

ISS Issues 2021 Benchmark Policy Updates

November 19, 2020

Securities and Capital Markets

On November 12, 2020, Institutional Shareholder Services (“ISS”) [published updates to its proxy voting guidance](#) generally for annual shareholder meetings to be held on or after February 1, 2021. The updated proxy voting guidelines primarily concern board composition, governance matters, and environmental and social issues.

Of particular note is the adoption by ISS of a new voting policy with respect to U.S. public company boards that appear to lack racial and ethnic diversity. Additionally, in a change from past practice, ISS will now generally vote in favor of exclusive forum or forum selection provisions in corporate charters or bylaws that designate certain courts as the required venue for litigation brought against a company.

Below we summarize these and other of the significant aspects of this year’s update to ISS’s guidelines.

1

Board Composition

- **Racial and ethnic diversity:** ISS adopted a new board racial and ethnic diversity policy that will be phased in during 2021 and become effective in 2022.
 - In 2021, ISS research reports will highlight Russell 3000 or S&P 1500 companies which have no apparent racial or ethnic diversity on their boards.
 - Effective for annual meetings in 2022, ISS will generally recommend voting against or withholding a vote 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 or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racially or ethnically diverse member within a year.
- **Gender diversity:** For companies in the Russell 3000 or S&P 1500 indices, ISS will generally recommend voting against or withholding a vote from the chair of the nominating committee, or other directors on a case-by-case basis, where there are no women on the company’s board. ISS had previously announced this policy in 2019 but had delayed its implementation until meetings held on or after February 1, 2021.

- As with its racial and ethnic diversity policy, ISS will not issue an adverse voting recommendation when a board has temporarily lost its gender diversity, i.e., 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 a gender-diverse status within a year.
- **Board Refreshment:** ISS revised its board tenure guidelines to emphasize its preference for ongoing evaluations of board composition over strict age or term limits.
 - ISS currently recommends voting against management proposals that limit the tenure of independent directors through mandatory retirement ages or through term limits.
 - ISS will continue generally to recommend voting against proposals seeking to implement director age limits, but it will now take a case-by-case approach on proposals seeking to implement term limits.
 - With respect to management proposals seeking to impose term limits, ISS will consider factors such as the underlying rationale of the term limit, the board's existing evaluation process, whether the limit is long enough to allow for a range of tenures, any potential disadvantages to independent directors and any potential for the board to impose the limit in a discretionary manner.
 - For shareholder proposals seeking term limits, ISS will consider the scope of the proposal and whether the lack of board turnover appears to be a contributing factor to problematic board issues or governance failures at the company.
 - ISS also expanded its board tenure policy guidelines to include a general statement in favor of board refreshment "best implemented through an ongoing program of individual director evaluations, conducted annually" in order to bring in "fresh perspectives, skills, and diversity as needed."

2

Corporate Governance Matters

- **Forum selection provisions:** ISS will generally recommend a vote in favor of certain forum selection provisions, in a change from its past stance on these provisions.
 - ISS added a new policy with a general recommendation to vote in favor of management proposals to amend charters or bylaws to provide that "the district courts of the United States" will be the exclusive forum for federal securities law matters, but against any provision that restricts the forum to a particular federal district court.
 - ISS will now generally recommend a vote in favor of management proposals to amend charters or bylaws to provide that state courts located within Delaware will be the exclusive forum for corporate law matters for Delaware corporations, in the absence of serious concerns about corporate governance or board responsiveness to shareholders (i.e. in the absence of concerns about abuse of the provision or about poor governance more generally). However, for other states, ISS will consider the provisions on a case-by-case basis, while evaluating the company's stated rationale, disclosure of past harm from duplicative

- shareholder suits, the breadth of the provision, and other relevant governance features, such as shareholders' ability to repeal the provision at a later date, whether the company has a declassified board and a majority vote standard in uncontested elections.
- ISS will recommend a vote against provisions specifying a state other than the state of incorporation, or that specify a particular local court within a state other than Delaware.
 - Virtual shareholder meetings: In light of the COVID-19 pandemic, ISS added a new policy generally recommending a vote in favor of management proposals allowing for the convening of shareholder meetings by electronic means, so long as they do not preclude in-person meetings. ISS also added a policy to vote case-by-case on shareholder proposals to that effect, considering the concerns identified with previous meeting practices and the scope and rationale of the proposal.
 - Advance notice requirements for shareholder proposals and nominations: The general ISS recommendation is to vote case-by-case on advance notice proposals, giving support to those proposals which allow shareholders to submit proposals or nominations as close to the meeting date as reasonably possible and within the broadest window possible.
 - Previously, ISS stated that the company's deadline for shareholder notice must be no more than 60 days prior to the meeting, with a submittal window of at least 30 days prior to the deadline.
 - The updated policy states that the deadline must be no earlier than 120 days prior to the anniversary of the previous year's meeting and have a submittal window of no shorter than 30 days from the beginning of the notice period (also known as a "90-120 day window").
 - Poison pill features: In its 2021 proxy voting updates, ISS explicitly states that poison pills, whether short-term or long-term, that have so-called "dead-hand" or "slow-hand" features will prompt an adverse voting recommendation.
 - ISS currently generally recommends a vote against board nominees where a company adopts a poison pill or makes a material change to an existing poison pill (such as extending the lifespan of the pill or lowering the trigger threshold) without providing for shareholder approval. ISS will make voting recommendations on a case-by-case basis where a poison pill is adopted with an initial term of one year or less.
 - ISS updated its poison pill policy to recommend an adverse vote where a company has any poison pill with "dead-hand" or "slow-hand" features, even if a short-term pill with one of these features expires before the next shareholder meeting. A "dead-hand" provision prevents a poison pill from being redeemed or terminated by new directors while a "slow-hand" provision prevents redemption or termination for a set period of time (generally 180 days). ISS stated that the inclusion of these features in poison pills adopted in 2020 was the basis for the new and explicit reference in its updated voting standards.

Environmental and Social Issues

- **Oversight of climate change, social and environmental issues:** ISS may recommend a vote against or withhold from director nominees where there are material governance failures relating to board oversight of environmental and social risks.
 - Currently, in “extraordinary circumstances,” ISS will recommend a vote against or withhold from directors individually, committee members, or the entire board, where there are material failures of risk oversight. ISS lists several examples of risk oversight failures such as serial fines or sanctions from regulatory bodies, significant adverse legal judgments or settlements or hedging of company stock.
 - The listed examples of risk oversight failures now include “demonstrably poor risk oversight of environmental and social issues, including climate change.”
- **Gender, race or ethnicity pay gaps:** ISS continues generally to recommend a case-by-case vote on shareholder proposals requesting reports about a company’s pay data by gender, race or ethnicity.
 - ISS currently recommends taking into account the company’s policies and disclosures related to diversity and inclusion. ISS also will take into account the company’s compensation philosophy and any recent controversy, litigation or regulatory issues related to gender, race or ethnicity pay gap issues.
 - ISS will now also recommend considering the company’s disclosures regarding gender, race or ethnicity pay gap policies or initiatives compared to its industry peers and local laws regarding categorization and definitions of race, ethnicities and racial minorities. ISS eliminated its recommendation to consider whether the company’s pay gap policies or initiatives are lagging those of its peers.
- **Mandatory arbitration:** ISS instituted a new policy recommending a case-by-case vote on shareholder proposals requesting a report on a company’s use of mandatory arbitration for employment-related claims, taking into account:
 - the company’s current policies and practices related to the use of mandatory arbitration agreements for workplace claims;
 - whether the company has been the subject of recent controversy, litigation, or regulatory actions related to 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.
- **Sexual harassment:** ISS instituted a new policy recommending a case-by-case vote on shareholder proposals requesting a report on company actions taken to strengthen policies and oversight to prevent workplace sexual harassment or a report on risks posed by a company’s failure to prevent workplace sexual harassment (taking into account the same three factors outlined above with regard to mandatory arbitration, as applied to sexual harassment).

COVID-19 Guidance Continues

ISS issued policy guidance on April 8, 2020, to account for the impact of the COVID-19 pandemic. This guidance concerned items such as virtual-only annual meetings, poison pills adopted due to market volatility, share buybacks and other executive compensation issues. ISS noted in its 2021 guidelines that it intends to carry this or similar policy guidance into 2021 and will provide further updates as needed.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Securities and Capital Markets practice:

<u>Kerry Burke</u>	+1 202 662 5859	kburke@cov.com
<u>Christopher DeCresce</u>	+1 212 841 1017	cdecresce@cov.com
<u>David Engvall</u>	+1 202 662 5307	dengvall@cov.com
<u>Brian Rosenzweig</u>	+1 212 841 1108	brosenzweig@cov.com
<u>David Martin</u>	+1 202 662 5128	dmartin@cov.com
<u>Matt Franker</u>	+1 202 662 5895	mfranker@cov.com
<u>Reid Hooper</u>	+1 202 662 5984	rhooper@cov.com
<u>William Mastrianna</u>	+1 202 662 5217	wmastrianna@cov.com
<u>Sebastian Marotta</u>	+1 202 662 5724	smarotta@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.