

M O R R O W S O D A L I

NOVEMBER 2020
PROXY UPDATE

ISS 2021 PROXY VOTING GUIDELINES UPDATE

INSTITUTIONAL SHAREHOLDER SERVICES INC. (ISS) ANNOUNCES ITS 2021 PROXY VOTING GUIDELINE UPDATES

We previously published a review of ISS' proposed amended voting policies derived from its policy survey results submitted by corporate issuers, clients and stakeholders. The deadline for feedback on the proposed voting policy changes was October 26 and in the time since ISS has honed and published its final voting policy updates (click [here](#) for a link to the policy updates) for all meetings after February 1, 2021.

Throughout 2020 ISS gathered information from investor clients, corporate issuers and internal research teams along with reviews of academic research and market studies to craft an updated voting policy for each market region. Two roundtable discussions, with 11 institutional investor clients, were conducted this past year to engage in discussion on a myriad of topics including racial and ethnic diversity at the board level, shareholder rights plans, audit oversight and other governance related topics. Additional roundtable discussions were held with varying levels of institutional investor client attendance to promote conversations on compensation in the COVID era, board responsiveness to a low say on pay vote, climate change risk and social shareholder proposals. The updates to ISS' voting guidelines also influence the voting guidelines of its clients where ISS' research teams craft specific policies to cater to investors' varying stewardship principles. As previously mentioned these guidelines become effective for meetings after February 1, 2021 and ISS may review, in January 2021, anticipated shareholder proposals and update its voting guidelines where applicable.

ISS POLICY CHANGES

BOARD OF DIRECTORS – BOARD COMPOSITION – GENDER AND RACIAL/ETHNIC DIVERSITY

The 2019 ISS voting guidelines update included the announcement of a policy regarding gender diversity on boards: *For companies in the Russell 3000 or S&P 1500 indices, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies where there are no women on the company's board.* 2020 was a transitional year so corporate issuers that did not previously have a female director on the board had an opportunity to make a commitment to appointing a female director the following year.

The "grace period" has since concluded and ISS announced last week that starting in February 2021 the only exception to a negative vote recommendation for lack of gender diversity at the board level would be if an issuer had at least one female director at the previous annual meeting but due to retirement, stepping down, etc. the board no longer included a woman. In these instances, if the board commits to nominating or appointing a female director by the next annual meeting, ISS will not issue a negative recommendation under this policy.

With regard to racial/ethnic diversity on boards, 60% of investor respondents in ISS' 2020-2021 Global Policy Survey indicated boards should strive to include board members from varying racial and ethnic backgrounds to reflect a company's diverse customer base. Further, 57% of investor respondents to the same survey signaled they would potentially vote against a member(s) of the nominating/governance committee on a board lacking racial and ethnic diversity. In response to this feedback ISS' new policy states: *For companies in the Russell 3000 or S&P 1500 indices, effective for meetings on or after Feb. 1, 2022, generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) where the board has no apparent racially or ethnically diverse members. An exception will be made if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racial and/or ethnic diverse member within a year.*

As ISS did with their board gender diversity voting guideline in 2019, ISS has given issuers a transition period, 2021, before beginning to potentially issue negative vote recommendations in situations where a board has no apparent ethnically or racially diverse board members. For 2021, ISS will highlight boards of Russell 3000 or S&P 1500 companies that lack diversity in their research reports.

BOARD OF DIRECTORS – GOVERNANCE FAILURES

ISS' current policy suggests under "extraordinary circumstances" a negative recommendation may be issued on individual directors, committee members or the entire board if a company experiences material governance failures, risk oversight or "egregious" actions of directors at outside boards. The scope of the board's risk oversight, where lack thereof could result in a negative recommendation, has been expanded in the updated policy guidelines to include the following language: *demonstrably poor risk oversight of environmental and social issues, including climate change.*

BOARD ACCOUNTABILITY – POISON PILLS

Language was added to ISS' current position on director accountability regarding poison pills, ISS currently will review the pill's features, length and recent modifications in making a recommendation, either positive or negative, on board members that were on the board when the pill was put in place. For 2021, ISS included another pill factor, deadhand or slowhand provisions, that it will review before making a voting recommendation. This policy change comes in response to a significant number of recent pills implemented with a deadhand or slowhand feature. This goes for pills that are both short term or long term. A deadhand provision restricts the ability of the board to terminate the pill. If a recently implemented pill has a provision such as this ISS will recommend a vote against/withhold all nominees, except new nominees, which will be considered on a case-by case basis.

BOARD REFRESHMENT – TERM & AGE LIMITS

Currently, ISS has a policy to vote against management proposals to limit the term of outside directors, however ISS notes that it will closely monitor boards where the average tenure is greater than 15 years. The opinion of ISS is that term limits can create issues if the limit is too brief and does not allow for an appropriate balance of experienced and new directors. The new policy notes ISS will vote case-by case on management sponsored proposals regarding term limits and will consider:

- *Rationale provided for adoption of term limit;*
- *Robustness of the company's board evaluation process;*
- *Whether the limit is of sufficient length to allow for a broad range of director tenures;*
- *Whether the limit would disadvantage independent directors compared to non-independent directors; and*
- *Whether the board will impose the limit evenly, and not have the ability to waive it in a discriminatory manner.*

ISS will vote case-by-case on shareholder sponsored proposals requesting the company implement term limits and will consider the scope of the proposal and disclosure of company specific concerns regarding board refreshment.

SHAREHOLDER RIGHTS & DEFENSES – ADVANCE NOTICE REQUIREMENTS

Advance notice provisions create a window for shareholders to annually submit director nominations. Historically the window is open for 30 days and allows appropriate time for the company to review as well as undertake any potential regulatory investigation prior to the filing of definitive proxy materials in connection with the annual meeting. In recent years it has become more common for U.S. companies to set its advance notice provisions starting 120 days prior to the annual meeting with a 30 day submittal period.

ISS amended its current voting policy, on advance notice proposals, to state it will vote case-by-case on those proposals allowing shareholders to submit nominations as reasonably close to the meeting with the broadest window possible, which is defined as no earlier than 120 days prior to the anniversary of the previous year's meeting and a window of no shorter than 30 days.

SHAREHOLDER RIGHTS & DEFENSES – SHAREHOLDER LITIGATION RIGHTS

Exclusive forum provisions, both state and federal, allow a company to determine a state or federal district where potential litigation will occur. Due to the significant case law built up historically in Delaware, it is often chosen by companies as the exclusive forum for any shareholder litigation. ISS' current policy is to vote case-by-case on exclusive forum bylaws by taking into consideration the rationale for the decision, disclosure of past harm by lawsuits, lawsuits that would apply under provision and the applicable governance features.

ISS' new policy permits ISS to generally support charter or bylaw provisions if Delaware is chosen as the exclusive forum for lawsuits for companies incorporated in Delaware and generally vote against a provision that specifies a state other than the state of the company's incorporation. Regarding federal forum selection provisions, ISS will generally vote in favor of proposals that specify the forum as "the district courts of the United States" and generally vote against provisions that restrict the forum to a particular federal district court.

In addition, if a company unilaterally adopts an exclusive forum provision that runs afoul of ISS' new policy, it would be considered a violation of ISS' policy regarding unilateral adoption of bylaw or charter amendments and could potentially result in a negative recommendation against directors.

VIRTUAL SHAREHOLDER MEETINGS

ISS notes some states currently include virtual meetings as part of their regulatory framework and those that did not, set rules to allow for virtual meetings expeditiously during the pandemic. The impact on shareholders of a long-term shift of virtual only meetings can be debated as some investors and groups have concerns over the rights of shareholders. ISS does not currently have a policy surrounding a stated policy for issuers mandating the ability to hold virtual only meetings. The new voting guidelines note ISS will generally vote in favor of management proposals allowing for the company to hold a shareholder meeting electronically as long as it does not preclude in-person meetings and that shareholder rights at a virtual meeting are comparable to in person meetings. Regarding shareholder proposals surrounding virtual-only meetings, ISS will vote case-by-case considering scope and rationale of scope of the proposal and the concerns identified with the issuer's prior meeting practices.

SOCIAL AND ENVIRONMENTAL ISSUES – GENDER, RACE/ETHNICITY PAY GAPS

Currently, ISS votes case-by-case on shareholder proposals that request a report on a company's pay data by gender, race or ethnicity or a report on a company's policies or goals to reduce gender, race or ethnicity pay gaps. In reviewing the proposal and making its recommendation ISS considers a number of factors:

- *The company's current policies and disclosure related to both its diversity and inclusion policies and practices and its compensation philosophy on fair and equitable compensation practices;*
- *Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to gender, race, or ethnicity pay gap issues; and*
- *Whether the company's reporting regarding gender, race, or ethnicity pay gap policies or initiatives is lagging its peers.*

In order to clarify its policy language around how it evaluates a company's policies and practices to its peers ISS removed the above listed third bullet and now includes: *The company's disclosure regarding gender, race, or ethnicity pay gap policies or initiatives compared to its industry peers.* In addition, ISS will review local laws (of target company) regarding categorization of race and ethnicity and the definitions of ethnic or racial minorities.

SEXUAL HARASSMENT

ISS notes that there were a number of shareholder proposals filed on this topic over the last few years and that its clients have expressed an interest in having a policy relating to these proposals. ISS' new policy is to vote on a case-by-case basis regarding proposals requesting a report on company actions to strengthen policies and oversight to prevent workplace sexual harassment. In making its recommendation, ISS will consider:

- *The company's current policies, practices, oversight mechanisms related to preventing workplace sexual harassment;*
- *Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to workplace sexual harassment issues; and*
- *The company's disclosure regarding workplace sexual harassment policies or initiatives compared to its industry peers.*

MANDATORY ARBITRATION

Similar to sexual harassment, there have been a number of shareholder proposals in recent years related to mandatory arbitration. ISS will vote case-by-case on proposals requesting a report regarding the company's use of mandatory arbitration on employment-related claims. In making its recommendation, ISS will consider the following:

- *The company's current policies and practices related to the use of mandatory arbitration agreements on workplace claims;*
- *Whether the company has been the subject of recent controversy, litigation, or regulatory actions related to the use of mandatory arbitration agreements on workplace claims; and*
- *The company's disclosure of its policies and practices related to the use of mandatory arbitration agreements compared to its peers.*

Please do not hesitate to reach out to your Morrow Sodali representative to discuss the potential impacts of these new voting guidelines on your company.

CONTACTS



Thomas Skulski
Managing Director, Proxy

t.skulski@morrowssodali.com
T. +1 203 658 9441
M. +1 203 274 2262



Bill Dooley
Vice President,
M&A and Activism Advisory Group

w.dooley@morrowssodali.com
T. +1 203 658 9388
M. +1 203 809 7676



Jillian Kenny
Vice President, Proxy

j.kenny@morrowssodali.com
T. +1 203 658 9413
M. +1 475 232 9847