

## Corporate

## Institutional Shareholder Services Announces Policy Updates for the 2021 Proxy Season

By: [Alexander J. May](#)

On November 12, 2020, Institutional Shareholder Services, or ISS, released its proxy voting policy updates for the 2021 proxy season.<sup>[1]</sup> The updates are effective for annual meetings on or after February 1, 2021. While the updates largely impact the 2021 proxy season, companies will need to consider in greater detail racial and ethnic diversity in their board composition for the 2022 proxy season. The updates are discussed below, with the most significant updates summarized here.

<u>Policy Update</u>	<u>Summary of Update</u>
Director Voting – Governance Failures	Under extraordinary circumstances, vote against or withhold from directors individually, committee members, or the entire board, due to failures in risk oversight including <b>demonstrably poor risk oversight of environmental and social issues, including climate change</b> .
Director Voting – Gender Diversity	Generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies in the Russell 3000 or S&P 1500 indices <b>where there are no female directors on the company's board</b> , with one exception discussed below.
Director Voting – Racial/Ethnic Diversity	<p><b>2021 Meetings:</b> Highlight boards with no apparent racial and/or ethnic diversity for companies in the Russell 3000 or S&amp;P 1500 indices.</p> <p><b>2022 Meetings:</b> Generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) where the board of a company in the Russell 3000 or S&amp;P 1500 has no apparent racially or ethnically diverse members, with one exception discussed below.</p>
Independence Determinations	<ul style="list-style-type: none"> <li>Revised rule on categorization of employees as non-independent directors.</li> <li>Directors with significant pay packages will not be considered independent.</li> </ul>
Board Accountability – Poison Pills	Vote against or withhold from all director nominees (except new nominees, who should be considered case-by-case) if the poison pill has a “deadhand” or “slowhand” feature.
Management and Shareholder Proposals – Board Refreshment	<ul style="list-style-type: none"> <li>New rule where management and shareholder proposals on director term or tenure limits will be considered on a case-by-case basis rather than voted against.</li> <li>Both management and shareholder proposals regarding age limits will be voted against.</li> </ul>

Management and Shareholder Proposals – Shareholder Litigation	<p><b>Federal Forum Selection:</b> Recommend <b>for</b> provisions that specify “the district courts of the United States” as the exclusive forum for federal securities law matters, but recommend <b>against</b> provisions that restrict the forum to a particular federal district court.</p> <p><b>State Forum Selection:</b></p> <ul style="list-style-type: none"> <li>• Generally vote <b>for</b> charter or bylaw provisions that specify courts located within the state of Delaware as the exclusive forum for corporate law matters for Delaware corporations.</li> <li>• <b>Vote case-by-case</b> on states other than Delaware.</li> <li>• Generally vote <b>against</b> provisions that specify a state other than the state of incorporation as the exclusive forum for corporate law matters, or that specify a particular local court within the state.</li> </ul> <p><b>Fee-Shifting:</b> Generally vote against provisions that mandate fee-shifting whenever plaintiffs are not completely successful on the merits.</p>
Management and Shareholder Proposals – Virtual Shareholder Meetings	Generally vote <b>for</b> management proposals allowing for the holding of virtual shareholder meetings, so long as they do not preclude in-person meetings and vote <b>case-by-case</b> on shareholder proposals concerning virtual-only meetings.
Management and Shareholder Proposals – ESG Factors	<p><b>Mandatory Arbitration:</b> Vote case-by-case on requests for a report on a company’s use of mandatory arbitration on employment-related claims.</p> <p><b>Sexual Harassment:</b> Vote case-by-case on requests for a report on company actions taken to strengthen policies and oversight to prevent workplace sexual harassment.</p>

### **Director Voting – Governance Failure**

ISS, in a universal update, expanded the type of governance failures that might result in voting against a director or the entire board to include poor oversight of environmental and social issues. While ISS specifically noted climate change as an environmental risk, it did not specify other “social issues” that would be risks. However, in the proposed rules, ISS noted that “the clarification is expected to impact a small number of directors each year”<sup>[2]</sup> and the change merely made explicit that ISS would have the ability to take these considerations into account, so the author believes that the change is less drastic than it might appear on paper.

### **Director Voting—Gender Diversity**

In 2019, ISS announced that 2020 would be a transitional year for gender diversity, whereby companies that did not have a female director could make appropriate additions without receiving negative voting recommendations. In accordance with its previously announced update, for 2021, ISS will generally vote against the chair of the nominating committee (or other directors on a case-by-case basis) for any Russell 3000 or S&P 1500 company that does not have at least one female director. Should a company be compliant with the gender diversity standard (i.e. at least one member of the board is a female) in 2020, but no longer satisfy the gender diversity standard in 2021, ISS will make an exception if the company commits to adding at least one female director at its next annual meeting.

## **Director Voting – Racial-Ethnic Diversity**

ISS is committed to a similar game plan regarding vote recommendations for racial/ethnic diversity as with gender diversity. For 2021, ISS will highlight companies in the Russell 3000 or S&P 1500 that do not have apparent ethnic or racial diversity. In 2022, ISS will generally vote against the chair of the nominating committee (or other directors on a case-by-case basis) for any Russell 3000 or S&P 1500 company that does not have at least one director who is racially or ethnically diverse. Should a company be compliant with the racial/ethnic diversity standard in 2021, but no longer satisfy the racial/ethnic diversity standard in 2022, ISS will make an exception if the company commits to adding at least one diverse director at its next annual meeting.

It is worth noting that ISS takes the position that aggregate diversity statistics provided by the board will only be considered if specific to racial and/or ethnic diversity. Thus, stating that “5 out of 10 directors are diverse” (without stating the diversity standard) will not provide the requisite information ISS is seeking.

## **Independence Determinations**

ISS made minor modifications to its definition of director independence and generally reorganized some of the definitions. To reflect the fact that employee representatives on a board are not necessarily “executive directors,” ISS elected to reclassify such employees under the “Non-Independent Non-Executive Director” rubric.

ISS added to the definition of “Non-Independent Non-Executive Director” any director with pay comparable to named executive officers.<sup>[3]</sup> While directors with significant pay packages could have been classified as not independent under the catch-all “Other relationships with the company” standard contained in ISS’ existing Guidelines, ISS elected to add this language to make the independence standard clearer.

## **Board Accountability – Poison Pills**

In 2020, ISS observed that slowhand<sup>[4]</sup> or deadhand<sup>[5]</sup> poison pills, which did not see wide use in recent years, were adopted by a handful of companies.<sup>[6]</sup> Like most other poison pills adopted without a shareholder vote, ISS will generally recommend against directors who adopt poison pills with such a feature, including recommending against directors who adopted the poison pill at the next annual meeting of stockholders even if the poison pill was subsequently cancelled or expired.

## **Management and Shareholder Proposals – Board Refreshment**

ISS updated their policies to reflect board refreshment and in particular term and tenure limits and age limits for directors. For 2021, ISS is taking a keener look at term and tenure limits, whereas in the past ISS recommended against any proposals regarding tenure or term limits.

For management proposals, ISS will vote case-by-case on management proposals regarding director term/tenure limits, subject to certain conditions.<sup>[7]</sup> Similarly, ISS will vote case-by-case on shareholder proposals asking for the company to adopt director term/tenure limits, and will consider (1) the scope of the shareholder proposal; and (2) evidence of problematic issues at the company combined with, or exacerbated by, a lack of board refreshment.

With respect to age limits, ISS updated its policy to “generally” vote against management and shareholder proposals for age limits and would vote for removal of any mandatory age limits.

## **Advance Notice Deadlines**

ISS updated its policies for the reasonableness of advance notice deadlines under company corporate documents. In order for advance notice deadlines to be “reasonable” such deadlines must be provided

no earlier than 120 days prior to the anniversary of the previous year's annual meeting and have a window of no shorter than 30 days from the beginning of the notice period. This generally matches the "90 to 120 day window" contained in many companies' bylaws. ISS did not update the content of such advance notice provisions and specifically noted that this advance notice provision did not impact shareholder proposals under Rule 14a-8 of the Exchange Act or proxy access bylaws.

### **Management and Shareholder Proposals – Shareholder Litigation**

As courts approve of various exclusive forum provisions and companies adopt such exclusive forum provisions, ISS updated their policies to respond to such judicial developments. ISS divided their policy into three categories: federal forum selection clauses, state forum selection clauses, and fee-shifting clauses.

- **Federal Forum Selection:** ISS bifurcated their recommendations on federal forum selection clauses.
  - ISS will generally vote for federal forum selection provisions where "the district courts of the United States" are the exclusive forum for federal securities law matters, in the absence of serious concerns about corporate governance or board responsiveness to shareholders.
  - However, ISS will recommend a vote against provisions that restrict the forum to a particular federal district court and adoption of such a provision without shareholder approval will be a "strike" against the company with respect to ISS' Unilateral Bylaw/Charter Amendments policy.
- **State Forum Selection:** ISS has adopted a similar stance on state forum selection clauses as the federal forum selection clauses, with a couple of caveats.
  - ISS will generally recommend a vote for charter or bylaw provisions that specify courts located within the state of Delaware 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.
  - For states other than Delaware, ISS will consider on a case-by-case basis, taking into account a limited number of governance factors.<sup>[8]</sup>
  - For companies electing to adopt provisions that specify a state other than the state of incorporation as the exclusive forum for corporate law matters, or that specify a particular local court within the state, ISS will recommend against such provisions and adoption of such a provision without shareholder approval will be a "strike" against the company in terms of ISS' Unilateral Bylaw/Charter Amendments policy.
- **Fee-Shifting Provisions:** ISS continued its policy of generally voting against provisions that mandate fee-shifting whenever plaintiffs are not completely successful on the merits. Similar to the federal forum selection and state forum selection requirements above, unilateral adoption of fee-shifting provisions will generally be "strike" under ISS' Unilateral Bylaw/Charter Amendments policy.

### **Management and Shareholder Proposals – Virtual Shareholder Meetings**

As a result of the COVID-19 pandemic, a significant number of companies held their annual meetings as virtual annual meetings. ISS will generally vote for management proposals allowing for holding shareholder meetings, so long as they do not preclude in-person meetings. In addition, ISS encourages companies 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. In contrast, shareholder proposals will only be considered on a case-by-case basis, and ISS will take into consideration the scope and rationale of the proposal and

any concerns identified with the company's prior meeting practices when making its recommendation.

## **Management and Shareholder Proposals – ESG Factors**

### *Mandatory Arbitration and Sexual Harassment*

In response to a number of shareholder proposals and comments from companies, ISS provided its view on two important policies regarding shareholder proposals: mandatory arbitration for employment-related claims and sexual harassment. Similar to other ESG factors, ISS will take a case-by-case review on reports related to such proposals.

For mandatory arbitration reports, ISS will take into account:

- the company's current policies and practices related to the use of mandatory arbitration agreements on workplace claims;
- whether the company has been the subject of recent controversy, litigation, or regulatory actions related to the use of mandatory arbitration agreements on workplace claims; and
- the company's disclosure of its policies and practices related to the use of mandatory arbitration agreements compared to its peers.<sup>[9]</sup>

For sexual harassment, requests for a report on company actions taken to strengthen policies and oversight to prevent workplace sexual harassment, or a report on risks posed by a company's failure to prevent workplace sexual harassment, ISS will take into account:

- the company's current policies, practices, and oversight mechanisms related to preventing workplace sexual harassment;
- whether the company has been the subject of recent controversy, litigation, or regulatory actions related to workplace sexual harassment issues; and
- the company's disclosure regarding workplace sexual harassment policies or initiatives compared to its industry peers.<sup>[10]</sup>

For shareholder reports on race, gender, and ethnicity pay gaps, ISS did not change its recommendation standard, but noted that it would take into account the company's disclosure regarding gender, race, or ethnicity pay gap policies or initiatives compared to its industry peers and local laws regarding categorization of race and/or ethnicity and definitions of ethnic and/or racial minorities in making its recommendation.<sup>[11]</sup>

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[1] Institutional Shareholder Services, Proxy Voting Guidelines-Updates For 2021 (Adopting Release) available at <https://www.issgovernance.com/file/policy/latest/updates/Americas-Policy-Updates.pdf>.

[2] Institutional Shareholder Services, Proposed ISS Benchmark Policy Changes for 2021, at 31-32 available at <https://www.issgovernance.com/file/policy/proposed-benchmark-policy-changes-2021.pdf>.

[3] Note that ISS did not provide any type of limitation or carve-out for smaller reporting companies which have the ability to report fewer named executive officers under scaled reporting standards. In addition, ISS did not specify which named executive officers (e.g. PEO/CEO or PFO/CFO) or whether the pay would be averaged amongst the named executive officers to determine the comparison level.

[4] "Slowhand" poison pills are designed to be limited in duration and may not be only redeemed during that period regardless of the composition of the board.

[5] "Deadhand" poison pills are designed only to be redeemed by the directors who originally adopted the poison pill. Thus, a new slate of directors elected or appointed by a third party stockholder would be unable to redeem a poison pill and provides a significant amount of power to the original directors.

[6] Adopting Release at 15.

[7] ISS listed the following factors: (1) the rationale provided for adoption of the term/tenure limit; (2) the robustness of the company's board evaluation process; (3) whether the limit is of sufficient length to allow for a broad range of director tenures; (4) Whether the limit would disadvantage independent directors compared to non-independent directors; and (5) whether the board will impose the limit evenly, and not have the ability to waive it in a discriminatory manner. Adopting Release at 16-17.

[8] ISS listed the following factors: (1) the company's stated rationale for adopting such a provision; (2) disclosure of past harm from duplicative shareholder lawsuits in more than one forum; (3) the breadth of application of the charter or bylaw provision, including the types of lawsuits to which it would apply and the definition of key terms; and (4) governance features such as shareholders' ability to repeal the provision at a later date (including the vote standard applied when shareholders attempt to amend the charter or bylaws) and their ability to hold directors accountable through annual director elections and a majority vote standard in uncontested elections. Adopting Release at 20.

[9] Adopting Release at 24.

[10] Adopting Release at 25.

[11] Adopting Release at 23-24.



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