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ISS Issues Final Policy Updates for 2022 Proxy Season

ISS has issued final voting policy updates for the 2022 proxy season. In line with continuing shareholder focus on environmental, social and governance issues, key U.S. policy changes center on diversity, climate change and shareholder rights.[1] These amendments are effective for meetings on or after February 1, 2022, unless otherwise noted. In typical practice, ISS will issue FAQs on its voting policies in January. There will also be updates to its specialty policies in January, including changes to its climate policies based on the separate survey process that ISS conducted this year.

Highlighted U.S Voting Policy Changes

- ***Unequal vote structures***. In 2015, ISS adopted a voting policy to recommend against directors at newly public companies that had unequal voting rights without a reasonable, time-based sunset mechanism. Then existing public companies with unequal voting rights were not impacted by this policy. Starting February 1, 2023, however, ISS will extend the policy to all covered companies and will recommend against one or more directors (except new nominees, who will be considered on a case-by-case basis) if the company has a common stock structure with unequal voting rights. ISS has clarified that these types of structures include high/low vote stock, classes of shares that are not entitled to vote on all the same ballot items or nominees and stock with time-phased voting rights ("loyalty shares"). Exceptions will be made for (i) newly public companies with a sunset provision of no more than seven years from the date of the IPO, (ii) limited partnerships and the operating partnership units of REITs, (iii) situations where the unequal voting rights are considered *de minimis* or (iv) companies providing sufficient protections for minority shareholders, such as allowing minority shareholders a regular binding vote on whether the capital structure should be maintained. ISS has clarified that, in addition to companies that emerge from bankruptcy, spin-offs, direct listing and those who complete a traditional IPO, "newly public companies" also includes companies going public in a de-SPAC transaction.

- ***Board diversity***. Starting February 1, 2023, the existing ISS policy to recommend against the nominating committee chair (or other directors on a case-by-case basis) for companies with no women on the board will be extended beyond the Russell 3000 and S&P 1500 indices to all companies. As is currently the case, an exception will be made if there was a woman on the board at the prior annual meeting and the board makes a firm commitment to appoint at least one woman within a year.

  As a reminder, the policy announced last year that ISS will generally recommend against the chair of the nominating committee (or other directors on a case-by-case basis) at companies in the Russell 3000 and S&P 1500 indices that do not have at least one racially/ethnically diverse director will go into effect in 2022. ISS will similarly make an exception if the board included at least one member who was racially/ethnically diverse at the prior annual meeting and the board makes a firm commitment to appoint at least one racially or ethnically diverse member within a year.

[1] In addition to the updated U.S. voting policies, ISS also issued updates to its policies for other Americas and global regions. For all these updates, see the ISS website. Also note that Glass Lewis earlier issued its policy updates. For our alert on this development, see here.

- ***Board accountability on climate***. For companies that are significant greenhouse gas (GHG) emitters through their operations or value chains (i.e., those 167 companies currently identified as the Climate Action 100+ Focus Group), ISS has added a policy to recommend against the incumbent chair of the responsible committee (or other directors on a case-by-case basis) where ISS determines that the company is not taking the minimum steps needed to understand, assess and mitigate risks related to climate change to the company and the larger economy. ISS defines "minimum steps" as making detailed disclosures of climate-related risks[2] and setting appropriate GHG emission reduction targets.[3] ISS expressly notes that its expectations about what constitutes "minimum steps" will increase over time.

- ***Say-on climate***. ISS has added policies on management and shareholder say-on-climate proposals, which ISS will evaluate case-by-case based on specified factors. With regard to management proposals requesting that shareholders approve the company's transition action plan,[4] ISS will examine the "completeness and rigor" of the plan based on the following factors:

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

  With regard to shareholder proposals that request the company to disclose a report providing its GHG emissions levels and reduction targets and/or its upcoming/approved climate transition action plan and provide shareholders the opportunity to regularly express approval or disapproval of the GHG emissions reduction plan, ISS will take into account the following factors in its recommendation:

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2 ISS notes that "detailed disclosure" might be made according to the framework established by the Task Force on Climate-related Financial Disclosures ("TCFD"), including (i) board governance measures, (ii) corporate strategy, (iii) risk management and analyses and (iv) metrics and targets.

3 "Appropriate GHG emissions reduction targets" are broadly defined as "any well-defined GHG reduction targets."

4 Variations of these types of management proposals include climate transition-related ambitions and a commitment to reporting on the implementation of a climate plan.

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

Additional U.S. Voting Policy Updates

- ***Common stock/preferred stock authorization***. ISS has modified its voting policy related to capital stock authorizations to remove specific ratios applicable to companies in the bottom 10% of total share return performance, and will apply the same dilution limits to those companies as apply to other companies. In addition, ISS has clarified that it will recommend against proposed increases in authorized shares of common stock if the company has unilaterally adopted a poison pill of any length. Under the current policy, ISS reviewed the use of capital for the last three years, which disregarded companies that had outstanding, longer term, non-shareholder approved pills (e.g., five- or 10-year pills).

- ***Equity-based and other incentive plans; three-year burn rate***. ISS has made certain changes to its adjusted burn rate calculations (utilized in equity plan score card evaluations). For meetings starting February 1, 2023, ISS will move from the multiplier-based adjusted burn rate method to a "Value-Adjusted Burn Rate" calculation based on the actual stock price for full-value awards and the Black-Scholes value for stock options for better valuation of recently granted equity awards.

- ***Pandemic-related compensation policies***. ISS has also updated its FAQs on U.S. compensation policies related to the COVID-19 pandemic. Key updates include the following:

  - Because many investors believe that in 2021 boards were in a position to return to traditional pre-pandemic annual incentive program structures, as in pre-pandemic years, ISS will view negatively mid-year changes to metrics, performance targets and/or measurement periods, or programs that heavily emphasize discretionary or subjective criteria, with particular focus on companies that exhibit a quantitative pay-for-performance misalignment. However, ISS may view as reasonable lower pre-set performance targets (as compared to 2020) and/or modest year-over-year increases in the weighting of subjective or discretionary factors for companies that continued to incur severe economic impacts and uncertainties as a result of the pandemic in 2021.
  - For companies that make mid-year program adjustments, companies are encouraged to disclose their reasons as to why such actions were necessary, although such disclosures will not necessarily mitigate concerns regarding mid-year program adjustments. For forward-looking disclosure of pay program changes beyond the year in review, for companies that made changes to pay programs that would normally be viewed as concerning from a pay-for-performance standpoint, clear and detailed forward-looking disclosure of the company's intention to return to a strongly performance-based incentive program going forward may be viewed as a mitigating factor. ISS will consider the level of detail provided in the proxy statement and the extent to which the disclosed changes are meaningfully positive.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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