

November 13, 2020

## ISS 2021 Benchmark Policy Updates

On November 12, 2020, Institutional Shareholder Services Inc. ("ISS") released its 2021 Proxy Voting Guidelines update to be applied to shareholder meetings taking place on or after February 1, 2021, **except for the more impactful diversity policies that have a one-year transition period and will be effective in 2022.**

As outlined in our October 16<sup>th</sup> client update memo, for the U.S. and the Canadian markets, the more significant changes that were subject to an open comment period from October 14 to October 26 have all been reflected in the updated 2021 policy as proposed, including board gender, race, and ethnicity diversity; director accountability on environmental and social concerns; and shareholder litigation rights related to exclusive forum provisions.

For the U.S. market, ISS also introduced relatively minor policy updates and clarifications on various topics under general governance, shareholder rights, and environment and social issues, including new policies on proposals related to virtual meetings, mandatory arbitration, and sexual harassment. We note that these minor changes were not subject to comments from market participants and they typically relate to regulatory requirements, shifting market practices, and the expiration of transition periods.

In addition, **ISS suggested that they intend to carry the COVID-19 guidance issued in April 2020 or similar policy guidance into 2021 and update going forward as needed.** For the U.S. market, ISS has published a FAQ on October 15, 2020 providing guidance on how the U.S. research team may approach pandemic-related pay decisions in the context of pay-for-performance qualitative evaluation.

The fully updated ISS proxy voting guidelines for 2021 will be published in late November and the updated Frequently Asked Questions (FAQ) documents will be published by December 2020.

### Board Diversity, Gender (Canada)

ISS's current benchmark policy, which was implemented in 2019, is to generally recommend voting WITHHOLD for the chair of the nominating committee (or other directors responsible for board nominations) if the company has not disclosed a formal written gender diversity policy **and** has no women on board, applicable to "widely-held" TSX issuers (i.e. S&P/TSX Composite Index companies as well as other companies that ISS designates as such based on the number of ISS clients holding securities of the company).

ISS's new policy has raised the bar substantially higher for large issuers, specifically, for S&P/TSX Composite Index companies. Effective February 1, 2022, ISS will generally recommend WITHHOLD on the chair of the nominating committee (or other directors responsible for board nominations) if the company's board gender diversity is less than 30% **and** the company has not disclosed a formal written gender diversity policy; or if the company's formal written gender diversity policy does not include a commitment to achieve at least

30% women on the board over a reasonable timeframe. The policy stays unchanged for non-Composite TSX issuers who are considered “widely-held” by ISS.

We note that the overall structure of the new policy is similar to the existing one, where either meeting the threshold or having a formal policy would avoid an adverse recommendation from ISS on directors. However, the key difference here, other than a higher threshold (30% vs. one director), is that ISS is making it explicit that the company's gender diversity policy must include a target of at least 30% women on the board within a reasonable timetable (vs. just a formal policy) to avoid an adverse recommendation if its gender diversity ratio is not already 30%.

As highlighted in our September 30 publication on “[\*The New Normal: How 2020 Has Changed The Future of Corporate Governance\*](#)”, the average gender diversity among TSX 60 issuers has already reached 30% – an aspirational target set by the 30% Club, although 26 companies or roughly 43% have fallen short. In addition, as at July 9, 2020, 48.8% of S&P/TSX Composite issuers have at least 30% women on the board per ISS. We believe the new policy is in line with the progress made so far and the expectation from institutional shareholders of large issuers (many of which have already set a higher standard than ISS’s benchmark policy). We anticipate board gender diversity will continue to be a focal point for Canadian issuers to enhance their governance practices leading up to the 2022 proxy season.

## Board Diversity, Race and Ethnicity (U.S.)

ISS has adopted a new policy, effective for meetings on or after February 1, 2022 and applicable to companies in the Russell 3000 or S&P 1500, to generally recommend voting AGAINST the chair of the nominating committee (or other relevant directors on a case-by-case basis) where there are no identified ethnic or racially-diverse board members. Mitigating factors include the presence of a racial and/or ethnic minority on the board at the preceding annual meeting and a firm commitment to appoint at least one racially and/or ethnically diverse member.

In 2021, ISS will highlight boards that lack racial and ethnic diversity or lack disclosure to help investors identify companies with which to engage on this topic. However, this will not be considered as a factor in ISS’s vote recommendations on directors in 2021, which essentially provides a one-year transition period for issuers to meet the new standard.

In light of the recent social unrest in the U.S., this new policy should not come as a surprise to the market. As we have advised our clients earlier this year, ISS has been sending letters to issuers seeking information on the self-identified race/ethnicity of each of the company’s directors and named executive officers (NEOs). In the letter, ISS acknowledged the focus on race and ethnicity among many institutional investors, and they intend to use such information to provide their clients with “a more holistic picture of board and leadership diversity across their investment portfolios and, more broadly, to help ensure that all stakeholders have accurate and complete information as they consider the wider debate concerning the state of corporate diversity beyond gender.” According to ISS, 1,260 of the Russell 3000 companies, 492 of the S&P 1500 and 71 of the S&P 500 do not have minority ethnic and/or racial board representation as of September 21, 2020.

While this new policy does not apply to Canadian issuers, we noted that some investors recommended during the open comment period that ISS expand this policy in other markets in the future. Therefore, we expect the practices ultimately adopted by U.S. issuers will set the pace for the Canadian market and the possibility of ISS adopting a similar policy for the Canadian market, especially considering that CBCA incorporated companies already started disclosing on broader diversity information this year under a “comply or explain” rule.

## Director Accountability (U.S. and Canada)

ISS has introduced clarifications related to the election of directors making it explicit that significant risk oversight failures related to environmental and social concerns may, on a case-by-case basis, trigger adverse vote recommendations AGAINST board members effective for shareholder meetings taking place on or after February 1, 2021. The change also makes it explicit that ISS has the flexibility to find that directors have failed in their risk oversight role if they have neglected to take meaningful steps to increase the resilience of companies to climate-related risks. However, we expect this clarification will impact only a small number of directors each year under extraordinary circumstances.

## Shareholder Litigation Rights (U.S. and Canada)

Exclusive forum by-laws have been widely adopted among U.S. issuers but are still relatively rare in the Canadian market. In light of some recent court cases and an increasing number of Canadian issuers adopting such provisions which require shareholder approval, ISS is proposing modifications in its U.S. policy and adding language codifying the Canadian policy related to exclusive forum provisions effective for shareholder meetings taking place on or after February 1, 2021.

For U.S. issuers, ISS will generally recommend voting FOR federal forum selection provisions in the charter or by-laws that specify the district courts of the U.S. as the exclusive forum for federal securities law matters, and AGAINST provisions that restrict the forum to a particular federal district court. As for exclusive forum provisions for state law matters, ISS will generally vote for charter or by-law provisions that specify Delaware, or the Delaware Court of Chancery, 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, and ISS will consider on a case-by-case basis for states other than Delaware. The policy on fee-shifting remains unchanged.

This policy change is almost a reversal of ISS's existing policy. For corporate law cases, ISS is acknowledging the likelihood of a speedy and efficient resolution of Delaware corporate law cases is considered to be greater if they are heard in Delaware courts. For federal law case, as stated by ISS as the reason for the change, charter and by-law provisions designating U.S. federal courts as the exclusive forum for cases arising under federal securities law, which had previously been held to be impermissible by the Delaware Court of Chancery, were deemed to be facially valid under Delaware law in a March 2020 ruling by the Delaware Supreme Court. Some U.S. companies began incorporating such provisions into their governing documents almost immediately. As such, ISS expects the number of vote recommendations likely to be impacted by this policy change is limited.

For Canadian issuers, the proposals will generally be considered on a case-by-case basis, taking into account a range of factors. Some the key considerations include the exclusive forum jurisdiction, the details of the extent and types of legal actions that would be subject to the exclusive forum by-law, and the board's rationale in adopting an exclusive forum by-law. The clarification provides greater transparency on how ISS will assess such proposals and the policy guideline it will follow. It should be noted that ISS has generally not been supportive of exclusive forum provisions proposed by Canadian issuers and we expect that the exceptions to the rule would be rare as the bar remains very high.

## Other Minor Changes and Clarifications (U.S.)

We summarize below a list of other relatively minor changes and clarifications that affect the U.S. issuers:

Topic	Policy Change
Gender Diversity (Director Election)	In light of the new racial and/or ethnic diversity policy, ISS has specified the previous diversity policy as gender diversity, and removed the language regarding mitigating factors and makes it explicit that an exception to an adverse recommendation will only be made if there was a woman on the board at the preceding annual meeting <b>AND</b> the board makes a firm commitment to return to a gender-diverse status within a year.
Classification of Directors (Director Election)	ISS has made several amendments to the existing language under Classification of Directors, most of which are minor clarifications in nature. One key change is to limit the “Executive Director” classification to only officers, not other employees.  While this change does not have any direct implication on the vote recommendations, for those institutional investors whose overboarding policies consider each “Executive Director” position as a mandate, this change will provide a more accurate assessment of the number of executive positions.
Poison Pills (Director Election)	ISS has added under the existing policy that they will recommend shareholders WITHHOLD votes from all nominees (except new nominees who should be considered case-by-case) if the poison pill, whether short-term or long-term, has a deadhand or slowhand feature. If the short-term pill with a deadhand or slowhand feature is enacted but expires before the next shareholder vote, ISS will generally still recommend WITHHOLD/AGAINST nominees at the next shareholder meeting following its adoption.  <i>Kingsdale Commentary: A deadhand provision is generally phrased as a “continuing director (or trustee)” or “disinterested director” clause and restricts the board’s ability to redeem or terminate the pill. A slowhand is where this redemption restriction applies only for a period of time (generally 180 days). During the COVID-19 pandemic, ISS noticed a number of issuers have re-adopted a deadhand or slowhand pill, and ISS has now made it explicit in its policy that such adoption will result in adverse recommendations.</i>
Board Refreshment (Board-Related Proposals)	ISS will now vote case-by-case on management and shareholder proposals regarding director term/tenure limits. For such shareholder proposals, ISS will take into account the scope of the shareholder proposal and evidence of problematic issues at the company combined with a lack of board refreshment. However, ISS will continue to vote AGAINST management and shareholder proposals to limit the tenure of independent outside directors through mandatory retirement ages.  <i>Kingsdale Commentary: In the past, ISS generally held the view that board refreshment is best achieved through an ongoing program of individual director evaluations and recommend AGAINST proposals that impose a mandatory term</i>

	<i>limit for directors. However, ISS is adjusting its position on this and taking a more balanced approach in light of the growing emphasis on achieving board diversity.</i>
Advance Notice Requirements <i>(Shareholder Rights &amp; Defenses)</i>	<p>ISS will now recommend FOR advance notice provisions that allow for notification 120 days prior to the meeting, a change from the previous policy of no earlier than 60 days prior to the meeting, in alignment with market practice.</p> <p><i>Kingsdale Commentary: It has become a more common practice in the U.S. market to set advance provisions that provide for shareholder notice of action 120 days prior to the meeting with a 30-day submittal period. ISS has updated this policy conform with market practice. It should be noted that advance notice provisions do not apply to shareholder proposals submitted under SEC Rule 14a-8(e)(2), nor to director nominations submitted under proxy access provisions.</i></p>
Virtual Shareholder Meetings <b>(NEW)</b> <i>(Shareholder Rights &amp; Defenses)</i>	<p>ISS has introduced a new policy on virtual meetings and stated that they generally support management proposals allowing for virtual shareholder meetings, as long as <b>companies do not preclude in-person meetings</b>. Companies are encouraged to disclose the circumstances under which virtual-only meetings would be held, and to allow for comparable rights and opportunities for shareholders to participate electronically as they would have during an in-person meeting.</p> <p><i>Kingsdale Commentary: In light of the widespread use of virtual meetings this year due to COVID-19, many institutional shareholders and activist groups including CII, CalPERS, CalSTRS and the New York City Pension Funds who voiced their concerns on virtual-only meetings and preference for technology to supplement rather than supplant in-person meetings. ISS has now clarified its stance with this new policy that the use of virtual meetings cannot be at the expense of rights and opportunities for shareholders to participate in meetings as they would have during an in-person meeting.</i></p>
Gender, Race/Ethnicity Pay Gaps <i>(Social and Environmental Issues)</i>	ISS has added a new factor – local laws regarding categorization and definitions of race and/or ethnicity – in its case-by-case approach when evaluating requests for reports on a company's pay data by gender or race/ethnicity, or a report on a company's policies and goals to reduce any gender or race/ethnicity pay gap. This change is to recognize that the definition of racial and ethnicity minorities differs from region to region, so a "global race/ethnicity" statistic is not meaningful.
Mandatory Arbitration <b>(NEW)</b> <i>(Social and Environmental Issues)</i>	ISS has introduced a new policy to state that it will apply a case-by-case approach when evaluating shareholder proposals requesting reports on a company's use of mandatory arbitration on employment-related claims, along with some defined criteria for its analysis.
Sexual Harassment <b>(NEW)</b>	ISS has introduced a new policy to state that it will apply a case-by-case basis when evaluating requests for a report on company actions taken to strengthen policies and oversight to prevent workplace sexual harassment, or a report on

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risks posed by a company's failure to prevent workplace sexual harassment. It also defines some criteria for analysis.

If you have any questions about this update, please feel free to contact Kingsdale's experts listed below to discuss directly.

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