

## ISS 2023 Policy Updates

The UK and Europe

2 December 2022

### Introduction

ISS ran its 2022 Global Benchmark Policy Survey from 3 August 2022 to 13 August 2022 and, on 10 October 2022, released the results<sup>1</sup> of this survey. Between 4 November 2022 and 16 November 2022 ISS made available for public comment a number of proposed changes<sup>2</sup> to ISS's benchmark voting policies for 2023. Finally, on 1 December 2022, ISS announced their policy updates for the 2023 AGM season<sup>3</sup>.

The updates will be effective from 1 February 2023 and apply to all shareholder meetings thereafter. The below memo summarizes the policy changes that will be applied across UK & Ireland and Continental Europe.

The most important changes applicable to large-cap companies across the UK & Europe fall under the following categories:

### Global

#### Board of directors

- > Climate accountability

### UK & Ireland

#### Board of directors

- > Board gender and ethnic diversity
- > Frequency of audit committee meetings

#### Remuneration

- > Salary increases

#### Shareholder rights

- > Authorisation to issue shares without pre-emptive rights

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<sup>1</sup> <https://www.issgovernance.com/file/policy/2022/2022-ISS-Benchmark-Survey-Summary.pdf>

<sup>2</sup> <https://www.issgovernance.com/file/policy/2022/2023-Benchmark-Policy-Changes-For-Comment.pdf>

<sup>3</sup> <https://insights.issgovernance.com/posts/iss-announces-2023-benchmark-policy-updates/>

## Continental Europe

### Board of directors

- > Composition of committees
- > Unequal voting rights

### Remuneration

- > Guidelines for Policy and Report

### Shareholder rights

- > Hybrid and Virtual Shareholder Meetings

## Global

### Climate Board Accountability

ISS is extending the framework for all applicable markets and updating the factors considered under the new policy. The general policy states that *“for companies that are significant greenhouse gas (GHG) emitters, through their operations or value chain [those on the current Climate Action 100+ Focus Group list], generally vote against the board chair in cases where ISS determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy.*

*Minimum steps to understand and mitigate those risks are considered to be the following. Both minimum criteria will be required to be in alignment with the policy:*

- > *Detailed disclosure of climate-related risks, such as according to the framework established by the Task Force on Climate-related Financial Disclosures (TCFD), including:*
  - o *Board governance measures;*
  - o *Corporate strategy;*
  - o *Risk management analyses; and*
  - o *Metrics and targets.*
- > *Appropriate GHG emissions reduction targets.*

*At this time, “appropriate GHG emissions reductions targets” will be medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets for a company's operations (Scope 1) and electricity use (Scope 2). Targets should cover the vast majority of the company’s direct emissions”.*

## UK & Ireland

### Board Gender and Ethnic Diversity

Last year’s changes on Board diversity are now applicable also for companies with financial years beginning on or after 1 April 2022. Specifically, ISS *“may consider recommending against the chair of the nomination committee (or other directors on a case-by-case basis) if the company has not met the reporting requirements of the FCA Listing Rules [at least 40% of the board are women and at least one of the senior board positions is a woman]. In respect of ISEQ 20 constituents and AIM-listed companies with a market capitalisation of over GBP 500 million, ISS will generally recommend against the chair of the nomination committee (or other directors on a case-by-case basis) if there is not at least one woman on the board.”*

Similarly, regarding Board Ethnic Diversity, for companies with financial years beginning on or after 1 April 2022, the following guideline will apply: *“For standard and premium listed companies, ISS may consider*

*recommending against the chair of the nomination committee (or other directors on a case-by-case basis) if the company has not met the relevant reporting requirement of the FCA Listing Rules, which require boards to confirm that at least one member of the board is from a minority ethnic background. [...] In respect of ISEQ 20 constituents and AIM-listed companies with a market capitalisation of over GBP 500 million, ISS will generally recommend against the chair of the nomination committee (or other directors on a case-by-case basis) if such companies have not appointed at least one individual from an ethnic minority background to the board by 2024.'*

In both cases, ISS considers the following mitigating factors: "1) Compliance with the relevant board diversity standard at the preceding AGM and a firm commitment, publicly available, to comply with the relevant standard within a year; and, 2) Other relevant factors as applicable."

## Frequency of Audit Committee Meetings

For FTSE 350 companies, ISS will note where four or fewer audit committee meetings have been held during the reporting period. For FTSE All-Share companies, excluding investment companies, ISS will draw attention to cases where three meetings, or fewer, of the Audit Committee have been held.

## Remuneration – Salary Increases

ISS has clarified that *"the wording of the existing ISS UK and Ireland policy on remuneration may have been misunderstood as encouraging companies to increase directors' base salaries proportionally in line with increases made to the wider company workforce, the language is being modified to clarify that keeping directors' annual salary increases low and ideally lower proportionally than general increases across the broader workforce is considered to be good market practice."*

## Authorisation to Issue Shares Without Pre-Emptive Rights

ISS has adopted the new Pre-emption Group guidance<sup>4</sup> as standard. We note that the new ISS provision appears to be significantly more generous than the UK & European guidelines of many leading institutional investors (and compared to ISS's guidelines in Continental Europe). This may be an area where investors take a stricter approach than ISS.

ISS will not recommend in favour of a resolution if *"the routine authority to disapply pre-emption rights exceeds 20 percent [up from 10%] of the issued share capital, provided that any amount above 10 percent [up from 5%] is to be used for the purposes of an acquisition or a specified capital investment. For the general disapplication authority and specific disapplication authority, a further disapplication of up to 2 percent may be used for each authority for the purposes of a follow-on offer"*. ISS also states that it is good practice for the authorities to last no more than 15 months or until the next AGM, whichever is the shorter period.

## Continental Europe

### Unequal Voting Rights

ISS has introduced a new policy on unequal voting rights structures for Continental Europe companies. After a one-year grace period and starting with meetings in February 2024, ISS will *"generally vote against directors or against the discharge of (non-executive) directors, if the company employs a stock structure with unequal voting rights. Vote recommendations will generally be directed against the nominees primarily responsible for, or benefiting from, the unequal vote structure."*

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<sup>4</sup> <https://www.frc.org.uk/news/november-2022/peg-issues-statement-of-principles-following-secon>

*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;*
- > *Situations where the unequal voting rights are considered de minimis [distortion between voting and economic power does not exceed 10 percent]; or*
- > *The company provides sufficient protections for minority shareholders.”*

## Composition of Committees

Under the new policy, ISS will recommend *“against the (re)election of any non-independent members of the remuneration and/or audit committee if fewer than 50 percent of the committee members, who are elected by shareholders in such capacity or another - excluding, where relevant, employee shareholder representatives – would be independent.”* This change harmonizes the approach to board elections in markets that legally require employee representatives on their boards.

## Remuneration Guidelines

ISS's Continental European voting guidelines have been adapted to and reflect the European legal framework on remuneration-related proposals. With the implementation of the SRD II across all EU member states, EU companies must submit their remuneration policy and their remuneration report to shareholder vote. Accordingly, two sets of guidelines are established, one on remuneration policy and one on the remuneration report, mirroring the UK & Ireland benchmark voting policy. The guidelines have therefore been rearranged and updated without being substantially amended.

## Hybrid and Virtual Shareholder Meetings

Based on the results of its survey, as well as feedback from investors at ISS policy roundtables in Europe, investor concerns remain about the use of virtual-only meetings. Therefore, the new ISS policy for proposals that would allow companies to hold virtual-only shareholder meetings will be to recommend on a case-by-case basis, taking into consideration:

- > *“Whether the company has committed to ensuring shareholders will have the same rights participating electronically as they would have for an in-person meeting;*
- > *Rationale of the circumstances under which virtual-only meetings would be held;*
- > *In-person or hybrid meetings are not precluded;*
- > *Whether an authorization is restricted in time or allows for the possibility of virtual-only meetings indefinitely; and*
- > *Local laws and regulations concerning the convening of virtual meetings.”*