
ISS Launches Open Comment Period for Potential 2023 Policy Updates and Announces New Governance QualityScore Factors

As part of its annual policy review and update process, ISS has issued draft 2023 policy updates for comment until November 16. U.S. companies should be aware of ISS' draft updates to climate accountability, problematic governance structures, board gender diversity and political activities, among others.

The open comment period runs until 5:00 p.m. ET on November 16. As in the past, the proposed policy changes do not cover all potential changes under consideration by ISS. The final policy often contains additional changes from the draft policy. We can expect ISS to publish FAQs in December or in the new year as a supplement to any new or existing policy guidelines.

Full details of the proposed changes can be accessed on the ISS [website](#). Comments should be submitted to ISS directly at policy@issgovernance.com.

Key topics relevant to U.S. companies include:

Climate Board Accountability for High-Emissions Companies (Global)

In the US, ISS' climate board accountability policy that went into effect in 2022 is being refined for 2023 to potentially apply to cases where a U.S. company is not considered to be adequately disclosing climate risk disclosure information such as:

- Disclosures in alignment with the Task Force on Climate-Related Financial Disclosures (TCFD), and
- The presence of publicly disclosed medium-term or net-zero greenhouse gas emission reduction targets by 2050 for scope 1 and 2 emissions.

The potential consequence if a company's disclosures are inadequate is that ISS will generally recommend that shareholders vote against the director nominees most responsible for climate risk oversight. ISS states that the emission reduction targets should cover 95 percent or more of a company's scope 1 and 2 emissions. This policy will continue to apply to high-emissions companies identified by the Climate Action 100+ focus [list](#) with each company implementing it differently based on market and company-specific factors. Additional data points and information will be included in ISS research reports for Climate Action 100+ companies.

Unequal Voting Rights

ISS is proposing multiple changes to its years-long recommendation against the full board at newly public companies that maintain multiple classes of common stock with unequal voting rights or that have a supermajority vote requirement to amend the charter or bylaws or approve a merger.

In 2022, ISS announced it will issue negative recommendations starting in 2023 at any company with unequal voting rights, not just newly public companies. There will be a new *de minimis* exception if the class of stock with superior voting rights holds less than 5 percent of the company's overall voting

power. Other exceptions that carry over from the existing policy include the presence of a provision sunsetting the unequal voting rights within seven years of going public, a regular binding proposal on whether the equity structure should be maintained or not, and certain equity structures specific to limited partnerships and real estate investment trusts.

Notably, ISS is seeking comment on whether it should continue to recommend against the full board or focus its actions more narrowly on governance committee members and any directors who own a controlling stake in the company. This potential change reflects not only the significant increase in the number and size of companies that would be subject to the policy in 2023, but also ISS' hesitation to automatically recommend against every director at these companies every year.

Classified Boards and Supermajority Vote Requirements

As with its unequal voting rights policy, ISS seeks comment now on whether it should continue to recommend against the full board or instead target just the governance committee members where a classified board, supermajority vote requirement or other problematic governance structure exists.

Furthermore, ISS proposes two clarifying amendments to its problematic governance policy. Based on investor and corporate responses to this summer's policy survey, ISS is clarifying that an acceptable sunset provision for a classified board, supermajority vote requirement or other problematic vote provision is seven years or less from the time the company went public. In the case of classified boards, ISS will expect the board to be fully declassified within seven years. For clarification, a newly public company is one that held its first annual shareholder meeting after February 1, 2015.

Board Gender Diversity

ISS currently recommends against the nominating committee chair at any company in the Russell 3000 or S&P 1500 index that does not have at least one female director. For 2023, this policy would extend to all U.S. companies reviewed by ISS, including smaller companies not included in these indexes and foreign private issuers listed on a U.S. exchange.

There is an exception for companies that had a female director on the board at the last annual shareholder meeting and that commit to adding a female director within one year.

Exculpation Provisions

This summer, the Delaware General Corporation Law was amended to permit companies to exculpate officers who violate their fiduciary duty of care. Exculpation provisions limit or eliminate the personal liability of a director or officer for a breach of a fiduciary duty. ISS proposes to generally support proposals providing for exculpation provisions in a charter to the extent permitted by state law.

Share Issuances by Certain Foreign-Incorporated Companies

Companies organized in certain countries are required by the laws of their country to seek shareholder approval for all share issuances, which gives rise to blanket proposals to authorize all share issuances through the next shareholder meeting. Some of these foreign companies are listed solely on U.S. exchanges, and ISS' U.S. policies did not adequately address these proposals. As a result, ISS proposes a 2023 policy that would support share issuance proposals of up to 20 percent of outstanding shares at foreign-incorporated companies that are solely listed on a U.S. exchange.

Shareholder Proposals on Political Expenditures and Disclosures

In response to the increasing number of shareholder proposals concerning the congruency of a company's political contributions and its public commitments, ISS is establishing a new case-by-case policy that would consider the strength of a company's political activities disclosure, the nature and severity of any identified incongruencies between its expenditures and its stated values and priorities and the presence of any recent significant controversies relating to political activities, contributions, or lobbying. This policy codifies its existing approach to these proposals.

ISS Changes Its Governance QualityScore Ratings

On October 31, ISS announced the release of Q4 2022 methodology updates to its Governance QualityScore ratings. Governance QualityScore reflects a company's governance risk relative to index and region without regard to industry. According to ISS, the recent methodology updates mark the "most extensive" QualityScore update to date.

The methodology enhancements to Governance QualityScore that affect US companies feature the introduction of 23 new factors. Following a proxy season where shareholder activists submitted a record-breaking number of shareholder proposals, the Governance QualityScore updates tend to be in line with financial regulator and institutional policy development. The newly released updates coincide with factors that stakeholders have prioritized, including board oversight, pledging, information security, human capital management, and director skills and diversity.

Notable 2022 Q4 Updates to Governance QualityScore

ISS is adding a wide range of factors, some of which will be scored immediately – most notably the factors relating to pledging and the diversity of board leadership – but most of the new factors will be unscored in their first year, including:

- *Director and Executive Pledging* - assess companies' existing pledging policies and the actual shares pledged by directors and executives expressed as a percentage of the company's outstanding shares and in aggregate value (these factors will all be scored).
- *Diversity, Equity, and Inclusion* - expand existing assessments of companies' diversity, equity, and inclusion profile by evaluating whether there are ethnically diverse leaders on the board (scored) and LGBTQ+ directors (unscored).
- *Compensation* - assess companies' outcomes on the quantitative pay-for-performance screening that ISS conducts on CEO pay (one scored factor, several unscored factors).
- *Information Security* - assess companies' third-party information security risks and breaches, support levels for information security-related shareholder proposals, and the disclosure level of information security-related performance measures in executive compensation plans (all unscored).
- *Director Skills* - assess companies' level of director skills pertaining to climate, diversity, equity, and inclusion, and other selected skills (all unscored).
- *Emerging Risk Oversight* - assess companies' emerging risk oversight by evaluating the independence of committees responsible for climate, human capital management, health and safety, and succession (all unscored).

Effective Dates

As with past ISS Governance QualityScore updates, the data verification period for 2022 is approximately two weeks long and concludes on November 23. After this period closes and the updated methodology goes into effect, the general verification window will reopen and will remain open throughout the year for all covered U.S. companies. Issuers will have access to ISS' data verification tool year round with the exception of the period between the filing of the company's definitive proxy statement and the publication of the ISS proxy advisory report for the annual meeting.

Next Steps

With respect to draft 2023 policy updates, ISS is seeking feedback as to whether respondents support the proposed changes or not. The proxy advisory firm is using this period to determine if there are any concerns or mitigating factors that arise that ISS should consider when evaluating these matters before issuing a negative vote recommendation. Additionally, ISS is seeking feedback on other factors to consider when evaluating the proposed policy changes.

Revised final ISS policies for 2023 are expected to be announced toward the end of November and will become effective for shareholder meetings taking place on or after February 1, 2023.

With respect to the changes to ISS Governance QualityScore, companies can preview and verify the data ISS has collected for all new factors between now and November 23 and any time after the new methodology goes live.

If you have questions about proposed policy updates and their impact on the 2023 annual meeting cycle or your ESG ratings, governance best practices, how QualityScore changes impact you or other related matters, including submissions in respect of the ISS proposals, please reach out to us at humancapital@aon.com.

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