Governance & Securities
Alert

Heads Up for the 2023 Proxy Season:

ISS and Glass Lewis Issue New and Revised Policies Focusing on Board Accountability, Diversity and ESG

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Institutional Shareholder Services (ISS) and Glass Lewis have released updates to their proxy voting policies for the 2023 proxy season, available here and here. Generally, ISS guidelines apply for shareholder meetings on or after February 1, 2023, and Glass Lewis guidelines apply for shareholder meetings held on or after January 1, 2023.

The updates for 2023 largely focus on board accountability for oversight of environmental, social and governance (ESG) issues, including board diversity and climate responsibility, as well as other top of mind topics, such as cybersecurity and officer exculpation. Companies should familiarize themselves and their boards with the new and updated policies, which will influence the results of director elections and support for shareholder proposals during the 2023 proxy season. Our updated summary of board vulnerabilities based on ISS policies is available here, and available here for Glass Lewis policies.

New or Updated Policies At-A-Glance

- ESG and Climate Concerns
  - Board Oversight and Accountability for Environmental, Climate and Social Issues – ISS & Glass Lewis
  - Shareholder Proposals on Lobbying and Political Spending – ISS
- Board Composition
  - Board Diversity – ISS & Glass Lewis
  - Overboarding – Glass Lewis
- Officer Exculpation – ISS & Glass Lewis
- Cyber Risk Oversight – Glass Lewis
- Problematic Governance Structures – ISS
  - Unequal Voting Rights
  - Reasonable Sunset Provision for Problematic Practices
  - Poison Pills
  - Unilateral Board Actions
- Share Issuance for U.S.-Listed Issuers Incorporated Outside the U.S. – ISS
- Summary of Additional Compensation Policy Clarifications – ISS & Glass Lewis

ESG and Climate Concerns

Board Oversight and Accountability for Environmental, Climate and Social Issues

ISS – REVISED. In 2022, ISS instituted a policy in several large markets, including the U.S., to recommend against the appropriate director or relevant voting item where a company in the Climate Action 100+ Focus Group does not adequately disclose climate risks and does not have quantitative greenhouse gas (GHG) emission reduction targets. Beginning in 2023, for companies in the Climate Action 100+ Focus Group, ISS will extend globally the policy on climate board accountability and will update the factors considered under the policy. ISS will generally recommend against applicable directors if the company has not taken the minimum steps to understand and mitigate such climate risks, which minimum criteria are as follows: (1) have adequate climate risk disclosure information, such as according to the Task Force on Climate-related Financial Disclosures ("TCFD"), and (2) have either medium-term GHG emission reductions targets or Net Zero-by-2050 GHG reduction targets for at least a company's operations (Scope 1) and electricity use (Scope 2).

Glass Lewis – REVISED. Beginning in 2023, Glass Lewis will generally recommend voting against the nominating committee chair of Russell 1000 companies that fail to provide explicit disclosure concerning the board's role in overseeing environmental and/or social (E&S) issues. Glass Lewis believes that companies should determine the best structure for E&S oversight, which can be effectively conducted by specific directors, the entire board, a separate committee, or combined with the responsibilities of a key committee. Also beginning in 2023, Glass Lewis will expand its tracking of board oversight of E&S matters to all Russell 3000 companies. Glass Lewis will review a company's proxy statement and governing documents such as committee charters to determine if directors maintain meaningful oversight and accountability for a company's material E&S risks.

Glass Lewis – NEW. Glass Lewis also has a new policy on director accountability for climate-related issues, particularly noting that clear and comprehensive disclosure regarding climate risk mitigation and oversight should be provided by companies in the Climate Action 100+ Focus Group. Like ISS, Glass Lewis believes companies should provide thorough climate-related disclosures in line with the recommendations of the TCFD. Glass Lewis will recommend against responsible directors in the absence of such disclosure, and in the absence of disclosure explicitly and clearly defining oversight responsibilities for climate-related issues.

Shareholder Proposals on Lobbying and Political Spending Congruency

ISS – NEW. ISS will vote on a case-by-case basis on proposals requesting greater disclosure of the congruency between a company's political contributions and its publicly stated values and policies. ISS will generally consider, among other things, the company's policies and oversight relating to political contributions or lobbying activities, the company's disclosure regarding its support of, or participation in, political activities or interests, recent significant controversies related to the company's lobbying or political activities, and any incongruences between a company's policies and its political expenditures.

Board Composition

Gender Diversity

ISS – REVISED. Starting in 2023, ISS's existing board gender diversity policy announced in 2021, which expects at least one woman board member, will apply to all U.S. companies and to all FPIs, expanding from Russell 2000 and S&P 1500 FPIs only to all FPIs. If there are no women on the board, ISS will recommend voting against the nominating/governance committee chair (and others on a case-by-case basis). Two notable allowances are that (1) an exception will be made if there was at least one 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 and (2) a one-year grace period will be applied at companies where there are no women on the board but there is at least one director who is disclosed as identifying as non-binary.

Glass Lewis – REVISED. Starting with annual meetings held on or after January 1, 2023, Glass Lewis will transition to a percentage-based approach for board gender diversity (rather than a fixed numerical approach) and will recommend that shareholders vote against the nominating committee chair at Russell 3000 companies if there is not at least 30% gender diversity on the board. For companies outside of the Russell 3000, Glass Lewis maintains its existing policy, which requires at least one gender diverse director on the board. As noted in the policy, Glass Lewis will carefully review a company's disclosure of its diversity considerations and may refrain from recommending that shareholders vote against directors when boards have provided a sufficient rationale or plan to address the lack of diversity on the board, including a timeline to appoint additional gender diverse directors (generally by the next annual meeting).

For context on the growing importance of board gender diversity, Glass Lewis published a blog with key data highlights from the first half of the 2022 proxy season, which highlights that Glass Lewis recommended voting against management-supported directors in just 14% of the 4,574 reports issued. However, of that 14% where director support was withheld, the vast majority (68%) were due to insufficient board gender diversity.

Racial/Ethnic Diversity

Glass Lewis – REVISED. Beginning in 2023, Glass Lewis will generally recommend against the nominating committee chair at Russell 1000 companies with fewer than one director from an underrepresented community on the board. Glass Lewis defines "underrepresented community" as an individual who self-identifies as Black, African American, North African, Middle Eastern, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaskan Native, or who self-identifies as gay, lesbian, bisexual, or transgender. Glass Lewis will rely on self-identified demographic information disclosed in company proxy statements for purposes of this evaluation.

Disclosure of Board Diversity and Skills

Glass Lewis – REVISED. Beginning in 2022, Glass Lewis began focusing on more comprehensive disclosure of board composition, particularly noting that companies are expected to disclose (1) the board's current percentage of racial/ethnic diversity, (2) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity, (3) 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 (i.e., the "Rooney Rule"), and (4) board skills disclosure. Beginning in 2023, Glass Lewis has revised its policy to provide that it will recommend against the nominating committee chair of Russell 1000 companies that have not provided any disclosure in each of the aforementioned tracked categories, and/or have not provided any disclosure of individual or aggregate racial/ethnic minority demographic information.

2023 Diversity Policies At-A-Glance

ISS

- At least one racially/ethnically diverse director at Russell 3000 or S&P 1500 companies
- At least one gender diverse director at all companies

Glass Lewis

- At least 30% gender diverse directors at all Russell 3000 companies
- At least one director from an underrepresented community at Russell 1000 companies
- Generally follow applicable state law mandates on board diversity, other than California, where such state law board composition requirements are currently being appealed

Overboarding

Glass Lewis – REVISED. Glass Lewis has revised its policy to clarify that it will generally recommend against (1) a director who serves as an executive officer (other than executive chair) of any public company while serving on more than one external public company board, (2) a director who serves as an executive chair of any public company while serving on more than two external public company boards, and (3) any other director who serves on more than five public company boards. Note that Glass Lewis continues to consider a company's rationale for an otherwise overboarded director's continued board service, and generally will not recommend against overboarded directors at the companies where they serve as an executive. For a summary of the policies of ISS, Glass Lewis and certain institutional investors on overboarding, see Annex A below.

Officer Exculpation Amendments under Delaware Law

In response to the August 2022 amendment to Section 102(b)(7) of the Delaware General Corporation Law (DGCL) that permits Delaware corporations to limit or eliminate personal liability of officers for claims of breach of the fiduciary duty of care in a manner that is generally consistent with the limitation on liability previously available only to directors, Delaware companies have begun to submit proposals to amend their certificates of incorporation in order to implement this change.

ISS – NEW. In a shift from its proposed policy which would have generally recommended "for" such proposals, according to its final adopted policy, ISS will vote on a case-by-case basis on proposals on director and officer exculpation. ISS will consider the stated rationale for such proposed changes, considering, among other factors, the extent to which a proposal would eliminate liability for monetary damages for violating the duties of care and loyalty, expand coverage beyond just legal expenses to more serious violations of fiduciary duties, or expand the scope of indemnification to provide for mandatory indemnification for acts that previously provided for permissive indemnification.

Glass Lewis – NEW. Glass Lewis will evaluate such proposals on a case-by-case basis and will generally recommend voting against such proposals, unless compelling rationale for the adoption is provided by the board and the provisions are reasonable.

Cyber Risk Oversight

Glass Lewis – NEW. Glass Lewis believes that cyber risk is material for all companies and is encouraging all issuers to provide clear disclosure concerning the board's role in cybersecurity oversight and how companies are ensuring that directors are well-versed on this dynamic issue. While Glass Lewis notes it will generally not make any recommendations on the basis of a company's oversight or disclosure concerning cyber-related issues, it will closely evaluate such oversight and disclosure particularly at companies afflicted by cyber-attacks.

Problematic Governance Structures

Unequal Voting Rights

ISS – REVISED. Beginning in 2023, ISS will recommend against directors at all companies with unequal voting rights structures, with a few exceptions, including for newly-public companies that implemented a sunset of no more than 7 years on the structure, limited partnerships or REITs, where supervoting shares represent less than 5% of the company's voting power, or minority shareholder protections are provided (e.g., allowing minority shareholders a binding vote on maintaining the structure). This update reflects the expiration of the one-year grace period for companies that had been grandfathered under the prior policy on unequal voting rights, and means directors at such companies are now subject to a negative recommendation if the company has multiple share classes with unequal voting rights without a reasonable sunset.

Reasonable Sunset Provision for Problematic Practices

ISS – REVISED. ISS has codified its policy relating to newly public companies with "problematic" governance structures (e.g., classified boards and supermajority vote requirements) to indicate that a 7-year sunset provision on such structures from the date of the company's public offering will mitigate a negative recommendation for directors.

Poison Pills

ISS – REVISED. ISS has clarified its policy on poison pills to provide that the ownership level at which the pill is triggered (i.e., low trigger thresholds of 5-10%) is also a consideration in evaluating the appropriateness of the board's actions in adopting a short-term pill that is not put to a shareholder vote.

Unilateral Board Actions

ISS – REVISED. ISS has clarified its policy to explicitly provide that fee shifting provisions unilaterally adopted by the board are considered an ongoing governance failure that will generally result in against recommendations in director elections.

Share Issuance for U.S.-Listed Issuers Incorporated Outside the U.S.

ISS – NEW. For domestic issuers incorporated outside the U.S. and listed solely on a U.S. exchange, ISS is introducing a new policy to generally vote for resolutions to authorize the issuance of common shares up to 20% of the issuer's currently issued common share capital, where such issuance is not tied to a specific transaction or financing proposal. Note that this policy applies only to companies with a sole listing in the U.S., and dual-listed companies that are required to comply with listing rules in the country of incorporation will continue to be evaluated under the policy for that market.

Additional Compensation Policy Clarifications At-A-Glance

ISS and Glass Lewis adopted several other notable revisions and clarifications in their 2023 policies.

ISS

- **ESG Metrics in Executive Compensation Shareholder Proposals**
  - ISS will continue to vote case-by-case on proposals seeking to include ESG metrics in executive compensation, but the updated policy clarifies that ISS generally considers that the company's compensation committee is in the best position to determine the metrics in the compensation program, while at the same time affirming that improved disclosure may benefit shareholders
- **Value Adjusted Burn Rate (VABR)**
  - The one-year transition period has ended and the previously announced methodology applies for 2023

GLASS LEWIS

- **Long-Term Incentives**
  - Glass Lewis will raise concerns in analysis of company's executive pay program if less than half of an executive's long-term incentive awards are subject to performance-based vesting conditions, which is an increase from 33% under prior policy (noted to be in line with market trends)

- **Compensation Committee Performance**
  - Glass Lewis will recommend against the compensation committee chair when outsized awards/"mega-grants" (outsized awards to one individual sometimes valued at over $100 million) have been granted and include concerns such as excessive quantum, lack of sufficient performance conditions, and/or are excessively dilutive, among others
- **Company Responsiveness to Say-on-Pay**
  - When assessing the level of opposition to say-on-pay proposals, Glass Lewis will examine the level of opposition among disinterested shareholders as an independent group
  - When evaluating a company's response to low support levels, Glass Lewis will expect disclosure of rationale for not implementing changes to pay decisions that drove low support
- **One-Time Awards**
  - Glass Lewis will expect disclosure surrounding the determination of quantum and structure for one-time awards
- **Grants of Front-Loaded Awards**
  - Glass Lewis will scrutinize the use of "mega-grants" in front-loaded awards
  - Glass Lewis will scrutinize situations where front-loaded awards are covering only time- or performance-based portion of an executive's long-term incentive awards
  - In situations where a front-loaded award covers a certain portion of an executive's regular long-term incentive awards, Glass Lewis' valuation of the remaining portion of the regular long-term incentives granted during the period will account for the annualized value of the front-loaded portion, and will expect that no supplemental grant be awarded during the vesting period of the front-loaded portion
- **Pay for Performance**
  - New SEC Pay-for-Performance disclosure will be reviewed by Glass Lewis, but no new policy has been adopted
- **Short- and Long-Term Incentives**
  - Glass Lewis recognizes the importance of the compensation committee's judicious and responsible exercise of discretion over executive pay outcomes to account for significant events and encourages companies to provide thorough discussion of how such events were considered in the committee decisions to exercise discretion
- **Recoupment Provisions**
  - Glass Lewis will raise concerns when companies maintain clawback policies that only meet the requirements set forth by Section 304 of the Sarbanes-Oxley Act, but will take into consideration disclosure of efforts to meet the standards of the SEC's final clawback rules under Exchange Act Rule 10D-1 (for a summary of the SEC's clawback rules, see our Alert here)

Annex A

Overboarding Policies

The following table provides a summary of the policies of ISS, Glass Lewis and certain other institutional investors on overboarding.

	CEOs, NEOs or Executive Directors of Public Companies, as applicable	Non-Executive Directors	Impact on Vote or Recommendation
ISS	3 for a CEO (including the board where he or she is the CEO)	5 public company boards	May recommend against the individual director; for a CEO, only at the boards where he or she is not CEO
Glass Lewis	2 for an executive officer (including the board where he or she is an executive officer), 3 for an executive chair (including the board where he or she is an executive chair)	5 public company boards	May recommend against the individual director; for an executive officer, only at the boards where he or she is not an EO
Vanguard	2 for an NEO (including the board where he or she is an NEO)	4 public company boards	May vote against the individual director, except at the boards where he or she is board chair; for an NEO, only at the boards where he or she is not an NEO
BlackRock	2 for a CEO (including the board where he or she is the CEO)	4 public company boards	May vote against committee members or individual directors, as applicable
State Street	3 for CEO and lead independent director (including the board where he or she is the CEO or LID)	6 public company boards	May vote against the individual director