

Potential Effects of ISS' New Board Diversity Voting Policy in the U.S.

This year, Institutional Shareholder Services began adding a new element to its analysis of proxy vote recommendations for public companies in the U.S. that considers the racial and ethnic composition of a board.

During the 2021 proxy season, Institutional Shareholder Services (ISS), one of the largest and most influential proxy advisory firms, began including board diversity in its analyses of proxy vote recommendations at United States (U.S.) companies.

Similar to its process with factoring gender diversity when recommending the re-election of board members, ISS began the process this year of adopting racial and ethnic diversity criteria.¹ For many companies, ISS indicated that its in-house dataset showed a lack of racial and ethnic diversity on the board of directors. In those cases, ISS' proxy voting advisory report included a warning of potential adverse vote recommendations in the 2022 proxy season cycle. In most cases, the director facing a potential adverse recommendation would be the incumbent chair of the nominating committee, ISS said.

ISS says adverse vote recommendations would be triggered for boards with either no disclosed racial or ethnic diversity on the board or no disclosed gender diversity (e.g., no female directors). The proxy firm said it may make exceptions in special cases, such as when the departure of a woman director from a board results in an all-male board, and the board clearly indicates a firm commitment to appoint another woman within a year.

Verify Data Collection and Proactively Disclose Diversity

Data collection underlying ISS' 2022 vote recommendations may contain irregular or incorrect datapoints regarding the racial and ethnic identity of individual directors. That's because ISS data on director diversity is largely unverified by companies and directors; designations are often based on analysts' subjective judgement of images of directors available online.

Therefore, we recommend that all public companies — even companies with boards currently thought to be sufficiently diverse — carefully examine the written analysis of director elections in their 2021 ISS report to determine whether it includes any indication of a lack of racial or ethnic diversity on the board.

¹ ISS, *Americas Proxy Voting Guidelines Updates for 2021: Benchmark Policy Changes for U.S., Canada, and Latin America*, pages 5-9 <https://www.issgovernance.com/file/policy/active/updates/Americas-Policy-Updates.pdf>

Additional concerns may arise in harmonizing ISS' definitions of diversity with those of other entities. For example, California identifies LGBTQ+ directors as diverse², while ISS does not. Meanwhile, NASDAQ does not consider directors of Middle Eastern descent as racially or ethnically diverse³ but ISS does⁴.

Companies may wish to consider including in their proxy statement a Board Diversity Matrix to clearly indicate the level of gender and racial/ethnic diversity of the board of directors. Firms may also consider providing language around composite board diversity percentages without publicly identifying individual directors.

Be Mindful of Overboarding

As board diversity becomes increasingly important for U.S. companies, individual directors who add to the racial or gender diversity of boards may be invited to serve on an increasing number of boards. As an unintended consequence, some directors may be at increased risk of overboarding if additional board service leads to what ISS deems an excessive number of mandates at public companies. Thus, the coming months may prompt balancing acts as nominating and governance committees endeavor to maintain diverse and highly qualified boards of directors.

For more information about governance topics and how we advise boards of directors, please visit our [Future-Ready Boardroom hub](#).

² David A. Bell et al., "New Law Requires Diversity on Boards of California-Based Companies"

<https://corpgov.law.harvard.edu/2020/10/10/new-law-requires-diversity-on-boards-of-california-based-companies/>

³ SR-NASDAQ-2020-081 Amendment 1, p. 327 https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081_Amendment_1.pdf

⁴ ISS, "United States Policies & Procedures (Non-Compensation): Frequently Asked Questions" p 21-22 <https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf>

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