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ISS Issues Final Voting Policies for the 2022 Proxy Season

Institutional Shareholder Services (ISS) recently released its final U.S. voting policies, which largely track previously proposed policies and become effective for shareholder meetings held on or after February 1, 2022. Glass Lewis released its final U.S. voting policies for the 2022 proxy season, including specific guidelines on environmental, social and governance matters (ESG), on November 15, 2021, as described here.

ISS's updated policies focus on climate, board diversity and uneven voting rights in multi-class share structures. The final voting policies also reflect revisions that reach racial equity or civil rights audits, common and preferred stock authorization and equity-based incentive plans. Despite expectations of more significant policy revisions for the U.S. market on ESG performance metrics in executive compensation and virtual-only meetings, among other topics, such revisions were not incorporated in the final voting policies. Notable takeaways from the final voting policies 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 final voting policies heighten board accountability for climate risk and performance, focusing on the responsible committee chair and/or other directors on a case-by-case basis.

- **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 incumbent chair of the responsible committee (or other directors on a case-by-case basis) 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 (in line with an established framework such as the Task Force on Climate-related Financial Disclosures (TCFD)), including:
    - board governance measures;
    - corporate strategy;

    - risk management analysis; and
    - metrics and targets.

- **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 (Scopes 1 and 2). Indirect emissions (Scope 3) are not required at this time, but the final policy notes that minimum climate-related expectations will increase over time.
- **"Say-on-Climate" Proposals Across Companies**: ISS has codified criteria to assess shareholder and management "say-on-climate" proposals.
    - **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.
    - **Management Proposals**: For management proposals requesting shareholders approve the 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 the 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.

Board Diversity:

On gender diversity, ISS will generally issue adverse director vote recommendations against the chair of the nominating committee (or other directors on a case-by-case basis) for 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). 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.

Shareholder Proposals Seeking Racial Equity or Civil Rights Audits:

ISS added a new policy outlining how it will assess shareholder proposals requesting companies to conduct racial equity or civil rights audits. The new policy appears to address feedback ISS received from survey results in which half of the investors surveyed responded that "most companies would benefit" from such an audit, and survey respondents provided a range of feedback on potentially relevant factors for a vote.

ISS will vote on a case-by-case basis on proposals asking the company to conduct an independent racial equity and/or civil rights audit, taking into account:

- the company's established process or framework for addressing internal racial inequity and discrimination;
- whether the company has issued a public statement related to its racial justice efforts in recent years, or has committed to internal policy review;
- whether the company has engaged with impacted communities, stakeholders and civil rights experts;
- the company's track record in recent years of racial-justice measures and external outreach;

- whether the company has been the subject of recent controversy, litigation or regulatory actions related to racial inequity or discrimination; and
- whether the company's actions are aligned with market norms on civil rights and racial or ethnic diversity.

Uneven Voting Rights:

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

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 new policy on unequal voting rights will impact major U.S. companies, such as Alphabet, Meta Platforms (formerly Facebook), Ford, Berkshire Hathaway, the New York Times and other notable companies of varying market capitalizations and across industries, all of whom had been grandfathered under the prior policy.

ISS did not change its approach for newly public companies that have other scrutinized governance features such as classified boards and supermajority voting requirements.

Common and Preferred Stock Authorization:

- **General Authorization Requests**: ISS will vote on a case-by-case basis on proposals to increase the number of authorized shares of common stock and/or preferred stock that are to be used for general corporate purposes, if share usage is within certain ratios (*e.g.*, share usage is 50% to 100% of the current authorized and the vote is for an increase of up to 100% of the current authorized shares).

  Even if the share authorization is within acceptable ratios, ISS will generally vote against proposed increases, if the proposal or the company's prior or ongoing use of authorized shares is problematic (*e.g.*, seeks to increase the number of authorized shares of a class that has superior voting rights).

- **Specific Authorization Requests**: ISS will generally vote for proposals to increase authorized common and/or preferred shares where the primary purpose is to increase shares in connection with certain transactions (*e.g.*, special purpose acquisition company (SPAC) transactions, private placements or similar transactions).

Equity-Based Incentive Plans

ISS has changed its current volatility-based adjusted burn rate calculation to a "Value-Adjusted Burn Rate" calculation. ISS expects the new calculation to more accurately measure the value of recently granted equity awards. Additionally, according to ISS, the Value-Adjusted Burn Rate is based on calculations more readily understood and accepted by the market (*e.g.*, actual stock price for full-value awards, Black-Scholes value for stock options). ISS's changes to its burn rate calculation is likely a welcome change for investors who use the metric to evaluate company requests to approve or amend equity compensation plans.

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Overall, the final proxy voting policies largely track ISS's previously proposed policies, are generally 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 environmental and social issues, including as to climate, racial inequity and discrimination, that its clients and institutional investors see as driving, or putting at risk, long-term value.

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