

Client Alert

ISS Issues Proxy Voting Guidelines and Policy Updates for 2021

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On November 12, 2020, Institutional Shareholder Services (“ISS”) issued its proxy voting guidelines and policy updates for 2021. These guidelines apply for shareholder meetings taking place on or after February 1, 2021. The most noteworthy changes are described below. Companies included in the S&P 500 index should also note that ISS will no longer provide drafts of its reports for company review prior to publication.

ISS Policy Updates for 2021

Board Composition – Gender Diversity and Racial/Ethnic Diversity

Notably, these guidelines introduce, for the first time, an explicit voting policy related to racial or ethnic diversity. For 2021, ISS will “highlight” boards of directors of Russell 3000 or S&P 1500 companies that lack apparent racial and/or ethnic diversity. ISS noted in its rationale that investors have expressed an increased interest in seeing ethnic or racial diversity on boards, citing reasons of equality and good corporate governance. For meetings on or after February 1, 2022, ISS will generally recommend a vote against the chair of the nominating committee (or other directors on a case-by-case basis) where the board has no apparent racially and/or ethnically diverse members. An exception will be made if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racial and/or ethnic diverse member within a year.

With respect to gender diversity, ISS’ 2019 policy guidelines included a policy related to gender diversity, which provided for a transitional period for 2020. Because the transition year has now passed, for 2021, ISS will generally vote against the chair of the nominating committee (or other directors on a case by case basis) at Russell 3000 or S&P 1500 companies where there are no women on the company’s board. An exception will be made if there was a 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.

As a result of these policy updates, we expect that proxy statements for 2021 annual meetings will include enhanced and prominent disclosures relating to the gender, ethnic and racial backgrounds of board members.

Material Environmental & Social Risk Oversight Failures

ISS' current policy provides that, in extraordinary circumstances, it will recommend a vote against board members in the event of "material" governance failures or risk oversight, failure to replace management, or other egregious actions related to a director's service. This policy has been updated to specifically include "demonstrably poor risk oversight of environmental and social issues" as an example of potential material risk oversight failures.

Exclusive Forum Provisions

Many companies, seeking to avoid litigating claims under the Securities Act of 1933 in state court, have adopted charter or bylaw provisions that require such claims to be brought in federal court, generally referred to as federal forum selection provisions. In March 2020, the Delaware Supreme Court in *Salzberg v. Sciabacucchi* upheld the validity of such federal forum provisions. As a result of these developments, in its 2021 policy updates ISS stated that it will generally recommend in favor of adopting federal forum selection provisions that specify "the district courts of the United States" as the exclusive forum for federal securities law matters. However, citing concerns about plaintiff inconvenience, ISS will generally recommend against federal form selection provisions that specify a *specific* federal court.

ISS also expressly endorsed the adoption of forum selection provisions that specify Delaware state courts as the exclusive forum for corporate law matters for Delaware corporations, "in the absence of serious concerns about corporate governance or board responsiveness to shareholders." Such forum selection provisions have increasingly been adopted by Delaware corporations since, as ISS notes, "the likelihood of a speedy and efficient resolution of Delaware corporate law cases, in particular, is considered to be greater if they are heard in Delaware courts." ISS will continue to consider exclusive forum provisions specifying state courts other than Delaware on a case-by-case basis.

We anticipate that more companies will adopt exclusive forum provisions in light of ISS' new policy positions. In considering whether to adopt a federal or state exclusive forum provision, boards of directors should continue to carefully consider the impact of such provisions on the corporation and its stakeholders.

Shareholder Proposals on Virtual Meetings

As a result of the COVID-19 pandemic, many companies pivoted to holding virtual-only meetings during 2020. Under its new 2021 policy, ISS will generally vote for management proposals allowing for virtual meetings, so long as they do not preclude in-person meetings. If a shareholder proposal provides for virtual-only meetings, ISS will vote on a case-by-case basis after considering (i) the scope and rationale of the proposal and (ii) any concerns identified with the company's prior meeting practices. Consistent with prior guidance on this topic, ISS appears to place importance on the level of disclosure provided by the company relating to its decision to hold a virtual meeting and focuses on the comparability of shareholder rights and opportunities at virtual meetings as compared to in-person meetings. Given that the COVID-19 pandemic has significantly shifted the way that the world views "virtual" interactions, we would expect a number of companies to continue to hold virtual-only meetings for 2021. Companies should be sure to provide adequate explanation and rationale in their proxy statements regarding its annual meeting practices.

ISS FAQs Regarding Compensation Policies & COVID-19

As previously discussed in Milbank's Client Alert "*ISS Issues Preliminary FAQs Regarding Compensation Policies & Covid-19*", on October 15, 2020, ISS issued frequently asked questions on U.S. compensation policies and the COVID-19 pandemic. As part of these FAQs, ISS provided helpful guidance on a number of key compensation and disclosure points, including:

- Specifying the level of disclosure that ISS expects to see in connection with compensation adjustments and making one-time awards, including (i) the specific challenges that were

incurred as a result of the pandemic, (ii) a rationale for why a particular approach was taken over another, (iii) performance considerations for one-time awards, (iv) how the adjustments or type of compensation furthers shareholders' interests and (v) how adjusted payouts compare to what would have otherwise been paid under the original program(s).

- Providing additional information on how ISS will view adjustments to “in-cycle” long-term incentives, noting that ISS will generally view these changes negatively, especially for companies that exhibit a quantitative pay for performance misalignment.
- Clarifying compensation policies unrelated to COVID-19, specifically (i) updating the passing EOSC score to 57 points for the S&P 500 and 55 points for the Russell 3000, and (ii) confirming that ISS' problematic pay practice policies will remain consistent with prior years.

For a more comprehensive discussion on ISS' compensation FAQs, see [ISS Issues Preliminary FAQs Regarding Compensation Policies & COVID-19](#).

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Corporate Governance

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