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ISS Opens Survey for 2023 Policy Changes; Glass Lewis Seeks Informal Feedback

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ISS Policy Survey

Toward the end of each year, Institutional Shareholder Services updates its proxy vote recommendation policies for meetings held on or after February 1 of the following year. As part of that process, ISS collects information from institutional shareholders, corporate issuers, corporate directors and other market constituents in the form of an annual survey. The survey questions provide a first look at certain policies that ISS is considering changing or adopting (though of course not all of the questions become policy updates, and there are typically policy updates not mentioned in the survey).

The response deadline for this year's ISS survey is Wednesday, August 31, at 5:00 pm EDT. We recommend that issuers and other interested parties respond to the survey, so their feedback will be incorporated into the policy development process.

Items in the survey that we found especially interesting for US issuers are outlined below.

Governance-related questions

Sunset for governance structures ISS finds "problematic"

In 2020, ISS updated its voting policy regarding newly public companies with "problematic" capital structures to indicate that no sunset of greater than seven years from the date of the IPO would be considered reasonable. ISS is now seeking input on what the appropriate sunset period is for the other governance structures it finds problematic (i.e., classified board and/or supermajority voting requirements).

The answer choices to the survey question suggest that ISS is trying to determine whether respondents view seven years or a lesser period as a reasonable sunset for these other governance structures. ISS also is seeking input on whether smaller companies should be exempted from the sunset period for classified boards and supermajority vote requirements and, if so, which companies should be considered sufficiently small enough to warrant such an exemption (i.e., companies outside the Russell 3000, S&P 1500 or S&P 500).

Supermajority voting threshold

Under its current policy, ISS considers any vote requirement that requires more than a majority of the outstanding shares to amend a company's governing documents as a problematic governance practice. However, ISS recognizes that a supermajority vote requirement set at two-thirds of the shares outstanding is easier to achieve or eliminate as the shareholder base evolves than a supermajority vote requirement set at a higher level (e.g., 75%, 80% or 85%).

The survey question suggests that ISS is considering whether a supermajority vote requirement that requires only two-thirds of the shares outstanding should be considered acceptable.

Unequal voting rights

Pursuant to a policy adopted in 2021, starting in 2023 ISS will recommend against directors at all companies with governance structures that provide their shareholders with unequal voting rights, whether newly public (unless the provision will sunset no more than seven years from the date of the initial public offering) or mature. ISS plans to apply a "de minimis" exception to this policy in cases where the capital structure is not deemed to meaningfully disenfranchise public shareholders (e.g., where most of the super-voting shares have already been converted into regular common shares). The survey asks respondents what percentage of the total voting power held by owners of the super-voting shares should be considered “de minimis” and what other relevant factors should be considered to exempt companies from this policy.

ISS also is seeking input on which directors are the appropriate targets for adverse recommendations due to the presence of a capital structure with unequal voting rights. The survey question offers a range of responses from all directors to only the directors who hold super-voting shares. In addition, in the instance where public shareholders do not have the ability to vote on certain directors, ISS is seeking input on whether adverse votes against the limited number of independent directors as a protest for multiclass structure should be considered appropriate.

Shareholder proposals calling for third-party racial equity or civil rights audits

ISS notes that in response to racial justice protests, shareholders have increased engagement with companies on issues of diversity and racial equity, including seeking better disclosure on representation in the workforce, and information about corporate programs for employees of color. As a result, in 2021 ISS reviewed its policy regarding assessing proposals calling for racial equity and/or civil rights audits, and adopted a new policy in 2022. The new policy implements a case-by-case approach of evaluating the relevant facts and circumstances relating to the company’s disclosure and performance in the area of racial equity and/or civil rights. The survey questions suggest that ISS is trying to further refine its case-by-case approach by better understanding how respondents view these audits and which factors respondents consider relevant to determine when a company may benefit from such an audit.

Capitalization-related questions

Share issuance mandates at cross-market companies under ISS’ US coverage

US-listed companies incorporated in certain other markets (e.g., the United Kingdom, Ireland and the Netherlands) may be required by the laws of the country of incorporation to seek approval for all share issuances, even where such approval is not required by applicable listing rules. ISS is seeking input on whether it should continue to evaluate these proposals under the policy of the market of incorporation, which is generally based on local codes of best practice that may not otherwise be applicable to companies without a local stock market listing, or whether it should develop a new policy for share issuance mandates at cross-market companies. The survey questions suggest that ISS is trying to determine the scope and application of a new policy, including the level of dilution that would be considered acceptable for issuances without preemptive rights, the frequency with which companies should seek shareholder approval for share issuance mandates, and whether the same policy should apply to US domestic issuers listed solely in the United States, dual-listed companies and foreign private issuers.

Climate-related questions

ISS added new policy recommendations in 2022 regarding say-on-climate proposals in response to the increased presence of these proposals since 2020. Its policy currently calls for a vote on a case-by-case basis based on a number of factors. Questions in the survey suggest that ISS is trying to determine which factors are the most important to investors when it comes to the minimum criteria needed for approval of a management-proposed climate transition plan. The range of answers is varied and includes a fill-in-the-blank response option. ISS’ 2022 voting guidelines currently recommend a vote on a case-by-case basis for management say-on-climate proposals. The survey’s questions indicate that ISS is looking to form a firmer policy recommendation and to decide whether to change its vote recommendation from a case-by-case basis to a vote for climate transition plan proposals.

Other questions in the survey relate to climate board accountability and critical audit matters policies in the world’s largest greenhouse gas (GHG) emitters (currently, the Climate Action 100+ focus group), and financed emissions for large companies in the banking and insurance sectors.

The survey questions suggest that ISS is still considering what rises to the level of “material governance failures” for the largest GHG emitters that would warrant a recommendation against a director or group of directors for its climate board accountability policy. The range of answers spans lack of disclosures, absence of a statement of ambition to align with the Paris Agreement, unrealistic GHG emissions targets (i.e., realistic targets do not rely on technologies that are not yet commercially available and are not overly reliant on offsets), and evidence of past poor GHG emissions performance and trajectory.

Questions regarding **critical audit matters/key audit matters** could be part of ISS' effort to fulfill its promise to provide additional data to support its current policy that recommends against incumbent directors of the largest GHG emitters in cases where the company is not adequately disclosing climate risk and does not have quantitative GHG emission reduction targets covering a significant portion of the company's direct emissions.

A question in the survey about **financed emissions** suggests that ISS is trying to better understand investors' expectations around large companies in the banking and insurance sectors regarding their lending, investment and underwriting activities with companies (or projects) significantly contributing to GHG emissions, and also gauge the trajectory of investors' expectations on climate-related disclosure and performance over time. With respect to investors' expected actions on financed emissions, survey answers range from doing nothing to requiring disclosure of directly or indirectly financed emissions, setting emissions targets, or committing to cease financing or underwriting new emissions altogether.

Glass Lewis informal feedback

As in prior years, Glass Lewis employs a less formal feedback process from market participants on its voting policies, inviting parties to submit feedback on its guidelines by emailing guidelinescomments@glasslewis.com. Glass Lewis recommends submitting any feedback by **Thursday, September 15**, to ensure sufficient time for review as part of the 2022 – 2023 round of policy guideline updates.

We expect Glass Lewis, like ISS, to publish its updated policy voting guidelines before the end of the year. As a refresher, Glass Lewis updates for 2022 were focused on (among other topics):

- **Board diversity**
  - Glass Lewis generally recommends voting against the nominating committee chair of a board with fewer than two gender-diverse directors for Russell 3000 companies and with no gender-diverse directors for other companies.
  - Glass Lewis generally recommends compliance with state law board composition requirements.
  - Starting in 2023, Glass Lewis will generally recommend voting against the nominating committee chair of a Russell 3000 board with less than 30% gender diversity and of an S&P 500 board with no disclosure of individual or aggregate racial/ethnic minority board demographic information.
- **Enhanced board diversity disclosure**
  - Glass Lewis may recommend against nominating chair if S&P 500 company fails to include adequate gender and racial/ethnic disclosure.
- **Environmental and social risk oversight**
  - While Glass Lewis maintains no specific policy on environmental and social risk oversight and reviews on a case-by-case basis, its 2022 policies stress the importance of adequate disclosure regarding material risk factors through the lens of long-term shareholder value and board involvement in risk oversight.

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