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ISS and Glass Lewis Issue Voting Policy Updates for 2022

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Institutional Shareholder Services ("ISS") and Glass, Lewis & Co. ("Glass Lewis"), the two major proxy advisory firms, recently released updates to their proxy voting policies for the 2022 proxy season. The ISS U.S. policy updates are available here. The ISS updates will apply for shareholder meetings on or after February 1, 2022, except for those policies subject to a transition period. ISS plans to release an updated Frequently Asked Questions document that will include more information about its policy changes in the coming weeks.[1]

The Glass Lewis updates are included in its 2022 U.S. Policy Guidelines and the 2022 ESG Initiatives Policy Guidelines, which cover shareholder proposals. Both documents are available here. The Glass Lewis 2022 voting guidelines will apply for shareholder meetings held on or after January 1, 2022.

This alert reviews the ISS and Glass Lewis updates. Both firms have announced policy updates on the topics of board diversity, multi-class stock structures, and climate-related management and shareholder proposals. Glass Lewis also issued several policy updates that focus on nominating/governance committee chairs, as well new policies specific to special purpose acquisition companies ("SPACs").

A. Board Diversity

- *ISS – Racial/Ethnic Diversity*. At S&P 1500 and Russell 3000 companies, beginning in 2022, ISS will generally recommend "against" or "withhold" votes for the chair of the nominating/governance committee (or other directors, on a case-by-case basis) if the board "has no apparent racially or ethnically diverse members." This policy was announced last year, with a one-year transition. There is an exception for companies where there was at least one racially or ethnically diverse director at the prior annual meeting and the board makes a firm commitment to appoint at least one such director within a year.
- *ISS – Gender Diversity.* ISS announced that, beginning in 2023, it will expand its policy on gender diversity, which since 2020 has applied to S&P 1500 and Russell 3000 companies, to all other companies. Under this policy, ISS generally recommends "against" or "withhold" votes for the chair of the nominating/governance committee (or other directors, on a case-by-case basis) where there are no women on the board. The policy includes an exception analogous to the one in the voting policy on racial/ethnic diversity.
- *Glass Lewis – Gender Diversity*. Beginning in 2022, Glass Lewis will generally recommend "against" or "withhold" votes for the chair of the nominating/governance committee at Russell 3000 companies that do not have at least two gender diverse directors (as announced in connection with its 2021 policy updates), or the entire committee if there is no gender diversity on the board. In 2023, Glass Lewis will move to a percentage-based approach and issue negative voting recommendations for the nominating/governance committee chair if the board is not at least 30% gender diverse. Glass Lewis is using the term "gender

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diverse" in order to include individuals who identify as non-binary. Glass Lewis also updated its policies to reflect that it will recommend in accordance with mandatory board composition requirements in applicable state laws, whether they relate to gender or other forms of diversity. It will not issue negative voting recommendations for directors where applicable state laws do not mandate board composition requirements, are non-binding, or only impose reporting requirements.

- *Glass Lewis – Diversity Disclosures.* With respect to disclosure about director diversity and skills, for 2021, Glass Lewis had announced that it would begin tracking companies' diversity disclosures in four categories: (1) the percentage of racial/ethnic diversity represented on the board; (2) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity; (3) whether the board has a policy requiring women and other diverse individuals to be part of the director candidate pool; and (4) board skills disclosure. For S&P 500 companies, beginning in 2022, Glass Lewis *may* recommend "against" or "withhold" votes for the chair of the nominating/governance committee if a company fails to provide any disclosure in each of these four categories. Beginning in 2023, it will generally oppose election of the committee chair at S&P 500 companies that have not provided any aggregate or individual disclosure about the racial/ethnic demographics of the board.

B. Companies with Multi-Class Stock or Other Unequal Voting Rights

- *ISS*. ISS announced that, after a one-year transition period, in 2023, it will begin issuing adverse voting recommendations with respect to directors at all U.S. companies with unequal voting rights. Stock with "unequal voting rights" includes multi-class stock structures, as well as less common practices such as maintaining classes of stock that are not entitled to vote on the same ballot items or nominees, and loyalty shares (stock with time-phased voting rights). ISS's policy since 2015 has been to recommend "against" or "withhold" votes for directors of newly-public companies that have multiple classes of stock with unequal voting rights or certain other "poor" governance provisions that are not subject to a reasonable sunset, including classified boards and supermajority voting requirements to amend the governing documents. Companies that were publicly traded before the 2015 policy change, however, were grandfathered and so were not subject to this policy. ISS had sought public comment about whether, in connection with the potential expansion of this policy to all U.S. companies, the policy should apply to all or only some nominees. The final policy does not specify, saying that the adverse voting recommendations may apply to "directors individually, committee members, or the entire board" (except new nominees, who will be evaluated case-by-case). For 2022, the current policy would continue to apply to newly-public companies. ISS tweaked the policy language to reflect that a "newly added reasonable sunset" would prevent negative voting recommendations in subsequent years. ISS considers a sunset period reasonable if it is no more than seven years.
- *Glass Lewis*. Beginning in 2022, Glass Lewis will recommend "against" or "withhold" votes for the chair of the nominating/governance committee at companies that have multi-class share structures with unequal voting rights if they are not subject to a "reasonable" sunset (generally seven years or less).

C. Climate-Related Proposals and Board Accountability at "High-Impact" Companies

- *ISS – Say on Climate*. In 2021, both shareholders and management submitted Say on Climate proposals. For 2022, ISS is adopting voting policies that document the frameworks it has developed for analyzing these proposals, as supplemented by feedback from ISS's 2021 policy development process. Under the new policies, ISS will recommend votes case-by-case on both management and shareholder proposals, taking into consideration a list of factors set forth in each policy. For management proposals asking shareholders to approve a company's climate

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transition action plan, ISS will focus on "the completeness and rigor of the plan," including the extent to which a company's climate-related disclosures align with Task Force on Climate-related Financial Disclosure ("TCFD") recommendations and other market standards, disclosure of the company's operational and supply chain greenhouse gas ("GHG") emissions (Scopes 1, 2 and 3), and whether the company has made a commitment to be "net zero" for operational and supply chain emissions (Scopes 1, 2 and 3) by 2050. For shareholder proposals requesting Say on Climate votes or other climate-related actions (such as a report outlining a company's GHG emissions levels and reduction targets), ISS will recommend votes case-by-case taking into account information such as the completeness and rigor of a company's climate-related disclosures and the company's actual GHG emissions performance.

- *ISS – Board Accountability on Climate at High-Impact Companies.* ISS also adopted a new policy applicable to companies that are "significant GHG emitters" through their operations or value chain. For 2022, these are companies that Climate Action 100+ has identified as disproportionately responsible for GHG emissions. During 2022, ISS will generally recommend "against" or "withhold" votes for the responsible committee chair in cases where ISS determines a company is not taking minimum steps needed to understand, assess and mitigate climate change risks to the company and the larger economy. Expectations about the minimum steps that are sufficient "will increase over time." For 2022, minimum steps are detailed disclosure of climate-related risks (such as according to the TCFD framework") and "appropriate GHG emissions reduction targets," which ISS considers "any well-defined GHG reduction targets." Targets for Scope 3 emissions are not required for 2022, but targets should cover at least a significant portion of the company's direct emissions. For 2022, ISS plans to provide additional data in its voting analyses on all Climate Action 100+ companies to assist its clients in making voting decisions and in their engagement efforts. As a result of this new policy, companies on the Climate Action 100 + list should be aware that the policy requires **both** disclosure in accordance with a recognized framework, and quantitative GHG reduction targets, and that ISS plans to address its new climate policies in its updated FAQs, so there may be more specifics about this policy when the FAQs are released.
- *Glass Lewis – Say on Climate*. Glass Lewis also added a policy on Say on Climate proposals for 2022, but takes a different approach from ISS. Glass Lewis supports robust disclosure about companies' climate change strategies. However, it has concerns with Say on Climate votes because it views the setting of long-term strategy (which it believes includes climate strategy) as the province of the board and believes shareholders may not have the information necessary to make fully informed voting decisions in this area. In evaluating management proposals asking shareholders to approve a company's climate transition plans, Glass Lewis will evaluate the "governance of the Say on Climate vote" (the board's role in setting strategy in light of the Say on Climate vote, how the board intends to interpret the results of the vote, and the company's engagement efforts with shareholders) and the quality of the plan on a case-by-case basis. Glass Lewis expects companies to clearly identify their climate plans "in a distinct and easily understandable document," which it believes should align with the TCFD framework. Glass Lewis will generally oppose shareholder proposals seeking to approve climate transition plans or to adopt a Say on Climate vote, but will take into account the request in the proposal and company-specific factors.

D. Additional ISS Updates

ISS adopted the following additional updates of note:

1. *Shareholder Proposals Seeking Racial Equity Audits*. ISS adopted a formal policy reflecting its approach to shareholder proposals asking companies to oversee an independent racial equity or civil rights audit. These proposals, which were new for

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2021, are expected to return again in 2022 given the continued public focus on issues related to race and equality. ISS will recommend votes case-by-case on these proposals, taking into account several factors listed in its new policy. These factors focus on a company's processes or framework for addressing racial inequity and discrimination internally, its public statements and track record on racial justice, and whether the company's actions are aligned with market norms on civil rights and racial/ethnic diversity.

2. *Capital Authorizations*. ISS adopted what it characterizes as "minor" and "clarifying" changes to its voting policies on common and preferred stock authorizations. For both policies, ISS will apply the same dilution limits to underperforming companies, and will no longer treat companies with total shareholder returns in the bottom 10% of the U.S. market differently. ISS also clarified that problematic uses of capital that would lead to a vote "against" a proposed share increase include long-term poison pills that are not shareholder-approved, rather than just poison pills adopted in the last three years. ISS reorganized the policy on common stock authorizations to distinguish between general and specific uses of capital and to clarify the hierarchy of factors it considers in applying the policy.
3. *Three-Year Burn Rate Calculation for Equity Plans*. Beginning in 2023, ISS will move to a "Value-Adjusted Burn Rate" in analyzing equity plans. ISS believes this will more accurately measure the value of recently granted equity awards, using a methodology that more precisely measures the value of option grants and calculations that are more readily understood by the market (actual stock price for full-value awards, and the Black-Scholes value for stock options). According to ISS, when the current methodology was adopted, resource limitations prevented it from doing the more extensive calculations needed for the Value-Adjusted Burn Rate.
4. *Updated FAQs on ISS Compensation Policies and COVID-19*. ISS also issued an updated set of FAQs (available here) with guidance on how it intends to approach COVID-related pay decisions in conducting its pay-for-performance qualitative evaluation. According to the FAQs, many investors believe that boards are now positioned to return to annual incentive program structures as they existed prior to the pandemic. Accordingly, the FAQs reflect that ISS plans to return to its pre-pandemic approach on mid-year changes to metrics, targets and measurement periods, and on company responsiveness where a say-on-pay proposal gets less than 70% support.

E. Additional Glass Lewis Updates

Glass Lewis adopted several additional updates, as outlined below. Where relevant, for purposes of comparison, the discussion also addresses how ISS approaches the issue.

1. *Waiver of Retirement or Tenure Policies*. Glass Lewis appears to be taking a stronger stance on boards that waive their retirement or tenure policies. Beginning in 2022, if the board waives a retirement age or term limit for two or more years in a row, Glass Lewis will generally recommend "against" or "withhold" votes for the nominating/governance committee chair, unless a company provides a "compelling rationale" for the waiver. By way of comparison, ISS does not have an analogous policy.
2. *Adoption of Exclusive Forum Clauses Without Shareholder Approval*. Under its existing policies, Glass Lewis generally recommends "against" or "withhold" votes for the nominating/governance committee chair at companies that adopted an exclusive forum clause during the past year without shareholder approval. With a growing number of companies adopting exclusive forum clauses that apply to claims under the Securities Act of 1933, Glass Lewis updated its policy to reflect that the policy applies to the adoption of state and/or federal exclusive forum clauses. The existing exception will remain in place for clauses that are "narrowly

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crafted to suit the particular circumstances" facing a company and/or include a reasonable sunset provision. By way of comparison, ISS does not have an analogous policy.

3. *Board Oversight of E&S Issues*. For S&P 500 companies, starting in 2022, Glass Lewis will generally recommend "against" or "withhold" votes for the chair of the nominating/governance committee if a company does not provide "explicit disclosure" about the board's role in overseeing environmental and social issues. This policy is taking effect after a transition year in which Glass Lewis noted concerns about disclosures it did not view as adequate. For 2022, Glass Lewis also will take the same approach for Russell 1000 companies that it took last year with S&P 500 companies, noting a concern where there is a lack of "clear disclosure" about which committees or directors are charged with oversight of E&S issues. Glass Lewis does not express a preference for a particular oversight structure, stating that boards should select the structure they believe is best for them.
4. *Independence Standard on Direct Payments for Directors*. In evaluating director independence, Glass Lewis treats a director as not independent if the director is paid to perform services for the company (other than serving on the board) and the payments exceed $50,000 or no amount is disclosed. Glass Lewis clarified that this standard also captures payments to firms where a director is the principal or majority owner. By way of comparison, ISS's independence standards likewise cover situations where a director is a partner or controlling shareholder in an entity that has business relationships with the company in excess of numerical thresholds used by ISS.
5. *Approach to Committee Chairs at Companies with Classified Boards*. A number of Glass Lewis' voting policies focus on committee chairs because it believes the chair has "primary responsibility" for a committee's actions. Currently, if Glass Lewis policies would lead to a negative voting recommendation for a committee chair, but the chair is not up for election because the board is classified, Glass Lewis notes a concern with respect to the chair in its proxy voting analysis. Beginning in 2022, this policy will change and if Glass Lewis has identified "multiple concerns," it will generally issue (on a case-by-case basis) negative voting recommendations for other committee members who are up for election.
6. *Written Consent Shareholder Proposals*. Glass Lewis documented its approach to shareholder proposals asking companies to lower the ownership threshold required for shareholders to act by written consent. It will generally recommend in favor of these proposals if a company has no special meeting right or the special meeting ownership threshold is over 15%. Glass Lewis will continue its existing policy of opposing proposals to adopt written consent if a company has a special meeting threshold of 15% or lower and "reasonable" proxy access provisions. By way of comparison, ISS generally supports proposals to adopt written consent, taking into account a variety of factors including the ownership threshold. It will recommend votes case-by-case only if a company has an "unfettered" special meeting right with a 10% ownership threshold and other "good" governance practices, including majority voting in uncontested director elections and an annually elected board.
7. *SPAC Governance*. Glass Lewis added voting guidelines that are specific to the SPAC context. When evaluating companies that have gone public through a de-SPAC transaction during the past year, it will review their governance practices to assess "whether shareholder rights are being severely restricted indefinitely" and whether restrictive provisions were submitted to an advisory vote at the meeting where shareholders voted on the de-SPAC transaction. If the board adopted certain practices prior to the transaction (such as a multi-class stock structure or a poison pill, classified board or other anti-takeover device), Glass Lewis will generally recommend "against" or "withhold" votes for all directors who served at

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the time the de-SPAC entity became publicly traded if the board: (a) did not also submit these provisions for a shareholder advisory vote at the meeting where the shareholders voted on the de-SPAC transaction; or (b) did not also commit to submitting the provisions for shareholder approval at the company's first annual meeting after the de-SPAC transaction; or (c) did not also provide for a reasonable sunset (three to five years for a poison pill or classified board and seven years or less for multi-class stock structures). By way of comparison, as discussed above, for several years, ISS has had voting policies that address "poor" governance provisions at newly-public companies, including multiple classes of stock with unequal voting rights, classified boards and supermajority voting requirements to amend the governing documents. For 2022, ISS has clarified that the definition of "newly-public companies" includes SPACs.

8. *"Overboarding" and SPAC Board Seats*. Under its "overboarding" policies, Glass Lewis generally recommends "against" or "withhold" votes for directors who are public company executives if they serve on a total of more than two public company boards. It applies a higher limit of five public company boards for other directors. The 2022 policy updates clarify that where a director's only executive role is at a SPAC, the higher limit will apply. By way of comparison, ISS treats SPAC CEOs the same as other public company CEOs, on the grounds that a SPAC CEO "has a time-consuming job: to find a suitable target and consummate a transaction within a limited time period." Accordingly, SPAC CEOs are subject to the same overboarding limit ISS applies to other public company CEOs (two public company boards besides their own).

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[1] ISS also issued an updated set of FAQs on COVID-related compensation decisions.

The following Gibson Dunn lawyers assisted in the preparation of this client update: Elizabeth Ising, Ronald Mueller, and Lori Zyskowski.

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