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ISS Proposes Benchmark Voting Policy Changes for the 2022 Proxy Season

Institutional Shareholder Services (ISS) recently released its proposed voting policy changes for the 2022 proxy season and has invited comments from issuers, shareholders and other market participants. The proposed changes focus on climate, board diversity and uneven voting rights in multi-class share structures. Final voting policies are expected to be released shortly following the end of the comment period on November 16, 2021, and final policies would generally apply to shareholder meetings held on or after February 1, 2022. The proposed changes follow the release of ISS's 2021 Global Benchmark Policy Survey and its inaugural 2021 Global Policy Survey on climate. The surveys' findings had led to expectations of more significant policy revisions for the U.S. market that reached environmental, social and governance (ESG) performance metrics in executive compensation, racial equity audits and virtual-only meetings, among other topics.

Notable takeaways from the proposed changes for the U.S. market include:

Climate:

In line with prior efforts to elevate risk oversight of environmental and social issues, and ISS's survey results, the proposed policies heighten board accountability for climate risk and performance, and provide new criteria for assessing "say-on-climate" proposals, whether management or shareholder-sponsored.

- **Significant GHG Emitters**: For companies that are significant greenhouse gas (GHG) emitters based on the Climate Action 100+ Focus Group, ISS will generally recommend voting against the responsible director, committee or full board where the company does not take the minimum steps to understand, assess and mitigate risks related to climate change both to the company and the larger economy.

- **Minimum Disclosure for Significant GHG Emitters**: ISS defines minimum steps for 2022 as the detailed disclosure of climate-related risks, including board governance measures, corporate strategy, risk management analysis, metrics and targets. Such disclosure should be in line with an established framework, such as the Task Force on Climate-related Financial Disclosures (TCFD).

- **Required Reduction Targets for Significant GHG Emitters**: Companies must disclose GHG emission reduction targets, which for 2022 should cover at least a significant portion of the company's direct emissions. Indirect emissions (Scope 3) are not required at this time, but the policy notes that minimum climate-related expectations will increase over time.

- **"Say-on-Climate" Proposals Across Companies**: ISS has proposed criteria to assess management and shareholder "say-on-climate" proposals. The proposed policy takes a slightly more measured approach than the survey responses, where over 40% of investors supported a regular advisory vote on a company's climate transition plan even if the board is managing climate effectively.

    - **Management Proposals**: For management proposals requesting shareholders approve a company's climate transition plan, ISS will assess:

        - alignment of disclosures with TCFD recommendations and other market standards;
        - disclosure of operational and supply chain emissions (Scopes 1, 2 and 3);
        - completeness and rigor of the company's short-, medium- and long-term targets for reducing emissions;
        - third-party approval of whether the company's targets are science-based;
        - commitment to reach "net zero emissions" by 2050;
        - commitment to report on plan's implementation in subsequent years;
        - third-party assurance;
        - alignment of lobbying activities and capital expenditures with company strategy;
        - industry-specific decarbonization challenges; and
        - commitments, disclosure and performance compared to industry peers.

- **Shareholder Proposals**: For shareholder proposals requesting disclosure of emission levels, reduction targets, a climate transition action plan or regular shareholder votes on emission reduction plans, ISS will consider:
    - completeness and rigor of the company's existing climate-related disclosure;
    - actual emissions performance;
    - any recent significant violations, fines, litigation or controversy related to emissions; and
    - how burdensome or unduly prescriptive the proposal is.

ISS has asked for comment on whether any of the criteria noted above should weigh more than others. In the 2022 proxy season, ISS will likely expect clear and appropriately detailed disclosure by companies as it considers whether to support them on an increasing number of "say-on-climate" proposals.

Board Diversity:

On gender diversity, ISS proposes generally issuing adverse director vote recommendations against essentially all public companies that do not have at least one woman on the board, beginning in 2023 (i.e., affording a one-year grace period and applying this policy even to companies that are not listed in the Russell 3000 and S&P 1500 indices). The previously announced policies calling for adverse vote recommendations at boards 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, as previously planned.

ISS will generally recommend a vote against or withhold for the chair of the nominating committee (or other directors on a case-by-case basis) for companies not meeting these expectations.

Uneven Voting Rights:

Under its Global Voting Principles, ISS identifies "shareholders' voting rights [being] proportional to their economic interest in the company" as a prong of board accountability. Since 2015, ISS has recommended voting against directors of newly public companies with a multi-class capital structure in which classes have unequal voting rights and where there is no reasonable time-based sunset period (such sunset period not to exceed seven years from the date of going public).

- **Adverse Voting Recommendations**: Starting in 2023, ISS will recommend voting against directors at all companies with unequal voting rights in multi-class share structures.

- **Exempted Companies**: Under the proposed policy, newly public companies with a sunset provision of no more than seven years will remain exempt, along with REIT limited partnerships and operating partnerships, situations of *de minimis* inequality in voting rights and where there is sufficient protection for minority shareholders in ISS's opinion, such as regular binding votes on the capital structure by minority shareholders. ISS cited survey results, roundtable discussions and evolving regulatory and index views to justify this change in policy on multi-class voting rights.

  The revised policy on unequal voting rights would impact major U.S. companies, such as Alphabet, Meta Platforms (formerly Facebook), Ford, Berkshire Hathaway and the New York Times, which had been grandfathered under the prior policy.

- **Treatment of Other Governance Structures**: It remains unclear whether the final policies will feature changes in how ISS will recommend in the case of newly public companies that have other governance features such as classified boards and supermajority voting requirements. ISS did note that its policy roundtables featured strong statements recognizing that newly public companies may appropriately have distinct governance profiles and protections that differ from the typical "large-cap" governance profile of mature public companies. In the ISS survey, over 90% of investors supported ISS (i) revisiting provisions of companies with such governance structures that were grandfathered under existing policy and (ii) issuing adverse voting recommendations in the absence of a sunset provision.

Shareholder Proposals Seeking Racial Equity Audits:

At this time, ISS has not proposed new policies outlining how it will assess shareholder proposals requesting companies conduct racial equity audits. However, after receiving pushback regarding its voting recommendations on such issues in the 2021 proxy season and with the expectation that such proposals will increase in frequency heading into 2022, ISS commissioned a survey addressing such audits in which half of the investors surveyed responded that "most companies would benefit" from a racial equity audit, and survey respondents provided a range of feedback on potentially relevant factors for a vote.

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The proposed revisions to ISS voting policies were more restrained than expected given prior survey results, and will likely have differing levels of impact. The push for greater climate accountability and diversity at the board level will continue to cement ongoing trends. Boards and management teams should continue to prepare for engagement as ISS dives deeper into social policy issues that its clients and institutional investors see as driving or protecting long-term value.

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