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Final 2022 Voting Policies from ISS Indicate Greater Accountability on Climate, Diversity and Pay

The final voting policy updates from the influential proxy advisor offer new criteria for assessing climate-related proposals from management and shareholders and heighten board accountability for climate, diversity and executive pay-related issues.

Institutional Shareholder Services (ISS) has issued its 2022 policy changes for U.S. companies following an extensive review of its yearly investor and company global policy surveys and stakeholder roundtable discussions. This year's policy update reflects growing interest on emerging corporate governance issues, regulatory changes and enforcement, and trends in global, regional and individual markets.

In this alert, we highlight important policy changes that companies and their boards should be aware of, including say-on-climate (SoC) management and shareholder proposals, as well as greater board accountability measures regarding climate and gender diversity policies. It's worth noting that the proxy advisory firm issued an updated U.S. Compensation & COVID-19 Pandemic FAQ as well. The full voting policy guidelines and FAQ can be accessed here. Unless otherwise stated, these policies go into effect for the 2022 proxy season.

SoC Proposals

ISS has formally adopted an approach for analyzing management and shareholder proposals known as say-on-climate or SoC, which ask for climate transition and reporting plans. SoC proposals first emerged in 2019 and assess management-recommended climate transition plans should be put up for shareholder approval. ISS is codifying them by utilizing the feedback received during their 2021 policy development process, including from the ISS Climate Survey. In late 2020, ISS established a case-by-case approach for shareholder-proposed climate transition plans and continues to provide a transparent framework of analysis that allows for consistency of assessment across markets.

Board Accountability – Climate

ISS has expanded its approach of climate-related issues by introducing a board accountability policy for the assessment of and focus on companies considered to be the world's highest greenhouse gas (GHG) emitting companies. ISS will recommend voting against one or more directors at 167 companies within the Climate Action 100+ Focus Group in cases where the company does not have both minimum criteria of disclosure, including risks from to the Task Force on Climate-related Financial Disclosures (TCFD) framework and the adoption of GHG emissions reduction targets covering at least a significant portion of the company's direct emissions.

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Board Accountability – Gender Diversity

Starting in 2023, ISS will expand the coverage of its 2019 board gender diversity policies to include all companies listed in the U.S. Currently ISS will recommend against, or withhold from, the chair of the nominating committee (or other directors on a case-by-case basis) at Russell 3000 and S&P 1500 companies where there are no female directors on the board. The updated coverage broadens the requirement to all companies listed in the U.S. regardless of index status.

Board Accountability – Unequal Voting Rights

ISS will rescind the grandfathering clause for companies not subject to the unequal voting rights policy following strong support expressed through survey results and roundtable discussions. Starting in 2023, ISS will recommend against relevant directors at all companies with unequal voting rights, irrespective of when they first became public companies. This update broadens coverage of ISS' problematic capital structure policy. Following this change, ISS will recommend against board members at all non-REIT U.S. companies that employ a common stock structure with unequal voting rights. The only exception would be if the company has subjected the practice to a sunset provision of no more than seven years or has provided sufficient alternative protections for minority shareholders.

COVID-19 Pandemic FAQ

ISS has updated its guidance on how U.S. Benchmark Research may approach coronavirus (COVID-19)--related pay decisions in the context of pay-for-performance evaluations. The updated FAQ document attempts to explain significant changes in how ISS U.S. Benchmark Research may approach these issues. The most important updates include:

- **Changes to Bonus/Annual Incentive Programs**: Pandemic-related changes to these programs in the middle of the year will be viewed negatively, especially in conjunction with a pay-for-performance disconnect. Companies are encouraged to provide added disclosure on why such actions were necessary and how the pandemic affected these changes.

- **External Factors Impacting Goal Setting**: With respect to ISS' analysis of incentive plan rigor, investors have indicated that lower performance expectations that reflect external factors (such as operational impacts due to the pandemic) may be a reasonable explanation for lower goal setting. These cases should be accompanied by disclosure that addresses the board's rationale for lower targets.

- **Incentive Award Evaluation**: Changes to in-progress long-term incentive awards will be viewed negatively, especially for companies that exhibit a quantitative pay-for-performance misalignment. Modest alterations to go-forward cycles may be viewed as reasonable, particularly for companies that continue to incur severe negative impacts over a long-term period.

- **Disclosure of Awards**: Companies that grant one-time awards throughout the COVID-19 pandemic should clearly disclose the rationale for the award. Vesting conditions attached to the award should be strongly performance based and the vesting period should be long term. Also, one-time awards should contain shareholder-friendly guardrails to avoid windfall scenarios, including limitations on termination-related vesting.

- **Disclosure of General Investor Feedback**: Companies should provide robust disclose of investor feedback related to say-on-pay proposals and any consequent changes to the program.

- **Disclosure of COVID-related Investor Feedback**: Issuers should consider actions to address investor feedback, and properly disclose the feedback received from any COVID-19--related adjustments.

- **Commitment to Resolving Concerns and Problematic Practices**: Compensation committees should make the necessary commitments to address investor concerns and problematic pay practices stemming from pandemic-related pay decisions.

Next Steps

ISS' policy updates contain numerous provisions that will impact boards and executives. ISS policies for 2022 will become effective for shareholder meetings taking place on or after February 1, 2022. We will continue to monitor and report on how these changes bear out in the 2022 proxy season. If you have questions about the topics described in this alert and would like to speak with a member of our governance team, please write to humancapital@aon.com.

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