ISS Issues 2022 Benchmark Voting Policy Updates

On December 7, 2021, Institutional Shareholder Services ("ISS") announced the updates to its U.S. benchmark voting policy guidelines for the 2022 proxy season. As we noted last month when ISS first disclosed its proposed policy changes (see our Thoughtful Pay Alert, *ISS Issues 2022 Draft Policy Updates; Board Diversity, Multi-Class Stock Structures and Climate in the Spotlight* (November 9, 2021), ISS made a number of updates in the corporate governance area, but no significant changes to its voting policy guidelines covering executive compensation matters. Descriptions of select ISS policy updates for 2022 are set forth below. A summary of ISS' benchmark policy changes for 2022 is available here.

ISS' updated policies will generally be effective for annual meetings of shareholders taking place on or after February 1, 2022.

Changes to Three-Year Burn Rate Calculation Coming

In an update to its U.S. voting policy guidelines which was not previewed in advance, ISS has announced that, starting in 2023, it will move from a multiplier-based adjusted burn rate methodology to a "Value-Adjusted Burn Rate" calculation based on the actual stock price for full-value awards and the Black-Scholes value for stock options for better valuation of recently granted equity awards. For the 2022 proxy season, the new methodology will be for display only, but will factor into the Equity Plan Scorecard methodology applicable to proxy proposals for new and amended equity plan proposals in 2023.

Thus, for annual meetings of shareholders held prior to February 1, 2023, adjusted burn rate will continue to be calculated as: Burn Rate = (number of appreciation awards granted + number of full value awards granted multiplied by a "Volatility Multiplier") / Weighted average common shares outstanding. (The Volatility Multiplier is used to provide more equivalent valuation between stock options and full value shares, based on the company's historical stock price volatility.) For annual meetings held on or after February 1, 2023, the "Value-Adjusted Burn Rate" will instead be used for stock plan evaluations. (The Value-Adjusted Burn Rate = ((number of options multiplied by the option's dollar value using a Black-Scholes model) + (number of full-value awards multiplied by the stock price)) / (Weighted average common shares outstanding multiplied by the stock price.)

According to ISS, the new Value-Adjusted Burn Rate will be a more accurate way to measure the fair value of recently granted equity awards, as the methodology is based on the actual stock price (for full value awards) and the Black-Scholes value (for stock options). The present methodology uses a multiplier based on three-year stock price volatility and places companies in broad categories based on six volatility-based multiplier buckets. This may also reflect the continued shift away from the use of stock options at many companies in the competitive market. We will continue to monitor for additional guidance from ISS related to this policy change.

Board Diversity

ISS continues to be active on promoting diversity on corporate boards of directors for several years now. Currently, ISS will recommend a vote against the chair of the nominating committee where there are no women on the board of companies in the Russell 3000 and the S&P 1500 at the time of the most recent annual meeting (subject to mitigation if there was a woman at the previous meeting and the board has made a firm commitment to add a woman within one year). ISS has now expanded this requirement to extend to all public companies beginning in 2023. ISS' previously-announced policy that U.S. companies (Russell 3000 and S&P 1500) will need to have at least one racially/ethnically diverse director takes effect in 2022.

Board Accountability on Unequal Voting Rights

In 2016, ISS adopted a policy recommending a vote against the entire board of directors of a newly public company if, prior to or in connection with its IPO, the company or its board implemented a multi-class common stock structure in which the classes have unequal voting rights without subjecting the structure to a reasonable time-based sunset provision. This year, ISS is taking a number of actions with respect to companies with unequal voting rights structures.

First, ISS is eliminating the "grandfathering" for companies with unequal voting rights structures whose first public shareholder meeting was prior to 2015. As a result, companies that went public prior to 2015 (such as Alphabet, Meta Platforms, the Ford Motor Company, Berkshire Hathaway, and The New York Times Company, among many others) will generally receive an against recommendation for the entire board where the company has a multi-class common stock structure with unequal voting rights if the provision doesn't sunset within seven years of the company's IPO. Thus, after a one-year grace period, starting in 2023 ISS will generally recommend a vote against relevant directors at all companies with multi-class capital structures with unequal voting rights, irrespective of when the company went public, unless the structure is reversed, removed, or subject to a newly added reasonable sunset provision.

For newly public companies in 2022, ISS will generally recommend a vote against the entire board if, prior to or in connection with its IPO, the company has a multi-class capital structure with unequal voting rights that is not subject to a reasonable time-based "sunset" provision of no more than seven years from the IPO date.

Exceptions to this policy will be limited and include situations where the unequal voting rights are considered *de minimis* (for example, the special shares have zero vote) or situations where the company provides sufficient protections for minority shareholders (for example, the company allows minority shareholders a regular binding vote on whether the capital structure should be maintained).

Climate-Related Items

In recognition of the critical importance of climate change and climate-related risks to investors, ISS has adopted three new policies in the environmental area.

Board Accountability on Climate

Beginning in 2022, ISS will be singling out companies that are considered significant greenhouse gas ("GHG") emitters (initially this will be based on companies on the current Climate Action 100+ Focus list) and will recommend a vote against the responsible incumbent directors, board committee, or the full board where it determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy.

Initially, these "minimum steps" will include detailed disclosure of climate-related risks (such as board governance measures, corporate strategy, risk management analyses, and metrics and targets) and setting appropriate GHG emissions reduction targets.

Shareholder "Say-on-Climate" Proposals

ISS will evaluate shareholder proposals seeking company Say-on-Climate votes (either requesting the company to disclose a report providing its GHG emissions levels and reduction targets and/or its upcoming/approved climate transition action plan) on a case-by-case basis, taking into account several factors, including the completeness and rigor of the company's climate-related disclosure, the company's actual GHG emissions performance, whether the company has been the subject of recent, significant violations, fines, litigation, or controversy related to its GHG emissions, and whether the proposal's request is unduly burdensome or overly prescriptive.

Management "Say-on-Climate" Proposals

In situations where management is requesting that shareholders approve the company's climate transition action plan, ISS will evaluate the proposal on a case-by-case basis, taking into account the completeness and rigor of the plan. Information that will be considered (where available) includes, but is not limited to, the extent to which the company's climate-related disclosures are in line with the Task Force on Climate-Related Financial Disclosures recommendations and meet other market standards; disclosure of its operational and supply chain GHG emissions, the completeness and rigor of the company's short-, medium-, and long-term targets for reducing operational and supply chain GHG emissions in line with the Paris Agreement goals, and the company's related commitment, disclosure, and performance compared to its industry peers.

Other Notable Policy Updates

Responsiveness to Results of Say-on-Pay Vote

In a change to its **Canadian** compensation-related policies, ISS is raising the minimum support threshold that triggers a responsive analysis on a Say-on-Pay proposal from 70% to 80%. We note this because the current minimum support threshold in the United States is 70%, so this may be a sign of things to come in the U.S. (Glass Lewis' U.S. responsiveness policy is already triggered where minimum support for a Say-on-Pay proposal is below 80%.)

Foreign Private Issuers

In response to an ambiguity in its policies as to how foreign private issuers that also voluntarily comply with certain of the disclosure requirements applicable to U.S. domestic issuers will be evaluated, ISS has indicated that it will apply the applicable U.S. policy under its guidelines to the foreign incorporated company for the relevant disclosure.

What's Next?

Each year, ISS publishes its U.S. benchmark voting policy guidelines (as updated for the items discussed herein) and updated FAQ documents and/or white papers related to its compensation and equity plan policies. These materials should be published before the end of the year, along with more information relating to its new climate-related policies. It should also be noted that ISS has updated for the 2022 proxy season its FAQs for its U.S. Compensation Policies and the COVID-19 pandemic, which is now available on its website.

As in past years, we expect ISS to be publishing updated "burn rate benchmarks" for each GICS industry/index group in December.

Need Assistance?

Compensia has extensive experience in assisting companies in addressing ISS' U.S. benchmark voting policy guidelines. If you would like assistance in analyzing the potential impact of the ISS policies on your executive compensation or corporate governance programs, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Jason Borrevik at 408.876.4035 or jborrevik@compensia.com, Mark A. Borges at 415.462.2995 or mborges@compensia.com, or Peter Kimball at 202.321.1234 or pkimball@compensia.com.

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