the relationship, if one exists, between the company's remuneration policy and the company's performance. We believe that, in order to align shareholder and executive interests, a significant portion of an executive's remuneration should be dependent on the company's performance.

Additionally, we believe that the remuneration committee performs a key service to the company, and that the associated workload cannot be satisfactorily performed by fewer than three members — two for smaller companies. This belief is supported by provision 32 of the UK Code. We will generally recommend shareholders abstain from voting on the re-election of the remuneration committee chair when this committee has fewer than the recommended number of members.

Please see "The Link Between Pay and Performance" for additional information regarding our standards for analysing executive remuneration in the UK.

## Nomination Committee Performance

Nomination committees are responsible for ensuring that the board contains the right balance of skills, experience, independence and knowledge to effectively oversee the company on shareholders' behalf. This process includes managing the terms and disclosure of board appointments, both in initial recruitment and on an ongoing basis, with an emphasis on progressive refreshment. When that balance does not reflect UK Code recommendations, the committee should disclose and justify those deviations. The committee should also set out the board's policy on diversity, with specific reference to gender, including details of any internal objectives and progress against them.

We expect the committee to meet all applicable disclosure requirements, and to take responsibility for board appointments and re-appointments. We usually recommend voting against the following nomination committee members under these circumstances:

- The committee chair when the roles of the chief executive and chair have not been split and a senior independent director has not been appointed.<sup>25</sup>
- All members of the nomination committee when the committee nominated or re-nominated an individual who has a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to represent shareholder interest.
- The nomination committee chair if the board has not conducted an external evaluation of its effectiveness within the past three years.
- The nomination committee chair if the committee did not meet during the year but should have (i.e., new directors were nominated).
- The nomination committee chair and/or all members of the nomination committee when the board consists of more than 20 directors

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<sup>25</sup> Provision 12 of the UK Code states that the board should appoint one of the independent non-executive directors to be the senior independent director.

- The nomination committee chair if a non-executive director has served for more than nine years, but is not standing for annual re-election and there are governance concerns at the company.
- The nomination committee chair when the tenure of the chair of the board exceeds nine years and a defined succession plan and definitive timeline for retirement has not been disclosed.
- The nomination committee chair if the company is in the FTSE 350 and has failed to meet the 33% gender diversity target set out by the Hampton-Alexander Review and has not disclosed any cogent explanation or plan to address the issue.
- The nomination committee chair of any listed companies outside of the FTSE 350 which have failed to appoint one gender diverse director, subject to mitigating circumstances.
- The nomination committee chair if the company is in the FTSE 100 and has failed to appoint one director of an ethnic minority group, as recommended by the Parker Review, and has failed to provide clear and compelling disclosure for why it has been unable to do so.

Additionally, we will generally recommend shareholders abstain from voting on the re-election of the nomination committee chair when the board has fewer than five members (four for Main Market non-FTSE 350 companies).

## Board-Level Risk Management Oversight

Glass Lewis evaluates the risk management function of a public company board on a strictly case-by-case basis. Sound risk management, while necessary at all companies, is particularly important at financial firms which inherently maintain significant exposure to financial risk. We believe such financial firms should have a chief risk officer reporting directly to the board and a dedicated risk committee or a committee of the board charged with risk oversight. Moreover, many non-financial firms maintain strategies which involve a high level of exposure to financial risk. Similarly, since many non-financial firms have complex hedging or trading strategies, those firms should also have a chief risk officer and a risk committee.

When analysing the risk management practices of public companies, we take note of any significant losses or write-downs on financial assets and/or structured transactions. In cases where a company has disclosed a sizable loss or write down, and where we find that the company's board-level risk committee contributed to the loss through poor oversight, we would recommend that shareholders vote against such committee members on that basis. In addition, in cases where a company maintains a significant level of financial risk exposure but fails to disclose any explicit form of board-level risk oversight (committee or otherwise),<sup>26</sup> we will consider recommending shareholders vote against the board chair on that basis. However, we generally would not recommend voting against a combined chair/CEO or executive chair, except in egregious cases.

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<sup>26</sup> A committee responsible for risk management could be a dedicated risk committee, the audit committee, or the finance committee, depending on a given company's board structure and method of disclosure. At some companies, the entire board is charged with risk management.

## Experience

We believe that a director's history is often indicative of future conduct. We often find directors with a track record of over-compensating executives or serving on boards where significant and avoidable disasters have occurred reappearing at different companies that follow these same patterns.

### Voting Recommendations on the Basis of Experience

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with a track record of poor performance, over-remuneration, audit- or accounting-related issues and/or other indicators of mismanagement, poor oversight or actions against the interests of shareholders.

Similarly, we look carefully at the backgrounds of key committee members to ensure that they have the required skills and diverse backgrounds to make informed and well-reasoned judgments about the subject matter for which the committee is responsible.

## Other Considerations

In addition to the key characteristics we analyse in evaluating board members as discussed above, we consider several other issues in making voting recommendations.

### External Commitments

We believe that directors should have the necessary time to fulfil their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis.

We will generally recommend that shareholders oppose the election of a director who:

- Serves as an executive officer of any public company while serving on more than one public company boards. In addition, an executive officer should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment;<sup>27</sup> or
- Serves as a non-executive director on more than five public company boards.

While non-executive board chair positions at North American companies are counted as one position, we generally count non-executive board chair positions at UK and European companies as two board seats given the increased time commitment associated with these roles. Accordingly, we would generally consider an executive officer of a public company that also serves as a non-executive chair of another UK or European company to have a potentially excessive level of commitments.

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<sup>27</sup> Provision 18 of the UK Code.



## Policy Application

As executive directors will presumably devote their attention to the company where they serve as an executive, we will generally not recommend that shareholders vote against the election of a potentially overcommitted director at the company where they serve in an executive function. Similarly, we will generally not recommend that shareholders vote against the election of a potentially overcommitted director at a company where they hold the board chair position, except where the director:

- Serves as an executive officer of another public company; or
- Holds board chair positions at three or more public companies; or
- Is being proposed for initial election as board chair at the company.

When determining whether a director's service on an excessive number of boards may limit the ability of the director to devote sufficient time to board duties, we may consider relevant factors such as the size, location, and scope of operation of the other companies where the director serves on the board, as well as the nature of the role (including committee memberships) that the director holds at these companies, whether the director serves as an executive or non-executive director of any large privately-held companies, and the director's attendance record at all companies.

We may also refrain from recommending against a potentially overcommitted director if the company provides a commitment that the director will sufficiently reduce their commitment level prior to the next annual general meeting, or otherwise presents a compelling rationale for the director's continued service on the board. Such rationale should allow shareholders to evaluate the scope of the director's other commitments as well as their contributions to the board, including specialised knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide, and other relevant factors. We will also generally refrain from recommending to vote against a director who serves on an excessive number of boards within a consolidated group of companies in related industries, or a director that represents a firm whose sole purpose is to manage a portfolio of investments which include the company. In these cases, we nevertheless believe that it is incumbent on companies to proactively address potential shareholder concerns regarding a director's overall commitment level.

## Conflicts of Interest

Irrespective of the overall presence of independent directors on the board, we believe that a board should be free of people who have identifiable conflicts of interest. Given the broad pool of director talent and the limited number of directors on any board, we believe shareholders are best served by board members who lack any personal conflicts to representing their interests on the board. Accordingly, we generally recommend shareholders vote against the following types of affiliated or inside directors:

- A director, or a director who has an immediate family member, currently providing material professional services to the company.<sup>28</sup> These services may include legal, consulting or financial services. We believe a director who receives remuneration from the company will have to make unnecessarily complicated decisions that may pit their interests against those of the shareholders they serve. Where a director has

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<sup>28</sup> See definition of "material" under Independence.



a material business relationship with a company that falls under the normal course of business, we will generally refrain from recommending to vote against the director on that basis alone provided that the company has adequately disclosed the relationship and mitigated the potential for serious conflicts of interest and so long as the board and key committees are sufficiently independent.

- A director, or a director who has an immediate family member, who engages in material commercial, real estate or other similar deals, including perquisite-type grants from the company amounting to more than £50,000. Directors who receive these sorts of payments from the company may have to make unnecessarily complicated decisions that pit their interests against shareholders.
- Directors who maintain “interlocking” board memberships. Top executives who serve on each other’s boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else. We find such relationships to be particularly worrisome for executives who cross-serve on each other’s remuneration committees.

## Board Responsiveness

Glass Lewis believes that when 20% or more of shareholders vote contrary to the recommendation of management, the board should, depending on the issue, demonstrate some level of responsiveness to address the shareholder concerns, a belief supported by provision 4 of the UK Code. These include instances when 20% or more of shareholders: (i) abstain from (or vote against) a director nominee; (ii) vote against a management-sponsored proposal; or (iii) vote for a shareholder proposal when the board has not recommended doing so. In our view, a 20% threshold is significant enough to warrant a close examination of the underlying issues and an evaluation of whether or not a board response was warranted and, if so, whether the board responded appropriately following the vote.

In line with provision 4 of the UK Code, we expect companies to explain, at the time of the announcing of the relevant voting results, what actions they intend to take to consult shareholders on the opposition received; and to provide an update on the views received from shareholders and the actions taken, no later than six months after the meeting and then provide a final summary in the annual report. While the 20% threshold alone will not automatically generate a negative vote recommendation from Glass Lewis on a future proposal (e.g. to recommend against a director nominee, against a remuneration proposal, etc.), it will be a contributing factor to recommend a vote against management’s recommendation in the event we determine that the board did not respond appropriately. Further, we may, where appropriate, hold chairs and members of the relevant committees accountable via a recommendation against their re-election where the response to shareholder concerns has fallen below a qualitative threshold.

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

- At the board level, any changes in directorships, committee memberships, disclosure of related party transactions, meeting attendance, or other responsibilities.
- Any revisions made to the company’s articles of incorporation, bylaws or other governance documents.
- Any press or news releases indicating changes in, or the adoption of, new company policies, business practices or special reports.

- Any modifications made to the design, structure and/or implementation of the company's remuneration practices.

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

## Proxy Voting Results

While the Companies Act does not require companies to disclose a detailed record of proxy voting results unless a poll has been demanded, we note that nearly all companies in the FTSE 350 Index currently provide full breakdowns of their voting results following their annual meetings. As such, at FTSE 350 companies we will generally recommend that shareholders hold the board chair responsible where a detailed record of the proxy voting results from the last annual meeting has not been disclosed. We acknowledge that the vast majority of management resolutions in the UK are approved by shareholders; however, opposition is not uncommon and generally indicates an issue noteworthy of action on part of the board.

Adequate disclosure of vote results is particularly relevant in the UK as shareholders frequently utilise their right to “withhold” or “abstain” from certain proposals as a way to voice dissent, albeit in a non-binding fashion. Such votes, although often quite substantial, are not counted in the final tally of votes, and resolutions may be passed despite high levels of shareholder abstentions.

## Board Size

While we do not believe that there is a universally applicable optimum board size, we do believe that boards should have a minimum of five directors – four for companies listed outside the FTSE 350 – in order to ensure that there is a sufficient diversity of views and breadth of experience in every decision the board makes. At the other end of the spectrum, we believe that boards whose size exceeds 20 members will typically suffer under the weight of “too many cooks in the kitchen” and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices can make it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

We typically advise shareholders to abstain from voting on the re-election of the chair of the nomination committee when boards have fewer than our recommended number of directors. With boards consisting of more than 20 directors, we typically recommend voting against the chair of the nomination committee.

## Human Capital Management & Diversity

[Glass Lewis believes](#) that diversity in organisations and the boards that lead them is a positive force for driving corporate performance. Research indicates that diverse and inclusive companies with robust human capital management policies yield superior returns, are more innovative than their peers, and outperform in attracting and retaining talent<sup>29</sup>. In addition to setting the tone from the top, we believe that a diverse board – particularly

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<sup>29</sup> See: Credit Suisse (2019) CS Gender 3000 in 2019; Boston Consulting Group (2017) The Mix That Matters - Innovation Through Diversity; Deloitte (2017) Unleashing the power of inclusion: Attracting and engaging the evolving workforce.

where a company's key stakeholders are taken into account in the composition of the board – also benefits companies by providing a broader and more representative range of perspectives and insights, which enhances board dynamics and can help boards to overcome groupthink.

### Gender Diversity at Board Level

Given the progress in increasing gender diversity at board level in the UK's largest companies, we generally expect the boards of FTSE 350 companies to be composed of at least 33% of gender diverse directors.<sup>30</sup> Further, we generally expect the boards of all UK listed companies to contain at least one gender diverse director. Where a proposed board election does not align with these targets, we will generally recommend that shareholders vote against the re-election of the chair of the nomination committee (or equivalent).

Where the proposed composition of the board does not align with these targets, we expect companies to provide disclosure to address this. We may provide limited exceptions to this policy, including:

- where a board consists of four or fewer directors;
- where a company discloses a credible plan to address the gender imbalance on the board within a near-term and defined timeframe (e.g. by the time of the next annual meeting or scheduled board election);
- where a company otherwise demonstrates its commitment to diversity through an exceptionally diverse board<sup>31</sup> or through the composition of, or disclosed succession plans for, its executive committee; and/or
- in other exceptional and company-specific cases (e.g. recent uplisting, unexpected director resignation etc.).

Additionally, in accordance with best practice in the UK, FTSE 350 boards should strive for 40% female representation by 2025.<sup>32</sup> Further, all main market boards with a reporting period starting on or after April 1, 2022 should report on a 'comply or explain' basis, against certain gender diversity targets as follows:<sup>33</sup>

- At least 40% of the board are women (including those self-identifying as women);
- At least one of the senior board positions (chair, CEO, senior independent director or CFO) is a woman (including those self-identifying as a woman).

Glass Lewis will monitor progress towards best practice prevalent in the market for 2023, and will consider recommending against the nomination committee chair in subsequent years in cases where a board has made insufficient progress, and has not disclosed any cogent explanation or plan to address the issue.

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<sup>30</sup> Women, and directors that identify with a gender other than male or female. The Hampton-Alexander Review set the target that women should hold at least 33% of board positions at all FTSE 350 companies by 2020.

<sup>31</sup> Principle J of the UK Code states that board appointment and succession plans should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

<sup>32</sup> FTSE Women Leaders Review targets.

<sup>33</sup> 9.8.6R(9), UK Listing Rules, The Financial Conduct Authority.

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

Glass Lewis generally believes that the composition of a board should be representative of a company's workforce, the jurisdictions in which it principally conducts its business activities, and its other key stakeholders. Accordingly, we believe that boards should consider including diversity of ethnicity and national origin as attributes in their composition profiles, whether defined targets for diversity of ethnicity and national origin should be set, and the manner and extent to which the ethnic and national backgrounds of directors and board nominees is publicly disclosed.

In particular, we expect FTSE 350 companies to provide meaningful disclosure regarding their performance against the Parker Review targets<sup>34</sup> that FTSE 100 companies and FTSE 250 companies should include at least one director from an ethnic minority group by 2021 and 2024, respectively. Glass Lewis will highlight where FTSE 350 companies have failed to provide meaningful disclosure in this regard and, we will generally recommend that shareholders vote against the re-election of the chair of the nomination committee at FTSE 100 boards that have failed to appoint one director of an ethnic minority group and have failed to provide clear and compelling disclosure for why they have been unable to do so.

Further, all main market boards with a reporting period starting on or after April 1, 2022 should report, on a 'comply or explain' basis, against a target of at least one member of the board being from a minority ethnic background.<sup>35</sup>

Glass Lewis will monitor progress towards best practice prevalent in the market for 2023, and will consider recommending against the nomination committee chair in subsequent years in cases where a board has made insufficient progress, and has not disclosed any cogent explanation or plan to address the issue. In egregious cases where a board has failed to address legitimate shareholder concerns regarding the diversity of ethnicity and national origin at board level, we may also recommend that shareholders vote against the re-election of the chair of the nomination committee.

### Diversity of Skills and Experience at Board Level

We believe companies should disclose sufficient information to allow a meaningful assessment of a board's skills and competencies. Our analysis of election proposals at FTSE 350 companies (excluding investment companies) includes an explicit assessment of skills disclosure. We expect these companies to provide a robust, meaningful assessment of the board's profile [in terms of skills and experience](#) in order to align with developing best practice standards.

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

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<sup>34</sup> Report into the Ethnic Diversity of UK Boards. The Parker Review Committee. October 2017.

<sup>35</sup> 9.8.6R(9), UK Listing Rules, The Financial Conduct Authority.

In egregious cases where the disclosure of a FTSE 350 company does not allow for a meaningful assessment of the key skills and experience of incumbent directors and nominees to a board, we will also consider recommending voting against the chair of the nomination committee.

### Workforce Diversity and Inclusivity Measures

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

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

In egregious cases where boards have failed to respond to legitimate concerns regarding a company's policies, practices and disclosure, we may recommend voting against the chair of the committee tasked with oversight of the company's governance practices or, where such a committee has not been established, the chair of the board.

### Human Capital Management Oversight

Glass Lewis believes that effective board oversight of human capital management issues is not limited to a company's policies and disclosure on workforce diversity and inclusivity measures; rather, boards should be considered broadly accountable for direct oversight of workplace issues at large, which includes labour practices, employee health and safety, and employee engagement, diversity, and inclusion.<sup>36</sup>

The UK Code recommends that the boards of premium-listed companies establish a mechanism for engaging the workforce in board discussions and decision-making.<sup>37</sup> Specifically, boards are recommended to i) allow for the appointment of an employee representative to the board; ii) establish a formal workforce advisory panel; iii) designate a non-executive director to represent the views of the workforce; or iv) establish an alternative arrangement. In addition to disclosing the chosen method, we believe that FTSE 350 companies should also provide meaningful disclosure on an annual basis regarding the implementation of their workforce engagement mechanism. Examples in this regard could include disclosure of the number of meetings and topics of discussion on the workforce advisory panel, activities of the designated NED in the past year, details of any employee engagement metrics or surveys used, and/or the means for reviewing complaints regardless of the chosen engagement mechanism.

In egregious cases where a board has failed to respond to legitimate concerns with a company's employee engagement or broader human capital management practices, we may recommend voting against, as

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<sup>36</sup> SASB Universe of Sustainability Issues.

<sup>37</sup> Provision 5 of the UK Code.

applicable, the NED designated to represent the views of the workforce, the chair of the committee tasked with oversight of the company's governance practices, or the chair of the board.

## Environmental and Social Risk Oversight

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

### Board-Level Oversight

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

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

, Glass Lewis will generally recommend voting against the governance committee chair (or equivalent)<sup>38</sup> of FTSE 100 companies that fail to provide explicit disclosure concerning the board's role, and specifically the role of independent directors, in overseeing material environmental and social issues. Additionally, we will note a concern when boards of FTSE 250 companies have failed to provide explicit disclosure in this regard.

### Board Accountability

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

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<sup>38</sup> For example, the chair of a committee with additional accountability for governance oversight, or board chair or Senior Independent Director.

### Director Accountability for Climate-related Issues

Given the exceptionally broad impacts of a changing climate on companies, the economy, and society in general, we view climate risk as a material risk for all companies. We therefore believe that boards should be considering and evaluating their operational resilience under lower-carbon scenarios. While all companies maintain exposure to climate-related risks, we believe that additional consideration should be given to, and that disclosure should be provided by, those companies whose GHG emissions represent a financially material risk.

We believe that companies with this increased risk exposure, such as those companies identified by groups such as Climate Action 100+, should provide clear and comprehensive disclosure regarding these risks, including how they are being mitigated and overseen. We believe such information is crucial to allow investors to understand the company's management of this issue, as well as the impact of a lower carbon future on the company's operations.

Accordingly, for such companies with material exposure to climate risk stemming from their own operations, we believe thorough climate-related disclosures in line with the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD") should be provided to shareholders. We also believe the boards of these companies should have explicit and clearly defined oversight responsibilities for climate-related issues. As such, in instances where we find either (or both) of these disclosures to be absent or significantly lacking, we may recommend voting against the chair of the committee (or board) charged with oversight of climate-related issues, or if no committee has been charged with such oversight, the chair of the governance committee. Further, we may extend our recommendation on this basis to additional members of the responsible committee in cases where the committee chair is not standing for re-election, or based on other factors, including the company's size and industry and its overall governance profile. In instances where appropriate directors are not standing for election, we may instead recommend shareholders vote against other matters that are up for a vote, such as the accounts and reports proposal.

### Cyber Risk Oversight

Companies and consumers are exposed to a growing risk of cyber attacks. These attacks can result in customer or employee data breaches, harm to a company's reputation, significant fines or penalties, and interruption to a company's operations. Further, in some instances, cyber breaches can result in national security concerns, such as those impacting companies operating as utilities, defence contractors, and energy companies.

In response to these issues, regulators have increasingly been focused on ensuring companies are providing appropriate and timely disclosures and protections to stakeholders that could have been adversely impacted by a breach in a company's cyber infrastructure.

Given the regulatory focus on, and the potential adverse outcomes from, cyber-related issues, it is our view that cyber risk is material for all companies. We therefore believe that it is critical that companies evaluate and mitigate these risks to the greatest extent possible. With that view, we encourage all issuers to provide clear disclosure concerning the role of the board in overseeing issues related to cybersecurity.

We also believe that disclosure concerning how companies are ensuring directors are fully versed on this rapidly evolving and dynamic issue can help shareholders understand the seriousness with which companies take this issue.



We will generally not make voting recommendations on the basis of a company's oversight or disclosure concerning cyber-related issues. However, we will closely evaluate a company's disclosure in this regard in instances where cyber-attacks have caused significant harm to shareholders and may recommend against appropriate directors should we find such disclosure or oversight to be insufficient.

## Controlled Companies

We make several exceptions for controlled companies on director independence standards. The primary function of a board is to protect the interests of shareholders; however, when a single individual or entity owns more than 50% of the voting shares, then the interests of the majority of shareholders are effectively the interests of that entity or individual. Consequently, Glass Lewis does not recommend voting against boards whose composition reflects the makeup of the shareholder population. In other words, affiliates and insiders who are associated with a firm's controlling entity are not subject to the one-half independence rule that we apply to non-controlled company boards.

Our independence exceptions for controlled companies are as follows:

- We do not require that controlled companies have boards that are at least one-half independent, excluding the chair. Provided the insiders and/or affiliates are connected with the controlling entity, we accept the presence of a majority of non-independent board members, provided their representation is not disproportionate.
- The remuneration committee does not need to consist solely of independent directors. Similarly, we do not believe the nomination committee must comprise a majority of independent directors. In each of these cases, we may raise concerns if the representation of the controlling shareholder is disproportionate.
- We do not require controlled companies to have a standing nomination committee. Although we generally believe that a committee charged with the duties of searching for, selecting and nominating independent directors can be beneficial to all companies, the unique composition of a controlled company's shareholder base makes such a committee less powerful and less relevant.
- Controlled companies do not need to have an independent chair or a senior independent director. Although, in our opinion, an independent director in a position of authority on the board is best able to ensure the proper discharge of the board's duties, controlled companies serve a unique shareholder population whose voting power ensures the protection of its interests.

We do not make independence exceptions for audit committee membership at controlled companies. We believe audit committees should consist solely of independent directors. Regardless of a company's shareholder structure, the interests of all shareholders must be protected by ensuring the integrity and accuracy of the company's financial statements.

## Significant Shareholders

Similarly, where an individual or entity holds between 10-50% of a company's voting power, but the company is not "controlled" and there is not a "majority" owner, we believe it is reasonable to allow proportional representation on the board and its committees (excluding the audit committee) based on the individual or



entity's percentage of ownership. However, in the case of a significant but non-controlling shareholder, we generally apply heightened scrutiny to the overall board structure and, where applicable, compliance with the Listing Rules, to ensure that minority shareholder rights are protected. For premium-listed issuers with a 30% or larger shareholder, the Listing Rules (as revised in May 2014) stipulate that independent director elections be subject to approval by shareholders as a whole, and separately by all shareholders excluding the controlling shareholder. Further, such companies must enact a relationship agreement with such significant/controlling shareholders that sets out provisions ensuring that the company can operate independently of them.

## Investment Company Boards

Investment companies pool investors' money and invest in the shares of a wider range of companies than most people could practically invest in by themselves. Investment companies include investment trusts, non-UK investment companies, Real Estate Investment Trusts (REITs)<sup>39</sup> and Venture Capital Trusts (VCTs). Generally, investment companies delegate the task of investing to a professional fund manager. Investment companies often have no executive directors or employees, and do not have customers in the traditional sense, only shareholders.

UK-incorporated investment companies are generally members of the Association of Investment Companies (AIC). AIC members may report against the AIC Code of Corporate Governance (AIC Code),<sup>40</sup> which is endorsed by the FRC, to meet obligations under the UK Code. AIC members which elect to report against the AIC Code are not required to report on certain issues in the UK Code that are not addressed in the AIC Code. Given the different structure of investment companies relative to other publicly traded companies, we believe it is appropriate to apply a different set of corporate governance standards.<sup>41</sup>

The following is a summary of our significant policy differences for investment companies:

- Unlike the chair of an operating company, the chair of an investment company is still considered independent following appointment. Provided the chair is independent, a senior independent director is not required. However, we will recommend voting against a chair who is employed by, or represents, the investment manager.
- Boards may have a minimum of four directors, rather than five.
- Boards need not maintain standing remuneration or nomination committees. The board's nomination process should however be led by its independent directors and outlined in the annual report.
- The chair of an investment company should not serve on the boards of other investment companies that are managed by the same investment manager. In this case, we will generally recommend shareholders vote against the chair. While other non-executive directors may serve on boards that are managed by the same manager, these directors will be classified as "affiliated".

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<sup>39</sup> We do not generally consider internally-managed REITs as investment companies for corporate governance purposes, as they often function much like any other operating company.

<sup>40</sup> <https://www.theaic.co.uk/aic-code-of-corporate-governance-0>

<sup>41</sup> Our policies are primarily based on the AIC Code.

- We may provide exceptions to the policies outlined in the “External Commitments” section of these guidelines for directors who serve on the boards of multiple investment companies, given the generally more limited scope of a non-executive role on the board of an investment company, compared with a company that maintains operations. We nevertheless believe it is incumbent on the board to provide context to shareholders regarding the nature of the roles held by a director who maintains more than five board positions at publicly-listed companies.

For additional exceptions related to share issuance authorities for investment companies, please refer to the “Capital Management” section of these guidelines.

# Transparency and Integrity in Financial Reporting

## Accounts and Reports

In the UK, companies must submit their annual financial statements, director reports and independent auditor's reports to shareholders for approval at the AGM. Shareholder approval of such a proposal does not discharge the board or management, and these types of resolutions are usually limited to an acknowledgement of receipt of the annual report. We will usually recommend voting for these proposals, except when there are concerns about the integrity of the financial statements/reports. Should the audited financial statements, auditor's report and/or annual report not be available at the time of writing of our report, we will recommend that shareholders abstain from voting on this proposal. We believe that a lack of sufficient corporate information can prevent shareholders from making informed decisions.

In rare instances, we may also recommend that shareholders vote against this proposal if there are serious governance failings (e.g., none of the board members are independent) that shareholders are unable to address through normal channels, such as the election of directors. Also in rare instances, we may recommend that shareholders reject an annual report if the company has serious recurring problems negatively affecting shareholder value that we believe the board has not adequately addressed.

## Appointment of Auditor and Authority to Set Fees

We believe that the role of the auditor is crucial in protecting shareholder value. Shareholders rely on auditors to ask tough questions and provide a thorough analysis of the company's books. Auditors must ensure that the information ultimately provided to shareholders is accurate, fair and a reasonable representation of the company's financial position. The only way shareholders can make rational investment decisions is if the market is provided with accurate information about the fiscal health of the company.

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

As entrenchment can erode the independence and effectiveness of the audit firm, the audit committee should ensure that audit work is tendered at least every ten years and that the auditor is rotated at least every twenty years.<sup>42</sup> In addition, the audit committee, rather than management, should serve as the auditor's point of contact.

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<sup>42</sup> Competition & Markets Authority's Audit Services Order 2014.

We generally support management's recommendation regarding the selection of an auditor, and we will usually recommend granting the board the authority to fix auditor fees, unless we believe the independence of a returning auditor or the integrity of the audit has been compromised.

Our reasons for recommending that shareholders vote against the board's authority to appoint the auditor and/or set the auditor's fees include:

- When non-audit fees are greater than audit and audit-related fees paid to the auditor.
- When the company has demonstrated aggressive accounting policies.
- When the company has poor disclosure or a lack of transparency in its financial statements.
- Where the auditor limited its liability through its contract with the company.
- When there have been recent material restatements or late filings by the company and the auditor bears some responsibility for the restatement or late filing (e.g., a restatement due to a reporting error).<sup>43</sup>
- When the company has, without a suitable explanation, failed to put its independent audit work to a tender within the past ten years. In addition, we may consider recommending against the audit committee chair for a continued failure in this regard and/or in the event that we have additional concerns as to the auditor's independence.
- When there are other relationships or issues of concern with the auditor that might suggest a conflict between the interests of the auditor and those of shareholders.
- When the auditor performs prohibited services, such as tax-shelter work, tax services for top executives or contingent-fee work, such as a fee based on the percentage of economic benefit to the company.

We are also mindful of fees for one-time corporate finance transactions and due diligence work related to mergers, acquisitions or disposals, and we may grant one-time exceptions when these fees make up a significant portion of the year's non-audit work. While we are generally opposed to a company's independent auditor providing a significant amount of services unrelated to the audit, given the auditor's intimate knowledge of the companies that they audit and the importance of these types of transactions, we consider their assistance in these matters to be acceptable, provided their provision of such services does not persist.

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<sup>43</sup> An auditor is not required to perform an audit of interim financial statements and accordingly, in general, we do not believe auditor-related proposals should be opposed based on a restatement of interim financial statements, unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

# The Link Between Pay and Performance

Glass Lewis strongly believes an executive's remuneration should be linked directly with the performance of the company. We typically look for remuneration arrangements that provide for a mix of performance-based short- and long-term incentives, in addition to base salary. Glass Lewis believes that comprehensive, timely and transparent disclosure of executive pay is critical to allow shareholders to evaluate the extent to which pay is aligned with company performance.

Glass Lewis reviews executive remuneration on both a qualitative basis and quantitative basis. The guidelines in this section reflect our views on best practice generally, with specific regard to the UK. The Investment Association serves as one of the primary drivers of remuneration best practice in the UK., Glass Lewis takes these principles into consideration when applying our guidelines.

## Remuneration Voting

In the UK, investors are provided with multiple platforms to demonstrate approval or register concerns regarding executive remuneration packages. From 2003, UK companies listed on the Main Market of the LSE have been required to prepare a directors' remuneration report and present it for shareholder approval on a non-binding, advisory basis annually.

Since 2014, the Enterprise and Regulatory Reform Bill has also required quoted UK-incorporated companies to submit their remuneration policy to a binding shareholder vote at least every three years, or when the board otherwise wishes to amend the policy. In conjunction, the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2013 introduced new reporting requirements for the directors' remuneration report, including a structural split between the Policy and Implementation Report to reflect the new voting structure.

The forward-looking Policy Vote sets out all components of executive remuneration, including the maximum amount payable under each component, the basis of performance measurement where applicable, and its connection to overall strategy. It should also explain the company's remuneration philosophy and all applicable policies relating to recruitment, service contracts and exit payments. No payments can be made outside of the approved policy without shareholder approval.

The Implementation Report sets out how the policy was implemented over the past fiscal year, and how it will be implemented in the current year. It is put to a non-binding, advisory shareholder vote annually and provides shareholders with an opportunity to weigh in on remuneration decisions during the past year, as well as ongoing structural issues. If the proposal does not receive majority approval, the company is required to submit its Policy Report to a binding vote at the next AGM.

## Vote on Remuneration Policy

We believe that reports which outline a company's Policy should provide clear disclosure of an appropriate framework for managing executive remuneration. While this framework will vary for each company, it should generally provide an explicit link to the company's strategy, setting appropriate quantum limits along with

structural safeguards to prevent excessive or inappropriate payments -- particularly any reward for failure. Remuneration policies should also provide sufficient flexibility to allow boards to manage matters of recruitment, severance, and professional development as they arise to avoid the necessity of seeking shareholder approval for policy amendments or special payments outside the policy.

For most companies, we expect a remuneration policy that complies with best practice to:

- Emphasise incentive pay in the form of equity, weighted towards performance and/or holding periods of three or more years;
- Incentivise executives based on goals aligned with strategy while avoiding overly complex structures or those that may encourage excessive risk-taking;
- Set reasonable and transparent award limits, expressed as a multiple of base salary, for normal and exceptional circumstances;
- Limit the application of discretion to clearly defined circumstances;
- Include structural safeguards and risk mitigating features such as clawback/malus provisions, deferral, post-vesting holding periods (typically two years) and post-employment shareholding requirements (typically over two years and comprising a majority portion of the in-employment requirements);
- Expressly comply with Investment Association recommendations regarding equity-related dilution;
- Disclose a clear approach to recruitment, including reasonable award limits and delivery structures that align the interests of incoming executives with those of shareholders;
- Disclose all relevant details of executive service contracts, limiting notice period entitlements to salary and benefits over 12 months or less, subject to mitigation; and
- Comply with all disclosure requirements set out by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2013.

When a company's executive remuneration policy deviates from these guidelines, we expect a clear and compelling rationale for why the proposed structure or practice is appropriate for the company. Some of the potentially troubling issues we will consider when analysing remuneration policies, and in particular when weighing a vote against these proposals, are as follows:

- The policy allows for high pay (as compared to the company's peers) that is not subject to relevant and challenging performance targets over the period and when such pay has not been merited by outstanding company performance over the period;
- Significant increases in quantum, absent a sufficient rationale;
- We do not believe the terms of an equity-based scheme are appropriate (see "Incentive Plans");
- We do not consider the overall remuneration structure or the balance between short- and long-term incentive plans to be appropriate or in shareholders' best interests;
- Overreliance on remuneration benchmarks;
- The policy does not include structural safeguards and risk mitigating features, such as clawback/malus provisions, deferral, post-vesting holding periods, and in-post and post-employment shareholding requirements;
- Service contracts provide for notice periods of longer than twelve months. For recruitment purposes only, we may approve longer contracts if they revert to one year or less after the initial term expires;
- Service contracts provide for the enhancement of employment terms or remuneration rights in excess of twelve months in the event of a change of control;

- The policy does not reflect appropriate share-based dilution limits; and
- The incentive structure relies on, or allows an excessive level of, committee discretion without appropriate justification.

Further, if the company has failed to sufficiently disclose the terms of its policy, we may recommend that shareholders vote against the proposal solely on this basis.

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

## Vote on Remuneration Report

We believe the advisory implementation vote provides shareholders with an important opportunity to support or oppose remuneration policies and practices; as such our voting recommendations may reflect ongoing structural concerns as well as remuneration decisions and outcomes during the past fiscal year. However, our analysis of the remuneration report focuses on the board's implementation and administration of the company's remuneration policy; particular attention is paid to the alignment between performance and pay outcomes, and the committee's level of disclosure regarding any application of discretion. We also believe that this annual vote provides shareholders with an important opportunity to express concern with a company's remuneration policies and practices that are not explicitly limited to the year under review.

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

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

- Remuneration outcomes that are not correlated with overall company performance or the stakeholder experience, or are high compared to a company's peers;
- Significant increases in base salary or variable incentive opportunity absent a compelling rationale;
- Egregious or excessive bonuses, equity awards, or severance payments;
- Guaranteed bonuses;
- Performance targets are not sufficiently challenging and/or providing for unreasonably high potential payouts, do not align with business strategy over the long-term, or are well below actual past

performance, previous targets, or strategic targets provided in guidance to shareholders, absent a compelling rationale for lowering the target;

- Lack of disclosure regarding performance metrics and targets;
- Discretionary payments which fall outside of short- and long-term incentive plans;
- Inappropriate use of committee discretion; and
- Non-executive directors are eligible for cash and/or equity awards on similar terms as those granted to executive directors.

## Accountability of the Remuneration Committee

In cases where Glass Lewis has substantial concerns with the performance of the remuneration committee, we may also recommend that shareholders vote against the re-election of the chair and/or other members of the committee. For example, we may recommend against the re-election of the committee chair where there are substantial concerns with the remuneration policy presented for shareholder approval and/or the pay practices outlined in the remuneration report, or against the re-election of all members for particularly egregious remuneration practices -- particularly where these are ongoing. Such instances may include cases in which a company maintains egregious remuneration practices, which have existed over multiple years without any apparent steps to address the issues. In addition, we may recommend voting against the entire committee based on the practices or actions of its members, such as approving large one-off payments, the inappropriate use of discretion in determining variable remuneration, and/or sustained poor pay-for-performance practices.

Please refer to the "Remuneration Committee Performance" section of these guidelines for further information.

## Disclosure

Clear, concise and comprehensive disclosure of the company's remuneration structure and practices is essential for shareholders to make an informed assessment. The level of explanatory disclosure provided by the committee is particularly important in relation to one-off exceptional issues (including recruitment), areas where the policy or practices deviate from best practice, or any application of discretion. In the case of recruitment grants, the committee should provide an explanation of the award's necessity, and of the methodology used in determining the size and structure of the award.

To facilitate an assessment of all payments and incentive awards and their relationship to performance and strategy, the Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 provide for a uniform set of disclosures.

Individual pay is calculated as a "single total figure", comprising salary, pension and benefits, as well as any other applicable awards or payments. Incentive awards are reported in the final year of the performance period; as such, bonuses reflect awards in respect of, not paid in, the past fiscal year; whereas long-term awards will typically reflect the ultimate vested value of awards granted three to five years previously, based on performance against targets and calculated using current share price for equity grants.

The terms of the incentive structure, including an explanation of how performance targets are determined, and the actual metrics and specific targets utilised where appropriate, should be disclosed and put in the context of the company's business strategy.



In addition, the regulations require that the Implementation Report disclose:

- Directors' shareholdings, including a breakdown of directly held shares and shares under award, including those that have yet to vest;
- A comparison of company performance and CEO pay for up to ten years preceding the current fiscal year, based on the single total figure;
- A comparison of the change in CEO pay to that of a wider group of company employees;
- A comparison of the remuneration paid to all employees relative to shareholder distributions and any other uses of profit or cash flow deemed relevant by the directors;
- Any other individuals or organisations that assisted the remuneration committee, including amounts paid in respect of consulting work; and
- Voting results for all remuneration proposals at the prior general meeting.

Further, we recognise that the disclosure of pay ratios between the CEO and median or average UK-based employee may be useful in contextualising the levels of executive remuneration both within a business and within industries. As such, we encourage companies to disclose such pay ratios, even where not required by the Companies (Miscellaneous Reporting) Regulations 2018,<sup>44</sup> accompanied by a description of the methodology for their calculation. However, while we believe the pay ratio has the potential to provide additional insight when assessing a company's pay practices, we will not base voting recommendations solely on such ratios in and of themselves.

## Engagement and Company Responsiveness

Engagement between the remuneration committee and shareholders can provide a constructive forum for dialogue, and in some cases allow companies to explain or address points of contention before they come to a vote. As such, we generally believe that the committee should be responsive to shareholder concerns regarding remuneration, particularly when remuneration proposals encounter significant opposition. Shareholder voting on remuneration proposals during the prior year should be disclosed in the Implementation Report, along with an explanation of any significant opposition and the board's response to such opposition, in accordance with the Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. In the event of significant opposition to remuneration proposals, we will assess the responsiveness of the committee to shareholder concerns on a case-by-case basis.

In addition, where practicable boards should keep shareholders engaged with the remuneration process through regular dialogue and pre-emptive consultation, particularly in relation to any one-off exceptional issues, or changes to the remuneration policy and/or its implementation.

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<sup>44</sup> UK-incorporated and quoted (excluding AIM) companies with more than 250 employees.

## Fixed Remuneration

### Salary

In line with the Investment Association's Principles of Remuneration, we generally expect any proposed salary increase to be justified and appropriate when compared to increases awarded to the wider workforce. Where an exceptional increase is sought, the remuneration committee's rationale should be fully disclosed.

### Pensions

We generally expect pension provisions for executive directors, both those newly appointed and incumbent executives, to be in line with those available to the majority of the wider workforce by the end of 2022, in line with provision 38 of the UK Code and the Investment Association's Principles of Remuneration. We recognise that it may have been necessary to reduce pension rates for incumbents over a period of time; however, we generally believe sufficient time has elapsed since the introduction of this provision under the UK Code for such reductions to be made. Accordingly, in the absence of a cogent rationale for any delay in such a reduction and/or a failure to provide a commitment to align contributions in the near-term, we may recommend shareholders vote against a company's remuneration Policy Vote.

## Incentive Plans

Two primary concerns regarding a company's remuneration policy are the level of alignment between the interests of executives and long-term shareholders, and the potential for unmerited pay. For most companies, incentive-based pay, with an appropriate structure and safeguards, provides a means of addressing both issues.

### Short-Term Incentives – Structure and Duration

A short-term bonus or incentive (STI) should be demonstrably tied to performance that supports a company's strategy. As short-term incentives usually reflect performance over a single year, we support the practice of deferring a specific portion of annual bonus payouts into equity for multiple years, which can offset the initial short-term focus and discourage unnecessary risk-taking. In the UK, short-term incentives are generally delivered in a mix of cash and deferred shares.

### Long-Term Incentives – Structure and Duration

Glass Lewis recognises the value of long-term incentive programmes. When used appropriately, they can provide a vehicle for linking an executive's pay to company performance, thereby aligning their interests with those of shareholders. We believe that incentives tied to long-term performance and holding restrictions provide the strongest alignment with the interests of long-term shareholders.

We generally believe that a significant proportion of incentive payouts should be delivered in equity to promote alignment with shareholder interests during the performance period and after. Long-term incentives generally

make up the largest component of the incentive opportunity in the UK and are generally delivered in full-value performance shares.

The majority of the incentive opportunity should generally be subject to a performance period of at least three years. In addition, extended vesting and/or holding requirements may serve to further enhance alignment.

### Restricted Share Plans

In July 2016, the Investment Association's Executive Remuneration Working Group opened the door to restricted share awards (RSAs) in an effort to simplify pay practices at UK companies and to allow for divergence from the so-called "one-size-fits-all LTIP model". Regardless of the specifics of a particular incentive plan, the Working Group affirmed that pay-setting should be carried out within a clear and simple structure that calls for alignment with shareholders' interest, recognition of company performance, and the implementation of a long-term strategy that is consistent with the approach taken for other employees.

Glass Lewis assesses all restricted share plans on a case-by-case basis; however, in line with Investment Association guidance,<sup>45</sup> we expect the following features at a minimum:

- The discount rate for moving from performance share awards to restricted share awards should be a minimum of 50%;
- The total vesting and post-vesting holding period should be at least five years;
- The grant of restricted shares should be accompanied by significant shareholding requirements, including a post-exit shareholding requirement of at least two years;
- Restricted share awards should be subject to an appropriate underpin; and
- A long-term strategic alignment.

### Combined Incentive Plans

We classify as combined incentive plans, or omnibus plans, any incentive schemes where performance is assessed for the full grant in an initial short-term period (typically one year) immediately following the grant, after which a portion of the award is paid out and the remaining portion is deferred, subject to time-vesting restrictions or other performance criteria.

Glass Lewis is generally sceptical of a company's decision to move from a traditional incentive structure, consisting of a short- and long-term incentive plan, to a structure consisting of a single incentive scheme, as this generally leads to a reduction of the portion of variable pay linked to long-term performance. Specifically, the shift to a combined incentive plan typically entails the removal of long-term performance conditions, with the deferred portion of the award effectively becoming a guaranteed payment once the initial performance period has ended.

For this reason, Glass Lewis will generally recommend that shareholders vote against a remuneration policy<sup>46</sup> that includes a combined incentive plan, unless:

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<sup>45</sup> Principles of Remuneration. The Investment Association. November 2020.

<sup>46</sup> Concerns regarding the structure of a combined incentive plan will generally be addressed in our analysis of remuneration policy proposals, or standalone proposals to approve the incentive plan.

- The plan has a minimum vesting period of three years<sup>47</sup>;
- At least part of the award is allocated in equity or equity-based instruments, subject to time-vesting restrictions;
- Quantitative underpin/gateway conditions are in place for the deferred portion of the award; and
- The company has provided a strategic rationale for the plan.

Where a company is amending its incentive structure to adopt a combined incentive plan while removing existing variable incentive plans, we generally expect a substantial reduction in the total target and maximum award opportunity, appropriately reflecting the reduction in the risk profile of the plan.<sup>48</sup>

## Performance Measures

Performance measures should be carefully selected to relate to the specific business/industry in which the company operates and, especially, the key value drivers of the company's business.

Metrics may be financial and non-financial; however, there should be a strong emphasis on overall financial performance. Given their more demonstrable link to shareholder value, we believe financial measures should account for a majority of the performance assessment employed. The remuneration report should provide a clear explanation for the performance measures selected and how they are calibrated in the context of the company's strategy.

Where the financial metrics used to determine payouts have been adjusted, such as to exclude exceptional items or other costs, the report should disclose how the calculation differs from reported accounting figures, and a rationale for these adjustments including the use of the adjusted financials by industry peers and financial analysts.

### Short-Term Incentive Measures

A short-term bonus or incentive (STI) should be demonstrably tied to performance that supports a company's strategy.

We believe performance measures for STIs should encompass a mix of corporate and individual performance measures, including internal financial measures such as net profit after tax, EPS growth and divisional profitability as well as non-financial factors such as those related to employee turnover, safety, environmental issues, and customer satisfaction. However, since performance metrics vary depending on company, industry and strategy, among other factors, we will consider metrics tied to the company's business drivers to be acceptable.

### Long-Term Incentive Measures

Glass Lewis believes that measuring a company's performance with multiple metrics serves to provide a more complete picture of performance; reliance on a single metric may narrow management focus and be more

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<sup>47</sup> The inclusion of an additional post-vesting holding period (of typically 1-2 years) will be viewed favourably in our analysis.

<sup>48</sup> We generally expect the reduction in the risk profile of an incentive plan to correspond with the reduction in award opportunity, e.g. if the previous long-term incentive plan represented half of the total target-level variable pay opportunity and the performance conditions on this portion of the award are removed, then the total target-level variable pay opportunity under the new plan should be approximately halved.

susceptible to manipulation. We generally believe that at least one metric should compare the company's performance to a relevant peer group or index. When utilised for relative measurements, external benchmarks should be disclosed and transparent. Internal benchmarks should also be disclosed and transparent, unless a cogent case for confidentiality has been fully explained.

### Linking Executive Pay to Environmental and Social Criteria

Glass Lewis believes that explicit environmental and/or social (E&S) criteria in executive incentive plans, when used appropriately, can serve to provide both executives and shareholders a clear line of sight into a company's ESG strategy, ambitions, and targets. Although we are strongly supportive of companies' incorporation of material E&S risks and opportunities in their long-term strategic planning, we believe that the inclusion of E&S metrics in remuneration plans should be predicated on each company's unique circumstances. In order to establish a meaningful link between pay and performance, companies must consider factors including their industry, size, risk profile, maturity, performance, financial condition, and any other relevant internal or external factors.

When a company is introducing E&S criteria into executive incentive plans, we believe it is important that it provides shareholders with sufficient disclosure to allow them to understand how these criteria align with its strategy. Additionally, Glass Lewis recognises that there may be situations where certain E&S performance criteria are reasonably viewed as prerequisites for executive performance, as opposed to behaviours and conditions that need to be incentivised. For example, we believe that shareholders should interrogate the use of metrics that award executives for ethical behaviour or compliance with policies and regulations. It is our view that companies should provide shareholders with disclosures that clearly lay out the rationale for selecting specific E&S metrics, the target-setting process, and corresponding payout opportunities. Further, particularly in the case of qualitative metrics, we believe that shareholders should be provided with a clear understanding of the basis on which the criteria will be assessed. Where quantitative targets have been set, we believe that shareholders are best served when these are disclosed on an ex-ante basis, or the board should outline why it believes it is unable to do so. In addition, we believe that shareholders of UK companies that have not included explicit E&S indicators in their incentive plans would benefit from additional disclosure on how the company's executive pay strategy is otherwise aligned with its sustainability strategy.

While we believe that companies should generally set long-term targets for their environmental and social ambitions, we are mindful that not all remuneration schemes lend themselves to the inclusion of E&S metrics. We also are of the view that companies should retain flexibility in not only choosing to incorporate E&S metrics in their remuneration plans, but also in the placement of these metrics. For example, some companies may resolve that including E&S criteria in the annual bonus may help to incentivise the achievement of short-term milestones and allow for more manoeuvrability in strategic adjustments to long-term goals. Other companies may determine that their long-term sustainability targets are best achieved by incentivising executives through metrics included in their long-term incentive plans.

### Target Setting and Disclosure

Targets should be disclosed or, if performance is assessed on a discretionary basis, an explanation of the overall methodology and specific rationale for individual allocations should be provided. Glass Lewis accepts that some measures may involve commercially sensitive information, in which case an explanation of how performance compared to target should be provided in support of any payouts, and the actual targets and performance

should be disclosed retrospectively. We expect companies to provide an indication of when the targets will be disclosed in the future; however, we acknowledge that a cogent rationale may be provided for the absence of such an indication.

We generally defer to the board in setting the appropriate measures for incentivising executives; however, where the financial metrics used to determine payouts have been adjusted, such as to exclude exceptional items or other costs, the report should disclose how the calculation differs from reported accounting figures, and a rationale for these adjustments. Further, in the event that performance under such adjusted measures differs significantly from their reported accounting counterparts, we closely scrutinise any payouts driven by plans incorporating those measures.

In line with UK market practice, we believe that the receipt of equity awards by key executives should normally require the achievement of at least median performance against the selected benchmark, unless a cogent case for lesser performance has been fully explained. Furthermore, we closely scrutinise plans that allow for more than 25% of an award to vest for threshold performance.

## Limits

We believe that incentive programs should feature clear and transparent award limits, expressed as a multiple of base salary per employee. In addition, payouts should be reasonable relative to company performance, and total remuneration to those included in the plan should be broadly in line with amounts paid by the company's peers.

## Discretion

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

Glass Lewis recognises the importance of the remuneration committee's judicious and responsible exercise of discretion over incentive pay outcomes to account for significant, material events that would otherwise be excluded from performance results of selected metrics of incentive programmes. For instance, major litigation settlement charges may be removed from non-GAAP results before the determination of formulaic incentive payouts, or health and safety failures may not be reflected in performance results where companies do not expressly include health and safety metrics in incentive plans; such events may nevertheless be consequential to corporate performance results, impact the shareholder experience, and, in some cases, may present material risks. Conversely, certain events may adversely impact formulaic payout results despite being outside executives' control. We believe that companies should provide thorough discussion of how such events were considered in the committee's decisions to exercise discretion or refrain from applying discretion over incentive pay outcomes. The inclusion of this disclosure may be helpful when we consider concerns around the exercise or absence of committee discretion.

## Remuneration Relative to Stakeholder Experience

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

- A company has suffered an exceptional negative event that has had a material negative impact on shareholder value;<sup>49</sup> or
- A company's decisions regarding working conditions have had a material negative impact on employees.<sup>50</sup>
- In cases of substantial misalignment between executive pay outcomes and the experience of shareholders or employees in the past fiscal year, we may recommend that shareholders vote against a company's remuneration report solely on this basis.

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

## Recovery Provisions (Clawback and Malus)

In line with provision 37 of the UK Code, all incentive schemes should allow for awards to be recovered or withheld in clearly defined circumstances, such as misstatement or misconduct. It should be clearly disclosed whether these provisions allow for the recovery of paid awards (clawback), or are limited to withholding or adjusting outstanding/deferred awards (malus).

## Dilution

Limits on the permissible amount of dilution to shareholders should be included in all executive and employee equity participation or incentive plans. Such a limit provides a measure of protection for the shareholders against excessive dilution. Best practice limits reflect the guidance of the Investment Association.

In the case of companies with established businesses, plan rules should limit dilution from any grant or series of grants, together with grants already made under all executive and employee plans, to 10% of total issued share capital in any 10-year period, with dilution relating to executive (discretionary) schemes limited to 5% over the same period. In the case of developing companies, we believe that higher limits may be reasonable, although a compelling rationale should be provided to shareholders before the plan is introduced.

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<sup>49</sup> For example, we generally expect a remuneration committee to consider reducing an annual bonus payout and/or the size of an LTI grant following a significant decline in share price. Further, we expect downward adjustments to the outcomes of awards linked to share price performance where windfall gains have been received.

<sup>50</sup> For example, we generally expect substantial workforce layoffs, furloughs, short-time working arrangements, salary freezes etc. to be reflected in executives' remuneration outcomes.



## Remuneration Relative to Ownership Structure

Glass Lewis recognises that differences in the ownership structure of listed firms can affect the incentive structure for executives. We believe boards should account for the natural alignment between shareholders' and an executive's interests whenever the executive directly or indirectly owns a significant portion of the company's shares. Conversely, we expect companies with a more dispersed ownership structure to demonstrate a more precise and linear pay-performance link.

In particular, where an executive owns or directly controls more than 10%-20%<sup>51</sup> of a company's shares or voting rights, we would not expect the individual to participate in equity incentive schemes unless a cogent rationale is provided by the company. In general, however, we would be sceptical of any large grant, either in equity instruments or cash, that would allow the executive to further consolidate its ownership level; in such cases, we would expect the board to implement anti-dilutive safeguards and disclose the terms thereof.

Similarly, where a company is controlled and managed by a family, we believe the use of equity incentives for representatives of the family to generally be inappropriate, unless safeguards are in place to protect against further entrenchment of the controlling shareholders' stake. When such grants are made or proposed, we will consider the individual stake of the family representative that is awarded equity incentives and the overall size of the grant.

Where a significant award is granted to a shareholder executive, we will closely scrutinise the appropriateness of the vesting terms and conditions of such award.

## Executive Remuneration at Financial Institutions

Following the 2007-2008 global financial crisis, UK and European regulators have directed significant attention to the reform of remuneration policies at financial institutions in order to mitigate risk to relevant stakeholders. Such firms are subject to specific regulatory requirements, namely the European Union's Capital Requirements Directive (CRD), and the UK Remuneration Code, which is jointly maintained by the FCA and the Prudential Regulation Authority (PRA).

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

### Capital Requirements Directive

The European Union introduced directives amending the existing Capital Requirements Directive in 2010 (CRD III), 2013 (CRD IV) and 2019 (CRD V) in order to harmonise the supervision of remuneration practices at financial

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<sup>51</sup> Depending on overall ownership structure, growth stage, and available liquidity of the company.



institutions across the EU.<sup>52</sup> Each CRD has been transposed into UK law through a combination of secondary legislation and PRA and FCA policy. The amendments introduced with CRD III established a requirement that national supervisory authorities directly oversee financial institutions' remuneration policies and practices in order to "promote sound and effective risk management."<sup>53</sup> The more notable provisions from the Capital Requirements Directives that apply to executive remuneration policies of affected firms<sup>54</sup> are the following:

- Performance-related remuneration must take into account the overall company results as well as financial and non-financial criteria;
- Fixed pay should be high enough relative to variable pay to adequately compensate individuals and avoid excessive risk-taking;
- Variable remuneration plans should allow the possibility of receiving no payment in case of poor company performance;
- Variable remuneration cannot exceed 100% of fixed remuneration (or 200%, with shareholder approval);<sup>55</sup>
- At least 50% of variable remuneration must be granted in the form of equity-linked or derivative instruments, which may include cash-settled phantom equity awards;
- At least 40% of variable remuneration must be deferred over at least four years, or five years for senior management and other material risk takers;<sup>56</sup>
- Variable remuneration, including equity deferral, must be subject to clawback or malus provisions; and
- Make-whole payments related to previous employment packages must also include retention, deferral, performance and clawback elements.<sup>57</sup>

## UK Remuneration Codes

The Remuneration Code was introduced by the now-defunct FSA in 2010 to reflect the recommendations of the G20's Financial Stability Board and was subsequently revised in 2011 and 2014 to align with CRD III and CRD IV.

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<sup>52</sup> Directives 2010/76/EU, 2013/36/EU, and 2019/878 of the European Parliament and of the Council of 24 November 2010, 26 June 2013, and 20 May 2019, respectively, amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies.

<sup>53</sup> Article 22(1) of Directive 2006/48/EC (CRD III).

<sup>54</sup> While all financial and credit institutions are affected by the Capital Requirements Directives, a "proportionality rule" prevents all requirements from being strictly applied to smaller companies or to companies or individuals with less direct risk exposure. CRD V defines such institutions as having a value of assets of which is on average and on an individual basis equal to or less than €5 billion over the previous four years, and staff members whose annual variable remuneration does not exceed €50,000 and does not represent more than one third of the staff member's total annual remuneration.

<sup>55</sup> Shareholders must approve any increase in variable remuneration over the threshold of 100% of base salary by a 75% supermajority.

<sup>56</sup> For variable remuneration that is "particularly high," at least 60% must be deferred. Material risk takers are defined as staff members whose remuneration is equal to or greater than €500,000 and equal to or greater than the average remuneration awarded to senior management.

<sup>57</sup> Buy-outs of variable remuneration. Prudential Regulation Authority. September 2016.

From 2015, there have been multiple remuneration codes managed by both the PRA and FCA, the FSA's successors.<sup>58</sup> The Remuneration Codes are intended "to ensure that firms have risk-focused remuneration policies, which are consistent with and promote effective risk management and do not expose them to excessive risk", principally by ensuring that a significant proportion of pay for material risk takers, including executives, is at-risk and that issuers have the capability to adjust payout levels.

Under revised rules released in June 2015,<sup>59</sup> the deferral requirements for variable payouts to executives stipulated under CRD were extended to a three-to-seven year period, depending on the individual's level of responsibility, and such awards are now subject to clawback for at least seven years from the date of award (or up to ten years if an investigation into potential material failures has commenced). In addition, the revised rules prohibit any variable pay for non-executive directors, and explicitly state that no variable or discretionary payments should be made to management of a firm that is receiving taxpayer support.

## Authorities to Increase Variable Remuneration

As described above, in accordance with CRD IV, certain financial institutions are required to seek shareholder approval in order to grant variable awards that exceed 100% of fixed pay, subject to an overarching limit of 200% of fixed pay. In general, Glass Lewis will support such requests where a company has provided adequate rationale and demonstrated a close alignment between pay and performance. Currently, CRD IV rules on variable pay only apply to significant financial institutions; however their application is currently under review and may be expanded going forward.

## Remuneration at AIM-Listed Companies

Companies listed on London's Alternative Investment Market (AIM) are exempt from the Enterprise and Regulatory Reform Bill and, as such, are not required to hold binding or advisory votes on executive pay. However an increasing number of AIM companies submit their remuneration report to shareholders voluntarily, including a smaller number that have complied with the voting requirements of the Regulatory Reform Bill by providing shareholders with a voice on a forward-looking remuneration policy, albeit on an advisory basis.

When assessing AIM company remuneration reports, we take a broadly similar approach as for main market issuers, particularly with regard to the alignment between executive and shareholder interests, pay for performance and protections against unmerited pay. However, we recognise that the remuneration structure, and level of disclosure, may be less developed at AIM-listed issuers than at larger, more established firms.

Where an AIM listed company does not provide shareholders with a say on pay, and we identify egregious remuneration practices, we may recommend shareholders vote against the remuneration committee chair.

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<sup>58</sup> The IFPRU Remuneration Code, AIFM Remuneration Code, BIPRU Remuneration Code, Dual-regulated firms Remuneration Code and UCITS Remuneration Code can each be found in the Senior Management Arrangements, Systems and Controls Sourcebook of the FCA's handbook, while the PRA's CRR Remuneration Code can be found in its Rulebook.

<sup>59</sup> Strengthening the alignment of risk and reward: new remuneration rules. Prudential Regulation Authority. June 2015.

## Save As You Earn (SAYE) Plans

Many companies listed on the LSE provide a way for all employees to acquire ordinary shares at a discount via salary sacrifice SAYE plans. Government regulations typically limit the discount of shares to 20% of their recent market price. Glass Lewis recognises the value of broad-based equity programs that encourage employees to invest in their company, thereby aligning their interests with those of shareholders. Further, these companies are bound by certain statutory limitations in terms of the amount of shares to be granted pursuant to any company share plan, as well as a monthly contribution limit in order to acquire shares. We are generally supportive of SAYE schemes given their regulatory basis and alignment of employee and shareholder interests.

## Remuneration of Non-Executive Directors

Glass Lewis believes that non-employee directors should receive appropriate remuneration for the time and effort they spend serving on the board and its committees. Glass Lewis believes that the quantum of non-executive fees should be broadly comparable to a company's country and industry peers, should take into account the time commitment required for a director to satisfactorily discharge their duties to shareholders and should be reasonable in order to retain and attract qualified individuals. At the same time, excessive fees represent a financial cost to the company and threaten to compromise the objectivity and independence of non-employee directors.

The UK Code states that non-executive director remuneration should not include share options.<sup>60</sup> Not only does the board lose objectivity when it allows non-executive directors to participate in such schemes, but individual directors locked in by longer-term grants could be inhibited from expressing dissenting views and, in extreme cases, from taking the ultimate step of resigning. Any non-executive director fees delivered in equity should be granted on a nil-cost basis, free of any performance criteria or time-based restrictions on exercise to ensure that directors hold these shares on the same basis as the shareholders they represent.

In certain circumstances, such as with options granted in connection with an IPO, or at a company in the development phase that has limited cash resources, the granting of options to non-executives may be a reasonable method of remuneration, provided that there are no performance conditions linked to these awards. In most cases, however, we will classify as affiliated any non-executive director who has received share options, or shares subject to any vesting restrictions, more than one year after the company's flotation.

## Retirement Benefits for Non-Executive Directors

We will recommend voting against proposals to grant retirement benefits to non-executive directors. Such extended payments can impair the objectivity and independence of these board members. Directors should receive adequate remuneration for their board service through annual fees.

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<sup>60</sup> Provision 34 of the UK Code.

# Governance Structure and the Shareholder Franchise

## Shareholders' Right to Call a Meeting

Although rarely exercised, the Act gives minority shareholders of UK companies the power to call a general meeting and require written resolutions to be circulated, along with a written statement about the meeting's subject matter. The minimum ownership threshold required to call a meeting is 5% of the company's total voting rights, although to prevent the abuse of this power, there are some limits on the types of resolution that may be circulated in this way.

## Notice Period for a General Meeting

Section 307A of the Act also allows for the shortening of a company's general meeting notice period from 21 days to 14, subject to annual shareholder approval of a special resolution granting such an authority. This authority, which is routinely sought at UK AGMs, is contingent upon a company having adequate electronic voting and communication provisions in place.

Assuming that such an authority, once granted, has not previously been abused, we will generally recommend that shareholders vote for a board's authority to set general meeting notice periods at 14 days as long as companies provide an assurance that the authority would not be used as a matter of routine, but only when merited. As such, we expect that such an authority should only be utilised where there is an exceptional need for urgency and is to the advantage of shareholders as a whole.

Where such an authority is utilised, we will expect a company to give its reasons for the need to call a general meeting at short notice. As such, we may recommend that shareholders vote against any resolution proposed at a shorter notice meeting if the use of the shorter notice period has not been adequately justified or we believe that shareholders need more time to consider their voting decision due to the complexity of the matters proposed.

## Virtual Shareholder Meetings

In order to hold a virtual shareholder meeting, UK companies must first propose and receive shareholder approval for changes to their statutes.<sup>61</sup>

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<sup>61</sup> In response to the spread of COVID-19, the UK Government included temporary measures in the Corporate Insolvency and Governance Act to allow for companies without the relevant provisions in their statutes to hold fully or partially virtual meetings. These measures applied retrospectively from March 26, 2020, to March 30, 2021, and have not been renewed.

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

## Meeting Format and Convocation

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

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

In egregious cases where inadequate disclosure of the aforementioned has been provided to shareholders at the time of convocation, we will consider recommending that shareholders hold the chair of the governance committee (or equivalent) or the board chair accountable.

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

## Amendments to Articles

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

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

### Amendments to Allow for Virtual-only Meetings

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

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

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

### Amendments to Allow for Hybrid Meetings

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

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

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

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

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

## Reporting Contributions and Political Spending

UK companies will sometimes seek shareholder approval to authorise the board, in accordance with sections 366 and 367 of the Act, to make political donations or incur political expenditures up to a disclosed monetary limit. These authorities are typically set forth as a precautionary measure to ensure a company does not inadvertently breach part 14 of the Act, which requires shareholder approval for political spending in excess of £5,000 in any 12-month period. Companies seeking this authority will generally provide an assurance that they have not used this authority in the previous fiscal year and do not intend to use it in the subsequent fiscal year. On that basis, and absent any indication of abuse of this authority, we typically recommend shareholders approve political spending-related proposals.

## Amendments to the Articles of Association

We will evaluate proposed amendments to a company's articles of association on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from judging each amendment on its own merits and is a practice which we believe negatively limits shareholder rights. In such cases, we will analyse each proposed change individually. We will recommend voting for the proposal only when, on balance, we believe that all of the amendments are in the best interests of shareholders.

## Shareholder Proposals

Glass Lewis believes that shareholders should seek to promote governance structures that protect shareholders, support effective ESG oversight and reporting, and encourage director accountability. Accordingly, Glass Lewis places a significant emphasis on promoting transparency, robust governance structures and companies' responsiveness to and engagement with shareholders. We also believe that companies should be transparent on how they are mitigating material ESG risks, including those related to climate change, human capital management, and stakeholder relations.

To that end, we evaluate all shareholder proposals on a case-by-case basis with a view to promoting long-term shareholder value. While we are generally supportive of those that promote board accountability, shareholder rights, and transparency, we consider all proposals in the context of a company's unique operations and risk profile.

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



# Capital Management

## General Authority to Issue Shares with Preemptive Rights

The vast majority of UK companies seek annual shareholder approval of the authority to issue shares with and without preemptive rights. In either case, companies typically do not anticipate using this authority, but rather place it on their ballots in order to provide the board with the flexibility to issue shares over the course of the coming fiscal year if needed.

In general, we will support the authority to issue shares with preemptive rights when the requested amount is less than or equal to one-third of issued ordinary share capital.<sup>62</sup> This authority should not exceed 15 months; however, we will generally not recommend voting against any authority with an expiry in excess of 15 months, as most companies continue to renew this authority on an annual basis.

Best practice in the UK, as prescribed by the Investment Association and the Pre-Emption Group, has traditionally limited the authority to issue shares with preemptive rights to one-third of issued ordinary share capital. During the economic downturn of 2008, however, difficulties in raising capital and disparate take-up rates at rights issues opened this issue to debate among a wide range of UK investor groups.

As a result, the Investment Association's predecessor, the Investment Affairs division of the Association of British Insurers (ABI), increased its ceiling on allotments to two-thirds of issued share capital, provided that the additional third apply to a fully preemptive rights issue only. The ABI also recommended that issuers adopt certain safeguards in the event that the extra authority was used, including the required annual election of all directors, with the intent that shareholders could vote against directors in the event of any perceived abuse of this increased authority.

We generally believe that the authority to issue shares on a preemptive basis will benefit shareholders by providing the company with the flexibility to finance operations and business opportunities; however, we are concerned that this increased authority will grant directors a dangerously high level of control over a company's share capital, possibly to the detriment of shareholders. Moreover, we note that the 2006 Companies Act allows issuers to abolish the concept of an authorised share capital. We are concerned that these two authorities leave very little shareholder control over capital management.

In light of such concerns, Glass Lewis will generally recommend voting against any authority allowing the board to issue shares representing more than one-third of issued share capital if such number of shares in excess of one-third is not specifically designated for a fully preemptive rights issue. In most other cases (i.e., one-third is designated for issuance with preemptive rights generally and one-third is designated for issuance in connection with a rights issue), we will generally view these authorities as standard and in the best interests of

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<sup>62</sup> Share Capital Management Guidelines. The Investment Association. July 2016.



shareholders. In any case, we note that such rights issues generally qualify as Class 1 transactions under the Listing Rules and as such require further separate shareholder approval prior to any actual transaction.<sup>63</sup>

## General Authority to Issue Shares Without Preemptive Rights

With regards to the authority to issue shares without preemptive rights, we generally view proposals to suspend preemptive rights for a maximum of 10% of the issued ordinary share capital of the company as non-contentious and routine, in line with the recently updated recommendations of the Pre-emption Group.<sup>64</sup> Further, we believe that this authority should be limited to 15 months.

However, we consider authorities requesting up to 20% of current issued share capital reasonable when the board provides an assurance that the portion of the authority in excess of 10% of the company's issued share capital will be limited to use in connection with an acquisition or specified capital investment, in line with the recommendations of the Pre-emption Group.

Further, we are generally supportive of proposals where an additional 2% of current issued share capital is requested for the purposes of follow-on issuances, as defined by the Pre-emption Group, under either, or both, of the 10% limits. We note that such an authority is currently limited, in practice, by the requirements imposed by the UK prospectus regime.

In line with the Pre-emption Group's guidance, where a company is issuing shares non-preemptively, we believe they should:

- Provide sufficient background to and reasons for the issuance, including the use of proceeds;
- Insofar as is possible, undertake a consultation with major shareholders prior to the issuance;
- As far as practicable, make the issue on a soft pre-emptive basis;
- Consider the involvement, through the issuance or a follow-on issue, of investors not allocated shares as part of a soft redemptive process;
- Involve company management in the allocation process; and
- Make a post-transaction report in line with Pre-emption Group guidance.

Where a company completes significant issuances and fails to adhere to the above best practice, we may consider recommending against subsequent general authorities to issue shares non-preemptively.

### 'Capital Hungry' Companies

Glass Lewis seeks to limit shareholder dilution while also taking into consideration that certain companies, such as those listed on the AIM or in a development phase, may need to raise larger amounts of capital more frequently (Capital Hungry Companies) and, as such, may justifiably request authorities of more than 10% of issued shares. In these instances, if the proposal seeks to allow for issuances of more than 10% (or 20% where

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<sup>63</sup> Chapter 10, UK Listing Rules. The Financial Conduct Authority.

<sup>64</sup> Disapplying Pre-emption Rights — A Statement of Principles. Pre-emption Group. November 2022.

the additional amount is limited in use as aforementioned), we will apply heightened scrutiny and generally require companies to provide a thorough explanation to shareholders. The factors we will consider when analysing such a request include:

- the company's short-term need for funding;
- whether the company has reasonably considered other funding options;
- the company's past actions; and
- the expected overall dilutive effect on shareholders.

Where a cogent rationale is provided, we believe Capital Hungry Companies may reasonably extend the authority duration beyond 15 months.

Where a Company seeks admission to the Official List and considers itself to be 'capital hungry', Glass Lewis believes, in line with the Pre-emption Group guidelines, that this should be disclosed in the IPO prospectus.

## Investment Companies

Investment companies present an additional exception to our guidelines for share issuance authorities. Given that the shares of investment companies generally trade at a discount to their net asset value (NAV), share issuances have the potential to result in substantial and immediate economic dilution for existing shareholders. While investment companies with a premium listing are prohibited from issuing shares below NAV regardless of their domicile, such restrictions do not apply to standard-listed investment companies. Accordingly, in cases in which standard-listed investment companies are seeking an authority to allot shares without preemptive rights in excess of the standard 5% limit, we will require a confirmation from the board that shares would only be issued at or above the prevailing NAV per share. Although we are generally concerned with significant voting dilution, any share issuances at or above NAV would not result in economic dilution to existing shareholders, and they would carry the added benefits of enhanced liquidity and costs, such as management fees, spread over a greater number of shares. As such, we generally consider such authorities to be in shareholders' best interests, and we will recommend shareholders approve share issuance authorities without preemptive rights of more than 5% of issued share capital, so long as shares will be issued at or above NAV.

## Specific Authorities to Issue Shares

While not as common as general authorities, companies may also seek shareholder approval of a direct issuance of shares for a specific purpose such as financing a merger, acquisition or expansion, or otherwise refinancing a company.

When a company seeks shareholder approval of a specific plan to issue shares, we will evaluate the plan on a case-by-case basis to weigh the merits of the proposed issuance against the dilutive effect to shareholders.

When assessing these issuances, we consider:

- the total number of shares to be issued and the dilutive impact on shareholders;
- the issuance price and discount/premium; and
- the intended uses of proceeds from the issuance in the context of the company's financial position and business strategy.

## Authority to Repurchase Shares

A company may want to repurchase its own shares for a variety of reasons. A repurchase plan is often used to increase the company's share price or EPS, distribute excess cash to shareholders, or provide shares for equity-based remuneration plans for employees. In addition, a company might repurchase shares in order to offset the dilution of earnings caused by the exercise of share options.

We will recommend voting in favour of a proposal to repurchase shares when the plan includes the following provisions: (i) a maximum number of shares which may be purchased (limited to 15% of a company's issued share capital in line with the requirements of Chapter 12.4 of the Listing Rules); and (ii) a maximum price which does not exceed the higher of (a) 5% above the average market value of the company's shares for the five business days before the purchase is made; and/or (b) the higher of the price of the last independent trade and the highest current independent bid on the market where the purchase is carried out (also in line with the requirements of Chapter 12.4 of the Listing Rules).

We often find proposals asking for an authority to make off-market share repurchases to be troubling. We recommend that shareholders vote against proposals asking for the authority to make off-market purchases (or contingent purchase contracts) that do not specify the maximum price for repurchases, as companies would then be authorised to make purchases at a large premium. Additionally, such purchases are outside the jurisdiction of the Listing Authority, and companies may be making off-market purchases without requesting any specific authority from shareholders.

## City Code on Takeovers and Mergers

Companies sometimes seek shareholder approval to waive Rule 9 of the City Code on Takeovers and Mergers (the "City Code"), which requires an all-cash offer be made by any party acquiring more than a 30% stake in a company. The requirement is also extended to any party currently carrying between 30% and 50% of the share capital to make a takeover offer when this stake is increased.<sup>65</sup> The City Code was instituted to ensure that all shareholders are treated fairly and not denied an opportunity to decide the merits of a takeover opportunity. It has also been designated as the supervisory authority to enact the requirements of the EU Directive on Takeover Bids. Offers must be made in cash or be accompanied by a cash alternative at not less than the highest price paid by the offeror during the 12 months prior to the offer.

We will analyse Rule 9 waivers on a case-by-case basis to determine the short- and long-term effect on current shareholders. Companies often put this proposal on a ballot when they are pursuing a repurchase program or a capital restructuring that would indirectly increase a significant shareholder's stake. While we typically find this proposal non-contentious, we will closely examine any measure that could potentially allow for a "creeping acquisition" through the increase in a significant shareholder's interest from below 50% to near or above 50% of the anticipated outstanding share capital following a repurchase, restructuring, or the exercise of vested awards.

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<sup>65</sup> The Takeover Code. The Panel on Takeovers and Mergers. September 2016.

## Allocation of Profits/Dividends

We generally recommend supporting a company's determination regarding the payment of dividends (or nonpayment thereof). However, we will apply particular scrutiny where the company's dividend payout ratio, based on consolidated earnings, has decreased to an exceptionally low level (as compared with historic practice), or where a company has eliminated dividend payments altogether without explanation. We will also scrutinise dividend payouts that are consistently excessively high relative to peers (i.e. a payout ratio over 100%) where not justified by outperformance and without satisfactory explanation. We will recommend supporting uncovered dividends when we believe that such payouts are justified and will not negatively impact the financial health of the company in the long-term.

In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend or if the company would be better served by forgoing a dividend to conserve resources for future opportunities or needs. As such, we will only recommend that shareholders refrain from supporting dividend proposals in exceptional cases.

By law, real estate investment trusts (REITs) are required to return 90% of the profits of the business arising in the relevant accounting period to shareholders in the form of a dividend. Given that REIT dividend payouts are monitored by law, we will not hold these companies to the standard dividend payout ratio outlined above.

## Dividend Reinvestment (or Scrip Dividend) Plans

We support plans that provide shareholders with the choice of receiving dividends in shares instead of cash. Scrip dividends allow the company to retain cash that it would otherwise distribute as a normal dividend. For shareholders, a dividend reinvestment plan offers a less expensive way to acquire additional shares without paying brokers' commissions or taxes.

# Non-Premium Listed Companies

## AIM-Listed Companies

As an adjunct to the Main Market of the LSE, the Alternative Investment Market (AIM) allows smaller companies from a wide range of industries and countries to raise capital while remaining subject to public regulation. Over 800 companies are currently listed on the AIM. While some of these companies will continue to trade on the AIM for some time, many will eventually ‘graduate’ to the Main Market upon reaching adequate size and productivity.

Companies listed on the AIM are required to comply or explain against a recognised corporate governance code — namely the UK Code or the less stringent QCA Code. Given the diverse range of companies listed on the AIM, we expect their boards to contain at least two independent non-executives, in line with the QCA Code; though we recognise that some companies may aspire to the higher independence standard set by the UK Code. Glass Lewis will apply an additional independence threshold and expect that this minimum number of directors, or any additional numbers as required by the overall size of the board, should account for a least 33% of the board. Further, with regard to committee composition, we generally apply the policies that pertain to smaller main market companies, as outlined above, to AIM-listed companies.

As noted, under the UK Code the chair is not considered strictly independent after appointment; however, many AIM companies continue to consider their chair independent. Where companies choose to comply with the QCA Code, deviation from best practice may be justified due to the small size of many AIM-listed boards and the relatively low level of responsibilities and remuneration associated with this role compared to chairs of larger companies. We will approach this issue on a case-by-case basis, considering the board’s determination, the remuneration provided to the chair, and any other relationships that may compromise their independence. If we consider the chair of an AIM-listed company to be independent, we will include them in our independence count.

Companies listed on the junior exchange generally provide poorer disclosure and apply less stringent corporate governance practices; however, we have seen a push for tighter regulation and improved practices in this section of the market by investor groups in the UK.

## Standard Listed Companies

The London Stock Exchange has a two-tiered listed structure under the Main Market: Premium and Standard Listing. Unlike premium-listed companies, companies with a standard listing are exempt from the recommendations of the UK Code; however, they are required to comply with the regulations of the UK’s FCA. Listing requirements are stipulated in the FCA Handbook, which, among other things, provides guidance on related-party transactions, capital requirements, shareholder notification rules and reporting deadlines. Unlike the UK Code, which operates on a “comply or explain” premise, the listing rules are strictly binding.

Nevertheless, and in line with prevailing market practice in the UK, Glass Lewis believes that companies with standard listings should adhere to the UK Code to the maximum extent possible and thoroughly explain any significant deviations.

## Off-Shore Companies (Guernsey, Jersey, the Isle of Man)

Some companies listed on the LSE are incorporated outside the UK for tax or general business purposes. Specifically, companies incorporated in Guernsey, Jersey, the Isle of Man and other off-shore markets (collectively, offshore companies) have historically been subject to neither the provisions of the UK Code nor UK Companies Law.

As with AIM-listed companies, Standard Listed offshore companies tend to have weaker disclosure and corporate governance practices than Premium Listed companies. Nonetheless, we believe that off-shore companies with Standard Listings should adhere to the UK Code to the maximum extent possible and thoroughly explain any significant deviations. Additionally, while offshore companies are not required to submit a remuneration report for shareholder approval, they sometimes do so, which we fully support.

### Reincorporation

In recent years, we have seen several companies reincorporating from the UK to offshore or overseas jurisdictions while retaining a UK listing. In shifting away from the jurisdiction of the UK Companies Act, the following significant changes for investors may apply: (i) shareholders do not retain statutory pre-emption rights in the case of new issuances; (ii) directors do not need shareholder approval to issue and allot shares; (iii) companies are not required to disclose significant beneficial owners of the company's shares; (iv) there is no maximum limit in the law regarding political donations; and (v) the appointment of more than one corporate representative in respect of a single shareholding is prohibited.

In many cases, such companies provide assurances that they will voluntarily comply with the provisions of the UK Code. Further, companies often state that the reincorporation will not change the company's adherence to best practices in corporate governance and shareholder rights, and many often enshrine key elements of UK law into their articles. Moreover, premium-listed companies are required to comply with the UK Code.

Although we remain concerned that companies reincorporating offshore or overseas will be subject to somewhat more relaxed corporate governance standards, we will generally recommend voting in favour of such a proposal when management provides the above key assurances. Further, the UK Listing Authority's two-tiered listing regime (see Introduction) mitigates some of these concerns. However, if the terms of a reincorporation fail to provide assurances regarding the maintenance of adequate governance standards, we will consider recommending shareholders vote against such a proposal in order to preserve vital safeguards of shareholder rights.

# Overall Approach to ESG

Glass Lewis evaluates all environmental and social issues through the lens of long-term shareholder value. We believe that companies should be considering material environmental and social factors in all aspects of their operations and that companies should provide shareholders with disclosures that allow them to understand how these factors are being considered and how attendant risks are being mitigated. We also are of the view that governance is a critical factor in how companies manage environmental and social risks and opportunities and that a well-governed company will be generally managing these issues better than one without a governance structure that promotes board independence and accountability.

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

Given the importance of the role of the board in executing a sustainable business strategy that allows for the realisation of environmental and social opportunities and the mitigation of related risks, relating to environmental risks and opportunities, we believe shareholders should seek to promote governance structures that protect shareholders and promote director accountability. When management and the board have displayed disregard for environmental or social risks, have engaged in egregious or illegal conduct, or have failed to adequately respond to current or imminent environmental and social risks that threaten shareholder value, we believe shareholders should consider holding directors accountable. In such instances, we will generally recommend against responsible members of the board that are specifically charged with oversight of the issue in question.

When evaluating environmental and social factors that may be relevant to a given company, Glass Lewis does so in the context of the financial materiality of the issue to the company's operations. We believe that all companies face risks associated with environmental and social issues. However, we recognize that these risks manifest themselves differently at each company as a result of a company's operations, workforce, structure, and geography, among other factors. Accordingly, we place a significant emphasis on the financial implications of a company's actions with regard to impacts on its stakeholders and the environment.

When evaluating environmental and social issues, Glass Lewis examines companies':

**Direct environmental and social risk** — Companies should evaluate financial exposure to direct environmental risks associated with their operations. Examples of direct environmental risks include those associated with oil or gas spills, contamination, hazardous leakages, explosions, or reduced water or air quality, among others. Social risks may include non-inclusive employment policies, inadequate human rights policies, or issues that adversely affect the company's stakeholders. Further, we believe that firms should consider their exposure to risks emanating from a broad range of issues, over which they may have no or only limited control, such as



insurance companies being affected by increased storm severity and frequency resulting from climate change or membership in trade associations with controversial political ties.

**Risk due to legislation and regulation** — Companies should evaluate their exposure to changes or potential changes in regulation that affect current and planned operations. Regulation should be carefully monitored in all jurisdictions in which the company operates. We look closely at relevant and proposed legislation and evaluate whether the company has responded proactively.

**Legal and reputational risk** — Failure to take action on important environmental or social issues may carry the risk of inciting negative publicity and potentially costly litigation. While the effect of high-profile campaigns on shareholder value may not be directly measurable, we believe it is prudent for companies to carefully evaluate the potential impacts of the public perception of their impacts on stakeholders and the environment. When considering investigations and lawsuits, Glass Lewis is mindful that such matters may involve unadjudicated allegations or other charges that have not been resolved. Glass Lewis does not assume the truth of such allegations or charges or that the law has been violated. Instead, Glass Lewis focuses more broadly on whether, under the particular facts and circumstances presented, the nature and number of such concerns, lawsuits or investigations reflects on the risk profile of the company or suggests that appropriate risk mitigation measures may be warranted.

**Governance risk** — Inadequate oversight of environmental and social issues carries significant risks to companies. When leadership is ineffective or fails to thoroughly consider potential risks, such risks are likely unmitigated and could thus present substantial risks to the company, ultimately leading to loss of shareholder value.

Glass Lewis believes that one of the most crucial factors in analysing the risks presented to companies in the form of environmental and social issues is the level and quality of oversight over such issues. 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, we believe shareholders should consider holding directors accountable. When companies have not provided for explicit, board-level oversight of environmental and social matters and/or when a substantial environmental or social risk has been ignored or inadequately addressed, we may recommend voting against members of the board. In addition, or alternatively, depending on the proposals presented, we may also consider recommending voting in favour of relevant shareholder proposals or against other relevant management-proposed items, such as the ratification of auditor, a company's accounts and reports, or ratification of management and board acts.



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