INDUSTRY INSIGHT

ISS Proposed Policy Updates for 2023: Diversity, Governance and Accountability

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On Nov. 4, 2022, ISS released its proposed benchmark policy changes for 2023. ISS is inviting comments through Wednesday, Nov. 16. Below is a summary of the updates planned for the U.S. market.

Board Gender Diversity

As announced last year, in 2023.[1] ISS will be extending its board gender diversity policy to all U.S. public companies and foreign private issuers (FPIs).[2] Currently, it only applies to Russell 3000 and S&P 1500 companies. Under the policy, ISS will recommend against the nominating committee chair (or other directors on a case-by-case basis) if there are no women on the board.

ISS is also adding a one-year grace period for companies that have no female directors but disclose at least one board member who identifies as non-binary.

Unequal Voting Rights

As announced last year, in 2023 ISS will recommend against individual directors, committee members or the entire board (except possibly new nominees) at all companies with unequal voting rights structures, not just newly public companies. ISS is also clarifying the de minimis exception to the policy, namely, where the supervoting shares constitute less than 5% of total voting power. Other exceptions will continue as is. the governance committee members and directors who hold supervoting shares (i.e., controlling ownership).

These include:

- Newly public companies with a sunset provision of seven years or less from the IPO.
- Limited partnerships and the operating partnership unit structure of REITs.
- The company provides sufficient protections for minority shareholders, such as giving them a regular binding vote on whether the unequal voting structure should be maintained.

Note: ISS is seeking comments on whether to limit the adverse director recommendations to

Problematic Governance Structures – Newly Public Companies

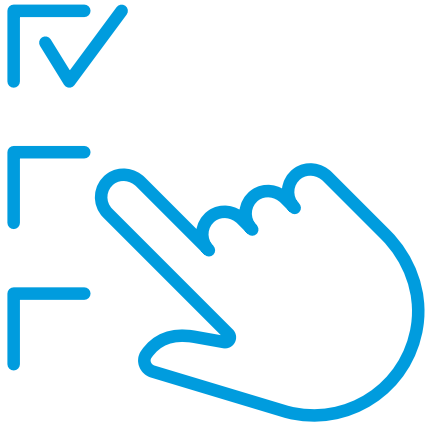
ISS is amending its policy on companies that go public with other problematic governance structures (classified boards, supermajority voting provisions) whereby it recommends against individual directors, committee members or the entire board (except possibly new nominees) until the adverse protection is reversed or removed. ISS is clarifying that the policy applies to companies that held their first annual meeting after Feb. 1, 2015. It is also specifying that to qualify as a mitigating factor, a sunset provision must be seven years or less. This conforms to the sunset exception in ISS's unequal voting rights policy.

Note: ISS is seeking comments on whether to limit the adverse director recommendations to only the full governance committee or the governance committee chair.

Director and Officer Indemnification, Liability Protection and Exculpation

ISS has adopted a new policy on the exculpation of corporate officers in view of August 2022 amendments to the Delaware General Corporation Law (DGCL) which permit companies to limit or eliminate the personal liability of officers for claims of breach of duty of care, if provided for in the certificate of incorporation.[3] Previously, the law only applied to directors.

ISS will recommend in favor of management proposals to provide for exculpation provisions in a company's charter to the extent permitted under applicable state law.



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[1] See ISS's full document at https://www.issgovernance.com/file/policy/2022/2023-Benchmark-Policy-Changes-For-Comment.pdf.
[2] The policy does not apply to all companies that file as FPIs with the SEC, but only those that are incorporated outside of the U.S. and are listed solely on U.S. exchanges.

Capitalization – Share Issuance Mandates at U.S. Domestic Issuers Incorporated Outside of the U.S.

ISS is introducing a new policy on common share issuances for U.S. domestic issuers that are incorporated outside of the U.S. but are listed solely on a U.S. exchange. ISS will recommend in favor of management resolutions to authorize the issuance of common shares up to 20% of the currently issued common share capital where not tied to a specific transaction or financing proposal (which will be evaluated case by case). ISS will apply a threshold of 50% of currently issued common share capital to pre-revenue or other early-stage companies that are heavily reliant on periodic equity financing, as long as they disclose a need for the higher limit.

ISS expects renewal of such mandates to occur at each annual meeting.

ISS will continue to evaluate share issuance mandate proposals at dual-listed companies under the policy applicable to their country of incorporation.

Climate Board Accountability

ISS is extending its climate board accountability policy globally after being adopted in 2022 for selected markets, including the U.S. The policy will continue to apply to high emitting companies, defined as the Climate Action 100+ Focus Group. [4] ISS is additionally updating the factors considered under the policy, specifically related to greenhouse gas (GHG) emissions reduction targets.

Under the policy, ISS will recommend against the appropriate directors and/or other voting items available if the company is not adequately disclosing climate risk, such as according to the Task Force on Climate-related Financial Disclosures (TFCD) framework, and does not have either medium-term or Net-Zero-by-2050 GHG emissions reduction targets for at least the company's operations (Scope 1) and electricity use (Scope 2).

Note: ISS is considering developing its own target group of high-emitting companies and is seeking comments on the criteria it should use and if certain industry sectors should be prioritized.

Lobbying and Political Contribution Congruency

ISS is codifying its position on shareholder proposals requesting company transparency on the alignment of its political contributions, lobbying and electioneering spending with its public commitments and policies. ISS will recommend case by case on such proposals, taking into account the following factors:

- The company's policies, management, board oversight, governance processes and level of disclosure related to direct political contributions, lobbying activities and payments to trade associations, PACs or other groups that may be used for political purposes;
- Company disclosure regarding the reasons for supporting candidates for public office and trade associations or other groups that may make political contributions;
- Any inconsistencies identified between a company's direct and indirect political expenditures and its publicly stated values and priorities; and
- Recent significant controversies related to the company's direct and indirect lobbying, political contributions or political activities.

ISS will recommend case by case on shareholder-sponsored climate lobbying proposals—namely, to report on how the company's direct and indirect lobbying activities align with the goals of the Paris Climate Agreement. [5]

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[3] Under the DGCL, the officers who may be exculpated include the CEO, president, COO, CFO, chief legal officer, controller, treasurer and chief accounting officer; named executive officers (NEOs) in the company's SEC filings; and individuals who have agreed to be identified as corporate officers. As with directors, officer exculpation does not include breach of the duty of loyalty; acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law; or any transaction in which the officer derived an improper personal benefit. The protection does not include actions that occurred prior to the recent DGCL amendment. Unlike directors, officers may not be exculpated from liability for derivative claims.

[4] A list of the Climate Action 100+ Focus Group companies may be found at https://www.climateaction100.org/whos-involved/companies/#

[5] In practice, ISS has supported all of the climate lobbying proposals on ballots since they were first introduced in 2020.

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