CLIENT ALERT: Institutional Shareholder Services Releases Updated Voting Guidelines on Various Topics Relevant to Shareholder Activism

CLIENT ALERT | 11.2020

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Institutional Shareholder Services ("ISS"), the leading proxy voting advisory firm, recently released its 2021 proxy voting guidelines updates for the U.S. and other jurisdictions (effective for meetings on or after February 1, 2021) following its annual global benchmark policy survey and comment period that ran from July 29, 2020 to October 26, 2020. ISS addressed various topics in its updated guidelines, which included additions and revisions that are relevant to shareholder activism in the U.S. and are the focus of this client alert.

U.S. Guideline Relating to Racial / Ethnic Diversity on Boards *(See New Guideline in Annex A - click here)*

ISS adopted a new voting policy that will address boards lacking racial and ethnic diversity. In 2021, ISS will highlight boards of Russell 3000 and S&P 1500 companies that lack racial and ethnic diversity with the objective of "helping investors identify companies with which they may wish to engage and to foster dialogue between investors and companies on this topic." ISS will not use any board's lack of racial or ethnic diversity as a factor in its vote recommendations on the election of directors in 2021. However, effective for meetings on or after February 1, 2022, ISS will generally recommend voting against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) for Russell 3000 and S&P 1500 companies where the board has "no apparent racially or ethnically diverse members." ISS will make an exception to this policy if, at the prior annual meeting, racial or ethnic diversity was present on the board and the board makes a firm commitment to appoint at least one racially and/or ethnically diverse director within one year.

U.S. Guideline Relating to Gender Diversity on Boards *(See Guideline Comparison in Annex B - click here)*

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ISS' existing guideline in this area provided that ISS will generally recommend voting against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at Russell 3000 and S&P 1500 companies where there are no women on the board, subject to mitigating factors, including, (i) at any time during a one year transitional period ending February 1, 2021, a firm commitment by the board to appoint at least one woman to the board within one year, (ii) the presence of a woman on the board at the prior annual meeting and a firm commitment to appoint at least one woman to the board within one year, or (iii) other relevant mitigating factors.

Given the ending of the one year transitional period, this guideline has been updated to remove the mitigating factor under clause (i) and, beginning February 1, 2021, the only exception to an adverse vote recommendation for a company that fails to have a woman on the board will be if there was a woman on the board at the prior annual meeting and the board commits to "return to a gender-diverse status" within one year.

U.S. Guideline Relating to Poison Pills *(See Guideline Comparison in Annex C - click here)*

ISS' existing guideline on poison pills provides that ISS will recommend voting against or withhold from all nominees (except new nominees, who will be considered on a case-by-case basis) if the company has a poison pill that was not approved by the shareholders. However, ISS will vote case-by-case on nominees if the board adopts an initial poison pill with a term of one year or less, depending on the disclosed rationale for the pill's adoption and other relevant factors. Under the existing guideline, ISS will also make an adverse vote recommendation if the board makes a material adverse modification to an existing pill.

This guideline has been updated to provide that ISS will also make an adverse vote recommendation if the pill has a "deadhand" or "slowhand" provision, which entrenchment provisions began to find their way back into new short-term pills adopted during the COVID-19 pandemic. ISS' explanation of what constitutes a "deadhand" and "slowhand" provision is set forth in Annex C. ISS' aversion to these provisions and reasons for explicitly referring to them in the guideline are discussed in the commentary to the policy update: "The adoption of a device like a deadhand poison pill or its variants (such as slowhand pills) is unjustifiable from a governance standpoint, as it is explicitly intended to thwart the will of shareholders in situations where they vote to replace the board in order to enable an offer to proceed. The policy for unilateral (without a shareholder vote) adoptions of pills is thus being updated to bring back the explicit referral to deadhand/slowhand features."

U.S. Guideline Relating to Advance Notice Requirements for Shareholder Proposals / Nominations *(See Guideline Comparison in Annex D - click here)*

ISS currently has a guideline providing that it will vote on a case-by-case basis on management advance notice proposals and support those proposals that allow shareholders to submit business proposals and nominations "as close to the meeting date as reasonably possible and within the broadest window possible . . ." Under the existing guideline, to be reasonable, the deadline for such business proposal or nomination could not be more than 60 days prior to the meeting, with a submittal window of at least 30 days prior to the deadline.

ISS has updated this guideline to deem reasonable a notice deadline of no earlier than 120 days prior to the anniversary of the prior year's meeting and a submittal window of no shorter than 30 days from the beginning of the notice period. ISS revised the guideline to reflect these timing parameters, which have become more common in the governing documents of U.S. companies in recent years. According to ISS, "This policy change recognizes the balance needed between allowing shareholder submissions sufficiently close to the meeting to account for developing issues, and still allowing sufficient time for shareholders to evaluate and vote the items on all the agenda items in the proxy."

U.S. Guideline Relating to Virtual Shareholder Meetings ***(See New Guideline in Annex E - click here)***

In light of the widespread use of virtual meetings during the COVID-19 pandemic and that such meetings "are being considered by more companies for future meetings," ISS adopted a new guideline providing that it will generally vote for company proposals permitting the convening of shareholder meetings by electronic means as long as they do not prohibit in-person meetings. ISS will vote on a case-by-case basis on shareholder proposals concerning virtual-only meetings after considering (i) the scope and rationale of the proposal, and (ii) concerns identified with management's prior meeting practices. Acknowledging concerns that virtual-only meetings could be abused by companies to the detriment of shareholders, ISS will now encourage companies to disclose the circumstances under which virtual-only meetings would be held and "allow for comparable rights and opportunities for shareholders to participate electronically as they would have during an in-person meeting."

U.S. Guideline Relating to Governance Failures – Environmental & Social Risk Oversight ***(See Guideline Comparison in Annex F - click here)***

ISS updated its guideline regarding director accountability for material failures of governance to include an explicit reference to poor risk oversight relating to environmental and social issues as examples of material failures that may cause ISS to issue an adverse voting recommendation. Under the current guideline, ISS will under extraordinary circumstances recommend voting against or withhold from directors, committee members or the entire board due to (i) material failures of governance, stewardship, risk oversight or fiduciary duties, (ii) failure to replace management when appropriate, or (iii) egregious actions relating to a board member's service on outside boards that "raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company."

This guideline has been updated to explicitly provide that an example of a "risk oversight" failure referenced in clause (i) includes "demonstrably poor risk oversight of environmental and social issues, including climate change."

U.S. Guideline Relating to Closed-End Funds – Opt-In to Control Share Acquisition Statutes ***(See New Guideline in Annex G - click here)***

ISS adopted a new guideline applicable to closed-end funds ("CEFs") that unilaterally opt-in to control share acquisition statutes. Control share acquisition statutes are anti-takeover provisions contained in the corporation laws of certain states that deny voting rights of shares of the corporation acquired by a shareholder within specified ownership ranges (e.g., with thresholds of 10%, 33 1/3% or majority under the Maryland Control Share Acquisition Act) unless these voting rights are conferred by a special shareholder vote of a specified percentage of the outstanding shares held by the other shareholders.

ISS' new guideline provides that it will recommend voting against or withhold from the nominating/governance committee members (or other directors on a case-by-case basis) at CEFs that "have not provided a compelling rationale for opting-in to a Control Share Acquisition statute, nor submitted a by-law amendment to a shareholder vote." ISS adopted this guideline in light of the SEC Division of Investment Management's reversal in May of its longstanding position in a no-action letter, known as the Boulder Letter, that allowing a CEF to opt-in to Maryland's control share acquisition statute would be inconsistent with the requirement under Section 18(i) of the Investment Company Act of 1940 that every share of stock issued by a registered management company "shall be a voting stock and have equal voting rights with every other outstanding voting stock." In its rationale for adopting this guideline, ISS states that because the Staff of the Division of Investment Management may no longer recommend enforcement action against a CEF for opting-in to a control share acquisition statute due to the reversal of the Boulder Letter, "CEF shareholders are denied important voting rights and are subject to management entrenchment."

Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you would like to discuss further or have questions.