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ISS and Glass Lewis Issue Final 2023 U.S. Voting Policies

Proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis have released final updates to their U.S. voting policies for the 2023 proxy season. ISS's 2023 Benchmark Policy Changes will take effect for shareholder meetings held on or after February 1, 2023, and Glass Lewis's 2023 U.S. Voting Policies will take effect for shareholder meetings held after January 1, 2023. The updates cover voting policies relating to officer indemnification and exculpation, board climate accountability and oversight, board diversity and broader board composition-related disclosures, multi-class capital structures, structural profiles of newly public companies, cybersecurity oversight, and political expenditures and lobbying congruency, among other changes. ISS also earlier announced updates to its Governance QualityScore, including the introduction of new factors that will be used by ISS in rating companies' corporate governance features, through an ISS lens.

ISS Benchmark Policy Changes. Notable updates to ISS's voting policies include:

Officer Indemnification and Exculpation. As previously discussed, Delaware has adopted amendments to the Delaware General Corporation Law (DGCL) that enable corporations to adopt exculpation provisions in their charters that would protect officers from personal liability for certain fiduciary duty claims other than breaches of the duty of loyalty, intentional misconduct or knowing violations of law, and other specified exceptions, in addition to preserving the right of the corporation to bring suits against officers and the right of stockholders to bring claims derivatively in the right of the corporation under well-established demand requirements. ISS has updated its formal voting policy on director and officer indemnification, liability protection and exculpation, and will recommend on a case-by-case basis on proposals going to a vote. ISS will generally assess whether proposed changes are reasonable, considering the stated rationale for the proposed change and the scope as well as (if applicable) whether the proposal would expand coverage beyond just legal expenses for more serious violations of fiduciary obligations than mere carelessness, and whether the proposal being voted on would provide for mandatory indemnification where indemnification was previously at the discretion of the board of directors.

ISS's final policy is less clear with respect to officer exculpation provisions than the proposed policy initially articulated by ISS in its draft benchmark policy changes (which proposed, as a default rule, that ISS generally would recommend in favor of proposals providing for exculpation to the extent permitted under state law). Notably however, ISS generally recommended in favor of officer exculpation provisions submitted for shareholder approval during the fall of 2022. It appears that ISS will be open to supporting reasonable, appropriately supported officer exculpation charter amendment proposals, subject to situation-specific concerns.

Climate Accountability. ISS has revised what it deems to be "appropriate GHG emissions reduction targets" and extended its policies with respect to board accountability for climate risk and performance globally.

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ISS's revised policy on climate board accountability requires that "significant greenhouse gas (GHG) emitters"—which ISS will continue to define as companies in the Climate Action 100+ Focus Group—take minimum steps to understand and mitigate risks related to climate change to the company and the larger economy. There are two criteria used to assess whether a significant GHG emitter has taken the required minimum steps:

- *Minimum Disclosure*: A significant GHG emitter must provide detailed disclosure of climate-related risks, such as disclosures aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), including disclosure of board governance measures, corporate strategy, risk management analyses, and metrics and targets.

- *"Appropriate GHG Emissions Reduction Targets"*: ISS will define such targets to include medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets, in each case, for at least 95% of a company's scope 1 and 2 emissions.

In cases where a "significant GHG emitter" fails to provide the aforementioned minimum disclosures and set appropriate emissions reduction targets, ISS will generally withhold from or recommend against certain responsible directors (such as the incumbent chair of the responsible committee) and/or other relevant voting items.

Political Expenditures and Lobbying Congruency. In response to the uptick of shareholder proposals requesting greater transparency on the company's alignment of its political contributions to its political commitments and/or its climate lobbying to its climate goals, ISS has adopted a new policy providing that it will generally recommend on a case-by-case basis on such shareholder proposals. Factors that ISS will consider include the company's policies, management, oversight, governance and existing level of disclosure (including payments to trade associations); any lack of congruency between its political expenditures and its stated values; and any recent significant controversies.

Board Gender Diversity. The one-year transition period for companies outside of the Russell 3000 and S&P 1500 to comply with ISS's gender diversity policy has now passed and ISS will generally withhold from or recommend against the chair of the nominating committee (or other appropriate directors) at all companies where there are no women on the board. An exception will be made if there was at least one woman on the board at the preceding annual meeting and the board makes a firm commitment to return to gender diversity within a year.

Unequal Voting Rights. The one-year grace period for companies that had been grandfathered under ISS's prior policy on unequal voting rights has expired and ISS will now withhold or recommend against directors at all companies that have unequal voting rights due to multi-class share structures. Only the following companies will be exempted from the policy: newly public companies with a sunset provision of no more than seven years from the date of going public; REIT limited partnerships and operating partnerships; situations of *de minimis* inequity (*i.e.*, where the super voting shares represent less than 5% of total voting power); and situations where the company, in ISS's view, has sufficient protections in place for minority shareholders, such as where minority shareholders are afforded a regular binding vote on the capital structure.

Racial Equity Audit Policy. ISS has updated the policy criteria it will apply to shareholder proposals asking a company to conduct an independent racial equity audit. Starting in the 2023 proxy season, ISS will evaluate such proposals based on the following factors: the company's established framework for addressing racial inequity internally; whether the company has sufficient disclosures regarding workforce diversity and inclusion goals and metrics; whether the company has issued a public statement related to its racial justice efforts or committed to an internal review; whether the company has engaged with impacted communities, stakeholders and civil rights experts; the company's recent track record on racial justice measures and outreach; and whether the company has been the subject of recent controversy related to racial inequity.

Adverse Governance Structures of Newly Public Companies. ISS has updated its guidelines to clarify that a "newly public company" is a company that holds or held its first annual public shareholder meeting after February 1, 2015, and has established that a seven-year sunset provision will be considered a mitigating factor for problematic governance structures such as classified boards or supermajority voting.

Unilateral Bylaw/Charter Amendments. ISS has updated its Unilateral Bylaw/Charter Amendment policy to explicitly include the unilateral adoption by the board of fee-shifting provisions (*i.e.*, provisions that require a shareholder who sues a company unsuccessfully to pay litigation expenses of the defendant corporation and its directors and officers) as among the actions that, if taken, will generally result in a recommended vote against directors at subsequent shareholder meetings. ISS also explicitly adopted a catch-all for the unilateral adoption by the board of any other provision deemed "egregious."

Changes to Governance QualityScore. ISS earlier announced methodology updates to its Governance QualityScore framework, which framework is used by ISS to rate public companies against ISS's views on qualitative aspects of corporate governance. The updates include the introduction of 23 new factors across the following seven topical areas: information security; director skills; director and executive pledging; emerging risk oversight; diversity, equity and inclusion; ISS pay-for-performance concerns; and the Holding Foreign Companies Accountable Act.

Glass Lewis Proxy Voting Guidelines. Notable updates to Glass Lewis voting policies include:

Board Diversity. Glass Lewis has further expanded its expectations for board gender diversity, announced new expectations for underrepresented community diversity at the board level, and revised its policies on disclosure of director diversity and skill sets.

Gender Diversity. Starting in 2023, Glass Lewis will generally recommend against nominating committee chairs of boards at companies within the Russell 3000 index where the board is not at least 30% gender diverse. For companies outside the Russell 3000 index, Glass Lewis's existing policy requiring a minimum of one gender diverse director will remain in effect. Glass Lewis may nonetheless refrain from a negative recommendation where the board has provided a sufficient rationale or clearly articulated a plan to address lack of gender diversity (*e.g.*, a timeline to appoint additional gender diverse directors, generally by the next annual shareholder meeting).

Underrepresented Community Diversity. Beginning in 2023, Glass Lewis will generally recommend against nominating committee chairs of boards at companies within the Russell 1000 index with fewer than one underrepresented community director, defined as an individual who self-identifies as Black, African American, North African, Middle Eastern, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaskan Native, or who self-identifies as gay, lesbian, bisexual, or transgender. As with gender diversity, Glass Lewis may refrain from recommending against where the company has provided an adequate rationale or stated a plan to remedy the lack of board diversity.

Disclosure of Director Diversity and Skill Sets. Glass Lewis assesses the quality of diversity disclosure according to four categories: (i) the board's current percentage of racial/ethnic diversity; (ii) whether the board defines diversity to explicitly include gender and/or race/ethnicity; (iii) whether the board has adopted the "Rooney Rule" requiring women and minorities to be included in the initial pool of director candidates; and (iv) board skills disclosure. Glass Lewis has revised its voting guidance to provide that it will generally recommend against the nominating committee chair and/or governance committee chair at any company in the Russell 1000 index that (1) has not provided any disclosure in **each** of the foregoing categories and/or (2) has not provided any disclosure of individual or aggregate racial/ethnic minority board demographic information.

Disclosure of Board Oversight of Environmental and Social Issues. Glass Lewis will generally recommend against governance committee chairs of companies in the Russell 1000 index that fail to explicitly disclose the board's role in overseeing environmental and social issues including, among others, matters related to climate change, human capital management, diversity, relations among stakeholders, and health, safety, and environment. The disclosure should include the company's overall governance practices as well as which directors or committees are responsible for oversight of environmental and social issues (*e.g.*, specific directors, a committee, or the entire board). Beginning in 2023, Glass Lewis will also expand its tracking of board-level oversight of environmental and social issues to all companies in the Russell 3000 index.

Board Accountability for Climate-Related Risks. Glass Lewis has heightened its expectations regarding board accountability for climate-related risks. Companies whose GHG emissions represent a "financially material risk" will be expected to provide clear and comprehensive disclosure regarding these risks in line with the disclosures recommended by the TCFD. If Glass Lewis finds a company's TCFD disclosures or its disclosures related to board oversight of climate-related issues to be lacking, it may recommend against appropriate directors.

Officer Exculpation. Glass Lewis will take a case-by-case approach to officer exculpation charter provisions and may recommend against officer exculpation provisions eliminating monetary liability for breaches of the duty of care absent a compelling rationale. We note, however, that Glass Lewis generally recommended in favor of officer exculpation charter amendment proposals that were put to a shareholder vote during the fall of 2022 that tracked

Delaware law, including the exceptions and limits to such officer exculpation set forth under the Delaware law amendments discussed above. It remains to be seen whether the phrasing of the formal voting policy will result in changes to Glass Lewis voting recommendations on such proposals.

Director Overboarding. Glass Lewis has expanded its policy on director commitments and now generally will recommend against any of the following: (i) a director who serves as an executive officer (other than executive chair) of any public company while serving on more than one external public company board, (ii) a director who serves as an executive chair of any public company while serving on more than two external public company boards, and (iii) any other director who serves on more than five public company boards.

Board Oversight of Cyber Risks. Glass Lewis has, for the first time, announced a cyber-risk oversight and disclosure policy. Glass Lewis will closely evaluate cyber-related disclosure where cyberattacks have caused significant harm to shareholders, and may recommend against appropriate directors where it finds the disclosure or oversight to be insufficient.

Long-Term Incentives. Glass Lewis has revised the threshold for the minimum percentage of the long-term incentive grant that should be performance-based from 33% to 50%, and will raise concerns with executive pay programs where less than half of an executive's long-term incentive awards are subject to performance-based vesting conditions.

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The 2023 voting policy updates announced by ISS and Glass Lewis are wide-ranging and reflect continued focus by these firms and shareholders on the oversight, management and disclosure of environmental, social and governance issues. The guidelines of ISS and Glass Lewis, although generally directionally aligned, continue to diverge in the specific requirements they impose (for example, and notably, expectations regarding board diversity), and it is prudent that boards and management carefully consider the updates in consultation with advisors to evaluate whether changes to existing practices and disclosures are warranted.

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