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Meridian Client Update

ISS Issues Final Policy Updates for 2021

On November 12, 2020, Institutional Shareholder Services (ISS) issued final policy updates on selected environmental and social issues and board diversity.

ISS has modified its proxy voting policies for U.S.-listed companies in the following respects:

- Adoption of a revised policy on director accountability for significant risk oversight failures related to environmental and social issues (effective for meetings held on or after February 1, 2021), and
- Adoption of a new policy on racial and ethnic diversity of corporate boards (effective for meetings held on or after February 1, 2022).

On November 2, 2020, ISS announced that starting in 2021, ISS **will not** provide S&P 500 companies the opportunity to review their draft ISS report before publication.

Director Accountability for Risk Oversight Failures Related to Environmental and Social Issues

Current Policy

Under extraordinary circumstances, ISS will recommend a vote AGAINST or WITHHOLD from directors individually, committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

The current policy includes a non-exhaustive list of examples of "risk oversight" that may lead to an ISS negative vote recommendation on incumbent board members. Risk oversight failures related to environmental and social concerns do **not** impact ISS's vote recommendations under its current policy.

New Policy

ISS has revised the non-exhaustive list of examples of "risk oversight" that may lead to an ISS negative vote recommendation on incumbent board members. ISS had added to the list of examples a board's "demonstrably poor risk oversight of environmental and social issues." However, ISS does not define or identify environmental and social risks, other than climate-related risks, that fall within the scope of the revised policy.

Meridian Comment. ISS expects the revised policy will impact its vote recommendations on a small number of directors each year. The revised policy allows ISS to evaluate whether corporate boards have prepared for *foreseeable future* environmental and social risks. Compliance with the revised policy may prove problematic for some companies given the absence of guidance on the scope and nature of environmental and social risks that fall under the revised policy.

Board Racial and Ethnic Diversity

Current Policy

Under its current proxy voting guidelines, ISS has adopted a principle that a board “should be sufficiently diverse to ensure consideration of a wide range of perspectives.” However, ISS does not identify an individual director’s identified racial and ethnic identity in its proxy research report, and ISS does not use the lack of racial/ethnic gender diversity as a factor in its vote recommendations on directors or on any other matter.

New Policy

Effective for the **2022 proxy season** (i.e., meetings held on or after February 1, 2022), ISS will generally recommend AGAINST the nominating committee chair (or other directors on a case-by-case basis) if a company does not have any apparent racial or ethnic minorities serving on its board of directors, absent mitigating factors. This policy is applicable to component companies of the Russell 3000 and S&P 1500 indices. 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 racial and/or ethnic diverse member within a year.

In 2021, ISS proxy research reports on U.S. companies will highlight boards that lack racial and ethnic diversity (or lack disclosure of such information) to help investors identify companies with which to engage on this topic. However, the lack of racial and ethnic diversity **will not** be a factor in ISS vote recommendations on directors in 2021.

Meridian Comment. The ISS policy on board racial and ethnic diversity could impact its vote recommendations on a significant number of directors when phased in starting in 2022.

The ISS policy on board racial and ethnic diversity is aligned with broad investor interest in seeing racial and/or ethnic diversity on boards. In response to ISS Annual Policy Survey, 61% of investors indicated that boards should aim to reflect a company’s customer base and the broader societies in which they operate by including directors drawn from racial and ethnic minority groups. ISS notes that investors cited equality and good governance as reasons for the need for racial/ethnic diversity on boards. We expect that investor concerns and investor engagement on this issue will lead to (1) changes in board composition to be more inclusive of racial and ethnic minorities and (2) enhancements in company disclosure practices on demographic characteristics of individual directors.

It unclear whether ISS will solely rely on a company’s proxy statement to determine a board’s racial and ethnic composition. In September 2020, [ISS announced](#) that ISS ESG, its responsible investment division, had developed data solutions to include racial and ethnic characteristics of senior leaders at more than 6,000 U.S. companies. On an individual basis, data coverage includes more than 33,000 directors and 6,800 named executive officers.

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