

2018 YEAR-END RECAP
PROXY-RELATED EVENTS
IN NORTH AMERICA

2018 Year-End Recap

– PROXY-RELATED EVENTS IN NORTH AMERICA

Against a backdrop of heightened social awareness, shareholders across North America made their passions known in 2018. In both the U.S. and Canada, environmental and social proposals continued to garner support. Many proposals also followed popular headlines. In the U.S., these covered a range of timely topics from gun violence to political contributions to the handling of “fake news” at social media companies. In Canada, although executive compensation had the highest number of proposal submissions, board diversity captured shareholders’ attention and received the highest levels of shareholder support.

As issuers reflect on the 2018 proxy season and prepare for their 2019 annual general meetings, they should expect this level of social consciousness to continue. Proxy advisory firms ISS and Glass Lewis continue to update voting policies on these hot topics, especially on the issue of board diversity, even as U.S. regulators look at these firms with increased scrutiny. Other trends to keep an eye on relate to the logistics of proxy voting, including the rise of virtual meetings and the uptick in retail investors acquiring shares through broker-managed accounts, resulting in these shares ultimately being voted in accordance with ISS/Glass Lewis voting platforms rather than investors themselves.

Following is a more detailed look at these and other trends from the 2018 proxy season, the learnings from which can guide North American issuers as they gear up for 2019. For more information about these topics, please reach out to us:

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Environmental, Social, and Governance Proposals

Environmental, social, and governance (ESG) issues surfaced as key priorities during the 2018 proxy season, but the sheer number and variety of ESG ratings agencies rankled investors and issuers alike. In the U.S., climate change, greenhouse gas emissions, and board and employment diversity policies were hot topics on the environmental and social front. In Canada, board diversity emerged as a top governance issue and, along with environment-related proposals, garnered strong support.

Environmental, Social, and Governance Proposals



ESG and Financial Performance

With mounting evidence of a link between strong ESG practices and positive financial performance, institutional investors are increasingly factoring these issues into their decision-making process. In the U.S., E&S topics informed more than 50 percent of shareholder proposals, according to ISS data. Support for these types of proposals grew despite fewer proposals going to a vote, likely a result of increased engagement and behind-the-scenes discussions between companies and their top shareholders.



Environmental Issues Hot in Canada

Canadian investors also prioritized environmental issues in 2018, especially in sectors in which environmental factors have a direct impact on business. For example, with mining playing such a significant role in the economy, shareholders in Canada's mining companies continue to be interested in how these companies are preparing for the risks posed by climate change.

Environmental, Social, and Governance Proposals



Ratings Agencies and Impacts

Investors are looking to outside ratings agencies for information on how companies are performing against such nonfinancial benchmarks. However, the proliferation of ESG research and ratings providers – all with different methodologies – has sown confusion among investors and created headaches for issuers. While some providers solicit input directly from companies, others rely solely on publicly available data to compile their scores. As such, one of the most common complaints is that ratings providers might reward companies for having comprehensive disclosure around their ESG practices rather than for having comprehensive practices themselves.

While there is no single gold standard, some of the most commonly referenced ratings providers include ISS (with its E&S QualityScore), MSCI ESG, RepRisk, and Sustainalytics. Industry groups are pushing toward a more standardized approach, which will help investors make more informed decisions and will help level the playing field for issuers.



Changing Demographics

Millennial shareholders are especially keen to consider environmental and social factors, so issuers should expect this trend to accelerate as these groups continue to account for more of the investing base.

Board Diversity

With institutional investors amending voting guidelines to reinforce their commitment to this issue, board diversity gained momentum during the 2018 proxy season. This year, we saw more companies strengthening their commitments to diversity and inclusion with enhanced disclosures around the composition of their boards. In Canada, the strength of the ISS Social Advisory group's position on racial diversity surprised a number of issuers.

Board Diversity



Commitment to Diversity

Issuers across North America are embracing different forms of diversity on their boards with greater accountability, and under greater pressure from investors, than ever before. Although the discussion remains largely focused on gender diversity, it has evolved to encompass other aspects of diversity such as skill sets, tenure, ethnicity, and background. As such, we noticed an uptick in skills matrices and discussions around director recruitment processes in proxy statements filed in 2018.



More Women in Leadership Roles

In the U.S., 2018 brought about a rise in the representation of women in board positions: 87% of S&P 500 companies had at least two women on the board ([2018 Spencer Stuart Board Index, page 19](#))¹. In addition, approximately 35% of the newly elected directors of the Russell 3000 in the second quarter of 2018 were women ([Equilar Gender Diversity Index, 8/18](#))². Large asset managers, including the likes of BlackRock in their [Proxy Voting Guidelines for U.S. Securities \(2/18, page 4\)](#)³ and State Street in their [Proxy Voting and Engagement Guidelines \(3/18, page 2\)](#)⁴ are increasingly voicing their support for and amending their guidelines on gender diversity.

87% OF S&P 500 COMPANIES HAD AT LEAST TWO WOMEN ON THE BOARD



35% OF THE NEWLY ELECTED DIRECTORS OF THE RUSSELL 3000 THIS YEAR WERE WOMEN



Board Diversity



ISS's Stand on Diversity

In Canada, the ISS Social Advisory group took a strong stance on the issue, withholding against nominating committees wherein the board does not include at least one woman and one racially diverse member. The position raised questions among some Canadian issuers about what specifically defines a racially diverse individual. D.F. King learned that the group's definition of racial and ethnic categories stemmed from the U.S. Office of Budget & Management's guidance, and distinctions are based on company filings and publicly available sources.

Ultimately, the ISS Social Advisory group's stance did not significantly affect vote outcomes in 2018, and ISS informed us that the requirement to have a racially diverse board member would not be included in its primary Proxy Analysis & Benchmark Policy Voting Recommendations report.



Governmental Factors

As we look toward 2019, North American issuers may be wondering whether the government will play an increasing role in achieving gender diversity on corporate boards. In October 2018, California became the first U.S. state to require public companies headquartered within its borders to have at least one female director, with compliance mandatory by year-end 2019. Going forward, this may inspire similar actions across the U.S. and in Canada as well.

Executive Compensation

Executive compensation is a topic that has long riled activist shareholders. Across North America, investors are keeping a close eye on management and board compensation structures relative to company performance – from both a financial and an environmental and social standpoint. While Say-on-Pay proposals continue to garner widespread support, a few noteworthy failures emerged in 2018.

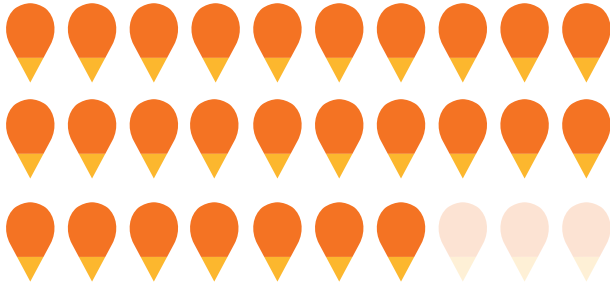
Executive Compensation



U.S. Say-on-Pay Increase

In 2018, U.S. shareholders continued to be diligent about executive compensation, with average support for Say-on-Pay proposals remaining high at 90% ([Sullivan & Cromwell LLP, 2018 Proxy Season Review, 7/12/18](#))⁵. At the same time, the rate of Say-on-Pay failures increased to 2.4% (up from 1.29% in 2017 and 1.47% in 2016), with a handful of high-profile failures making headlines ([Semler Brossy, 2018 Say on Pay and Proxy Results, 8/4/18](#))⁶.

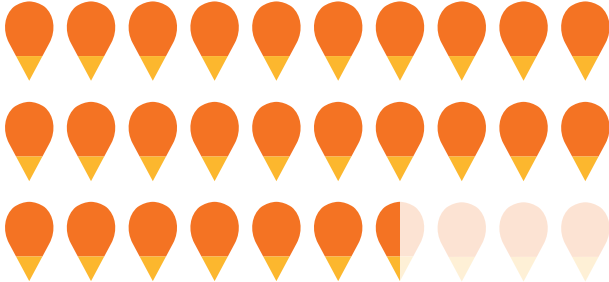
SAY-ON-PAY SUPPORT AVERAGES AT 90%



U.S. Equity Proposals Remain High

It was an uneventful year for equity proposals in the United States, as they sustained a high level of support (88%). Many of the proposed revisions to equity plans stemmed from the elimination of Section 162(m) from the tax code, which reshaped the rules around executive compensation deduction for covered companies.

EQUITY PROPOSALS SUSTAINED HIGH LEVEL SUPPORT OF 88%



Executive Compensation



Canadian Compensation and Performance

In Canada, Say-on-Pay results remained fairly steady in 2018, with just two issuers receiving less than 50% on their Say-on-Pay votes. The most notable example was the contentious fight between Crescent Point Energy Corporation and the activists at Cation Capital, which decried the company's compensation structure. While the dissidents were ultimately defeated in their attempts to appoint four new directors to the ten-member board, Crescent Point's Say-on-Pay proposal failed, just as it did in 2016.

Also in Canada, several issuers that performed poorly with regard to Say-on-Pay in the past saw significant improvements in shareholder support in 2018, driven by renewed dedication to shareholder engagement. Investors have come to view compensation as a function of company performance, and they need to see alignment

of value distribution between executives and themselves. Some of the companies that experienced a turnaround in shareholder support incorporated Performance Stock Units (PSUs) alongside Restricted Stock Units (RSUs) and other stock options, provided increased clarity and disclosure around compensation packages, and reduced or eliminated discretionary awards.

Heading into spring 2019, issuers should heed these lessons, keeping the lines of communication about executive compensation open and transparent.

Mini Topics

– OTHER TRENDS AND DEVELOPMENTS

Among other key trends and developments, virtual meetings remain on the rise while still encountering some objections. As retail investors continue to buy stock via brokerage accounts and brokers outsource proxy voting to advisors, ISS and Glass Lewis influence increases. Meanwhile both companies face increased regulatory scrutiny amid calls for greater transparency. And companies should stay alert to exempt solicitations, increasingly used by retail shareholders to garner support.

Mini Topics

– OTHER TRENDS AND DEVELOPMENTS



An Uptick in Virtual Meetings

With technology transforming nearly every aspect of business, virtual-only meetings continue to rise in popularity. In the U.S., the 2018 proxy season saw virtual meetings at 130 companies, marking a 30% increase from the prior season ([Sullivan & Cromwell LLP, 2018 Proxy Season Review, 7/12/18, page 57](#))⁷. Many issuers argue that a virtual approach saves time and money, but a handful of vocal critics have suggested that an issuer may leverage this arrangement to pre-screen and filter submitted questions. A few asset managers have even adopted a policy to vote against board members at companies that hold exclusively virtual meetings.

A “hybrid” annual meeting, comprised of both online and in-person components, offers a potential compromise for companies that wish to hold a virtual meeting but are concerned about shareholder backlash. Companies that have embraced this dual approach have evaded many of the typical criticisms.



Broker-Managed Accounts Playing a Larger Role

In 2018, more and more retail investors acquired shares through broker-managed accounts – a voting trend that’s likely to continue into 2019. In accordance with the rules governing these types of accounts, brokers outsource the voting for these shares to proxy advisors rather than having shareholders vote them directly – giving ISS and Glass Lewis even greater influence than many issuers might expect.

Issuers should also be aware of the higher Annual General Meeting costs posed by broker-managed accounts. These are incurred both because of the increased number of shareholder accounts that must be processed as well as increased suppression fees that arise from these account holders not receiving physical proxy materials.

Mini Topics

– OTHER TRENDS AND DEVELOPMENTS



U.S. Regulators Taking a Harder Look at Proxy Advisory Firms

In the U.S., ISS and Glass Lewis have come under increased scrutiny in the past few years, with the Securities and Exchange Commission (SEC) and the Senate Banking, Housing, and Urban Affairs Committee each calling for heightened transparency. Areas of concern include the accuracy of their reporting, the methods they use to arrive at analyses and recommendations, and their disclosure of potential conflicts of interest.

In November, the SEC held a roundtable discussion with investors, representatives from public companies, and other market participants to review the current rules governing the proxy process, including those related to voting mechanics and technology, shareholder proposal submission, and the role and regulation of proxy advisory firms. Although no tangible outcomes resulted from this roundtable discussion, the discussions were a key step toward identifying any changes that investors and issuers are looking for in the proxy process.



Exempt Solicitations Arrive on the Scene

As we head into spring 2019, companies should be on the lookout for a new type of tactic being employed by retail shareholders. This year, proponents such as John Chevedden and James McRitchie launched multiple notices of exempt solicitation, or PX14A6G filings, to drum up support for their shareholder proposals.

When a proponent uses this type of filing, he/she is exempt from having to distribute proxy materials to all shareholders – and he/she can skirt the 500-word limit imposed by Rule 14a-8 in order to express his/her views ([Hunton & Williams, 2013 Proxy Season Review and Corporate Governance Update, page 13](#))⁹. Instances of these filings were up by at least 20% year over year, led by a couple of proponents in particular ([Gibson Dunn, Shareholder Proposal Developments During the 2018 Proxy Season, 7/12/18](#))⁹. Given this momentum, companies should anticipate more such activity in future seasons.

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ENDNOTES

¹ 2018 Spencer Stuart Board Index, page 19: https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf

² Equilar Gender Diversity Index, 8/18: <https://www.equilar.com/images/reports/58/equilar-gender-diversity-index-2018q2-aug2018.pdf>

³ Proxy Voting Guidelines for U.S. Securities, 2/18, page 4: <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf>

⁴ Proxy Voting and Engagement Guidelines, 3/18, page 2: <https://www.ssga.com/investment-topics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-Guidelines-NA-20180301.pdf>

⁵ Sullivan & Cromwell LLP, 2018 Proxy Season Review, 7/12/18: <https://www.sullcrom.com/files/upload/SC-Publication-2018-Proxy-Season-Review.pdf>

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⁷ Sullivan & Cromwell LLP, 2018 Proxy Season Review, 7/12/18, page 57: <https://www.sullcrom.com/files/upload/SC-Publication-2018-Proxy-Season-Review.pdf>

⁸ Hunton & Williams, 2013 Proxy Season Review and Corporate Governance Update, page 13: https://www.huntonak.com/files/Uploads/Documents/Events/2013_Proxy_Season_Review_and_Corporate_Governance_Update.pdf

⁹ Gibson Dunn, Shareholder Proposal Developments During the 2018 Proxy Season, 7/12/18: <https://www.gibsondunn.com/wp-content/uploads/2018/07/shareholder-proposal-developments-during-the-2018-proxy-season.pdf>

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