Davis Polk

ISS seeks comments on significant proposed policies on multi-class structures and ESG matters

November 8, 2021 | Client Update | 6-minute read

On November 4, 2021, ISS proposed for comment potential U.S. voting policies. Of particular note are proposed policies where ISS will hold directors accountable at U.S. companies with multi-class structures with unequal voting rights, high greenhouse gas emissions without adequate disclosures or reduction targets, or no board gender diversity. The comment period ends Tuesday, November 16, 2021.

On November 4, 2021, Institutional Shareholder Services Inc. (ISS) proposed for comment potential new voting policies that will have significant effects on U.S. companies:

- Starting in 2023, ISS will recommend against directors at all companies having multi-class structures with unequal voting rights, rather than limiting the policy to IPO companies;
- Starting in 2022, ISS will hold accountable directors at companies on the Climate Action 100+'s focus list that fail to have adequate disclosure, such as in accordance with recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), or to have set quantitative greenhouse gas (GHG) reduction targets; and
- In 2022, ISS will recommend against directors at all Russell 3000 and S&P 1500 companies with no female directors; starting in 2023, ISS proposes to extend this policy to most other listed U.S. companies.

ISS invites market participants to submit comments by email at policy@issgovernance.com until **5:00 p.m. ET** on **Tuesday, November 16, 2021**.

If adopted, these policies will apply to meetings scheduled on or after February 1 in 2022 or 2023, depending on the policy.

Multi-class structures with unequal voting rights

ISS currently recommends withhold votes against directors who were on the board at the time of the IPO at IPO companies with multi-class (high vote / low vote) structures with no sunset provisions or with sunset provisions exceeding seven years. Companies that had their structures in place and held their first annual meetings before 2015 (when ISS adopted the policy) are grandfathered. For those companies, while ISS will support shareholder proposals to repeal the multi-class structure, it historically has not taken action against directors at such companies or the other public companies with multi-class structures.

As proposed, starting in 2023, ISS would recommend against all directors (except new nominees, who would be considered case-by-case), at all companies with multi-class structures with unequal voting rights.

- Exceptions to this policy will generally be limited to:

- Newly public companies with a sunset provision of no more than seven years from the date of going public;
- Limited Partnerships and the Operating Partnership (OP) unit structure of REITs;
- Situations where the unequal voting rights are considered *de minimis*; or
- Where the company provides sufficient protections for minority shareholders, such as allowing minority shareholders a regular binding vote on whether the capital structure should be maintained.

For existing public companies with multi-class structures, these sunsets are not included in their charters, which would mean that ISS will recommend withhold votes against all directors. If the company has a single shareholder that owns more than 50% of the vote, the withhold recommendation will not have more than symbolic impact, but for companies with high vote stock where the high vote class does not have a majority vote, resulting withhold votes can be significant. We would note that it is a bit ironic, and arguably ineffective, to punish directors when the directors cannot actually remove the multi-class structure, as the owners of the high vote stock must approve any amendment to the charter.

Climate Action 100+ focus companies

Climate Action 100+ is an initiative composed of over 600 global investors with more than $60 trillion in assets under management that focuses on seeking corporate change on climate change matters by targeting more than 100 so-called "focus" companies that the organization believes are the world's largest corporate GHG emitters. ISS refers to these companies as the "Climate 100+ Focus Group."

Beginning in 2022, ISS proposes to recommend against the reelection of directors at Climate Action 100+ focus companies in cases where ISS determines that the company has failed to take the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy.

For 2022, ISS will consider the following items to constitute minimum steps to understand and mitigate those risks:

- Detailed disclosure of climate-related risks, including:
  - Board governance measures;
  - Corporate strategy;
  - Risk management analyses; and
  - Metrics and targets.
- Appropriate GHG emissions reduction targets.

For 2022, ISS proposes to interpret the phrase "appropriate GHG emissions reduction targets" as any well-defined GHG reduction targets. Targets for Scope 3 emissions will not be required in 2022.[1] ISS anticipates that its expectations regarding what constitutes adequate "minimum steps" will increase over time.

Gender board diversity

ISS proposes to start in 2023 recommending against directors at all companies where there are no female directors. Currently, the policy is limited to Russell 3000 and S&P 1500 companies.

Racial and ethnic board diversity – *Reminder*

As previously announced in 2020, starting in 2022, ISS will recommend against directors at Russell 3000 and S&P 1500 companies with no racially/ethnically diverse directors.

Say-on-climate

ISS proposes to begin in 2022 assessing both management say-on-climate and shareholder say-on-climate proposals against numerous factors on a case-by-case basis. Say-on-climate proposals, which were first introduced in the United States last season and have been compared in concept to say-on-pay votes in the executive compensation context, would require companies to include on the ballot at each annual meeting a shareholder advisory vote on that company's climate action plan. For management say-on-climate proposals, ISS will consider the level of completeness and rigor of any proposed transition plan. ISS will also consider the following factors (when the information is available):

- The extent to which the company's climate-related disclosures are in line with TCFD recommendations and meet other market standards;
- Disclosure of its operational and supply chain GHG emissions (Scopes 1, 2, and 3);
- The completeness and rigor of the company's short-, medium-, and long-term targets for reducing operational and supply chain GHG emissions (Scopes 1, 2, and 3 if relevant);
- Whether the company has sought and approved third-party approval that its targets are science-based;
- Whether the company has made a commitment to be "net zero emissions" for operational and supply chain emissions (Scopes 1, 2, and 3) by 2050;
- Whether the company discloses a commitment to report on the implementation of its plan in subsequent years;
- Whether the company's climate data has received third-party assurance;
- Disclosure of how the company's lobbying activities and its capital expenditures align with company strategy;
- Whether there are specific industry decarbonization challenges; and
- The extent of the company's related commitment, disclosure, and performance compared to its industry peers.

For shareholder say-on-climate proposals, ISS proposes to take into account factors such as:

- 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 (scope or time frame) or overly prescriptive.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Maurice Blanco
+55 11 4871 8402
+1 212 450 4086
maurice.blanco@davispolk.com

Ning Chiu
+1 212 450 4908
ning.chiu@davispolk.com

Alan F. Denenberg
+1 650 752 2004
alan.denenberg@davispolk.com

Joseph A. Hall
+1 212 450 4565
joseph.hall@davispolk.com

Michael Kaplan
+1 212 450 4111
michael.kaplan@davispolk.com

Emily Roberts
+1 650 752 2085
emily.roberts@davispolk.com

Richard D. Truesdell, Jr.
+1 212 450 4674
richard.truesdell@davispolk.com

[1] Scope 1 emissions are direct GHG emissions that occur from sources controlled or owned by a company (e.g., fuel combustion at the facility). Scope 2 emissions are indirect GHG emissions associated with the electricity or energy the company buys, such as for heating and cooling its facilities. Scope 3 emissions are generated by sources not owned or controlled by the company, but are in the company's value chain.