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Client Alert

Corporate, Finance and Investments

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Significant 2021 Proxy Advisor Policy Changes

Proxy advisory firms ISS and Glass Lewis have issued their annual updated proxy voting guidelines for the upcoming 2021 proxy season. Glass Lewis's new guidelines apply to shareholder meetings on or after January 1, 2021, while ISS's guidelines will be used for meetings on or after February 1 next year. Among other key changes, the recently published annual updates signal enhanced scrutiny of boards that lack racial/ethnic and gender diversity – a topic that has generated substantial attention recently, including from NASDAQ's recent request for SEC approval of "comply or explain" rules on board diversity.

With regard to gender diversity, ISS will now generally recommend against nominating committee chairs at Russell 3000 and S&P 1500 boards that lack a female member, while Glass Lewis will identify boards with fewer than two female directors and recommend against nominating committee chairs at boards with no female members.

On racial/ethnic diversity, Glass Lewis's reports for S&P 500 companies will include an assessment of the quality of director diversity and skill disclosures, including the board's definition of diversity, the board's current percentage of racial/ethnic diversity, and whether the company has adopted a "Rooney Rule" to ensure that women and minority candidates are included in the pool from which director candidates are chosen. ISS's 2021 reports will identify Russell 3000 and S&P 1500 companies that have no apparent racial/ethnic diversity; in 2022, it will generally recommend against nominating committee chairs of companies in those indexes that lack a racially/ethnically diverse board member.

In addition to these policy updates on board diversity, both proxy advisors made numerous other changes to their benchmark voting policies, including those on issues related to exclusive forum provisions, environmental and social risk oversight, and other matters. The remainder of this client alert summarizes the most important changes. The full text of ISS's updates can be viewed on pages 4-26 of Proxy Voting Guidelines Updates for 2021; Glass Lewis's updates are on pages 2-4 of their United States Policy Guidelines.

Summary of Significant Policy Changes and Clarifications

Institutional Shareholder Services (ISS) – Policies generally effective as of February 1, 2021

- *Racial and Ethnic Diversity* – Starting in 2021, ISS will identify Russell 3000 and S&P 1500 companies that lack racial/ethnic diversity on their boards; in 2022, it will generally recommend against nominating committee chairs in those indexes if boards have no apparent racial/ethnic diversity. ISS will make an exception if (a) there was racial/ethnic diversity in the board as of the prior annual meeting and (b) the board makes a firm commitment to appoint a racially/ethnically diverse member within a year.
- *Gender Diversity* – Starting in 2021, ISS will generally recommend against nominating committee chairs of Russell 3000 and S&P 1500 companies that have no gender diversity on their boards unless they (a) had gender diversity as of the prior annual meeting and (b) make a firm commitment to appointing a female director within a year.
- *Board Refreshment* – ISS strongly supports board refreshment but has generally recommended against proposals to set arbitrary board refreshment mechanisms related to age and tenure. ISS is modifying that policy slightly, still opposing age limits but evaluating shareholder proposals for term limits on a case-by-case basis, evaluating the scope of the proposal, any evidence of problematic issues at the company "combined with, or exacerbated by, a lack of board refreshment."
- *Environmental and Social Risk Oversight* – ISS will now consider "demonstrably poor risk oversight of environmental and social issues, including climate change," as a material governance failure that could warrant a withhold recommendation against an entire board.
- *Sexual Harassment Shareholder Proposals* – Responding to client interest, ISS created a new policy that will evaluate, on a case-by-case basis, shareholder proposals requesting reports related to sexual harassment prevention and the risks of workplace sexual harassment. ISS will consider recent or ongoing controversies related to sexual harassment at the company as part of the analysis.
- *Advance Notice Requirements* - ISS will now support proposals for advance notice provisions that require the market standard notice (120 days prior to the meeting), eliminating the prior policy that only supported proposals that permitted notice to be given as late as 60 days prior to the meeting.
- *Exclusive Forum Provisions* – ISS's prior "case-by-case" policy on all exclusive forum charter or bylaw provisions is being replaced by several more targeted policies. With regard to federal litigation (i.e., litigation related to violations of the federal securities laws), ISS will generally support selecting federal district courts (but not a specific federal court). This change was prompted by the Delaware Supreme Court March 2020 decision, *Salzberg v. Sciabacucchi*, which resulted in some companies adopting federal forum charter or bylaw provisions. For litigation relating to claims arising out of state corporate law, ISS will not take action against board members of Delaware corporations that set Delaware state courts as the exclusive forum. For corporations incorporated elsewhere, the selection of an exclusive forum for state corporate law matters will be evaluated on a case-by-case basis, considering the stated rationale for adopting such a provision, the breadth of the provision, and the disclosure of past harm from duplicative lawsuits in multiple forums, among other factors. ISS will now presumptively recommend a vote against provisions that select the courts of a state other than the state of incorporation or a specific court within the state of incorporation. Adoption of an exclusive forum provision without shareholder approval that does not satisfy ISS will be considered a one-time failure under ISS policy, generating a recommendation that shareholders vote against one or more directors for one year.

Glass Lewis – Policies generally effective as of January 1, 2021

- *Board Diversity* – Starting in 2021, Glass Lewis will identify boards with fewer than two female directors. Starting in 2022, it will generally recommend against the nominating committee chair if there are fewer than two female members on boards with more than six members. A recommendation that shareholders vote against the nominating committee chair may be avoided with adequate disclosure that highlights a plan to address the lack of diversity on the board or in situations in which there is "a sufficient rationale" for the lack of diversity. Importantly, though the applicability of such laws remains open to question, companies that are subject to state laws requiring greater diversity will face recommendations that shareholders vote against if state law requirements are not met.
- *Board Refreshment and the "10/5 Rule"* – Reports from Glass Lewis will note if the average tenure of non-executive directors is ten years or greater and there have been no new independent directors in the past five years. Failure to satisfy this 10/5 rule will not by itself result in recommendations to vote against, but may be a contributing factor on other voting recommendations.
- *Director Diversity and Skill Disclosure* – Glass Lewis will begin commenting on the quality of director diversity and skill disclosures in 2021. "Specifically, we will reflect how a company's proxy statement presents: (i) the board's current percentage of racial/ethnic diversity; (ii) whether the board's definition of diversity explicitly includes gender and/or race/ ethnicity; (iii) whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (aka "Rooney Rule"); and (iv) board skills disclosure." Disclosure that Glass Lewis rates as "poor" will not necessarily result in any recommendations to vote against, but it may be a contributing factor in recommendations on other matters.
- *Environmental and Social Risk Oversight* – Starting in 2021, Glass Lewis will note a concern regarding any boards of S&P 500 companies that do not provide "clear disclosure concerning the board-level oversight afforded to environmental and/or social issues." Starting in 2022, such companies will generally see recommendations against the governance committee chair. Glass Lewis specifically notes that there is no one-size approach to E&S risk oversight; the concern is ensuring that there is oversight and that such oversight is clearly disclosed.
- *Virtual-Only Shareholder Meetings* – Glass Lewis's new policy demands enhanced proxy statement disclosure if a company elects to host a meeting in a virtual-only format. Glass Lewis may recommend against the governance committee chair if there is not robust disclosure on how shareholders can ask questions, among other items. This policy replaces Glass Lewis's temporary COVID-related policy for meetings held between March 1 and June 30 of this year.
- *Newly Public Companies* – For companies with multi-class share structures with disproportionate voting rights, a classified board, or other anti-takeover mechanisms preceding an IPO, Glass Lewis will now recommend against all board members who served at the time of the IPO unless the Board either set a reasonable sunset period for the provisions (three to five years for a classified board or poison pill; seven years or less for multi-class share structures) or committed to submitting the provisions to a shareholder vote at the company's first shareholder meeting following the IPO.

Takeaways

Proxy advisor voting guidelines are an important signal of evolving shareholder views on corporate governance issues. Many investors, especially smaller investors, will follow a proxy advisor's guidance; those investors that do not will often independently agree with some or all of a proxy advisor's positions. Companies should evaluate how they will fare under both sets of updated proxy advisor guidelines, as well as the guidelines of their largest institutional shareholders, to proactively identify areas where additional shareholder engagement or corporate action may be helpful.