

# ISS to consider racial and ethnic diversity in making voting recommendations

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Board diversity (gender, racial and ethnic), climate accountability, deferred share unit plans and venture-issuer overboarding are the focus of updates to Institutional Shareholder Services’ (ISS) [Proxy Voting Guidelines](#) (the Guidelines) for the 2023 proxy season.

## Takeaways

- ISS expects women to comprise at least 30 per cent of the board for S&P/TSX Composite Index constituents. Other boards expected to have at least one woman.
- Beginning in 2024, ISS will expect issuers to have at least one racially or ethnically diverse member.
- Significant greenhouse gas (GHG) emitters will have to provide detailed disclosure of their climate-related risks and adopt GHG reduction targets to avoid a negative recommendation against the chair of a committee responsible for climate-related risks.

## Board diversity remains a focus

### Gender diversity

While eight years have passed since the implementation of reporting obligations with respect to board gender diversity for non-venture issuers in Canada, ISS reports that the topic remains a “high-profile governance issue in the Canadian market”. As a result, ISS has once again tweaked its voting policies with respect to women on boards and, beginning on **February 1, 2023**, will generally recommend a withhold vote against the Chair of the Nominating Committee (or a similarly tasked committee) under the following circumstances:

Issuer Type	ISS Expected Representation	Factors to Mitigate a Negative Recommendation
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S&P/TSX Composite Index Constituents	<b>30% women</b>	Publicly disclosed written commitment to achieve 30% women on the board at or prior to next AGM <i>and</i>		
		New S&P/TSX Composite Index constituent never subject to a 30% requirement	<i>or</i>	Issuer has fallen below 30% due to extraordinary circumstances
Other TSX Issuers	<b>At least one woman</b>	New public listing within the current or prior fiscal year <i>or</i> Transition from the TSXV within the current or prior fiscal year <i>or</i> Four or fewer directors <i>or</i>		
		Publicly disclosed written commitment to achieve 30% women on the board prior to next AGM	<i>and</i>	Issuer has fallen below 30% due to extraordinary circumstances

ISS may also consider recommending shareholders vote withhold from additional directors where the above expectations are not met over two years or more.

### Racial and ethnic board diversity

Since 2020, CBCA-incorporated “distributing issuers” in Canada (CBCA Pubcos) have been required to report on board diversity, including diversity beyond gender. In its [2021 annual report on the Diversity of Boards of Directors and Senior Management of Federal Distributing Corporations](#), the Government of Canada notes that only 23 per cent of CBCA Pubcos reported having at least one member of a visible minority on its board of directors (51 per cent reporting having none and 26 per cent did not disclose) and only 2 per cent reported having one Indigenous person on the board (72 per cent reported having none and 26 per cent did not disclose). In addition, it was found that only 7 per cent (4 per cent in 2020) of board seats at CBCA Pubcos were held by visible minorities and 0.4 per cent by Indigenous peoples (0.3 per cent in 2020).

Unsurprisingly, during its Canadian policy roundtable discussions, ISS found that **investors want boards to reflect issuers’ customer base and the society in which they operate**. Investors also support fulsome disclosure about racial and ethnic diversity at the board level.

To address these goals, beginning with meetings on or after **February 1, 2024**, ISS will expect S&P/TSX Composite Index constituents to have **at least one racially or ethnically diverse board member** in addition to satisfying ISS’ gender diversity expectations. Where an issuer does not meet ISS’ expectation, ISS will generally

recommend voting against or withholding from the Chair of the Nominating Committee (or similarly tasked committee) unless there was racial and/or ethnic diversity on the board in the prior year and the board publicly commits to appointing at least one racially and/or ethnically diverse member at or prior to the issuer's next annual general meeting. Where an issuer has failed to meet ISS' diversity expectations over two or more years, ISS will evaluate whether negative voting recommendations are warranted against additional board members. For the purposes of this new policy, ISS defines racial and/or ethnic diversity to include Aboriginal peoples (Indigenous, Inuit or Métis) and members of visible minorities (persons other than Aboriginal peoples who are non-Caucasian in race or non-white in colour).

## The environment and climate change cannot be ignored

### Climate accountability

Expanding on a policy that was implemented in certain non-Canadian jurisdictions in 2022, in the 2023 proxy season ISS will begin to make voting recommendations in **Canada based on issuers' actions with respect to climate change**. More specifically, for issuers that are considered to be significant greenhouse gas (GHG) emitters, as set out in the current [Climate Action 100+ Focus Group](#), ISS will recommend votes against or withhold from the chair of the responsible committee where the following steps to understand, assess and mitigate risks related to climate change to the company and the larger economy have not been taken:

- **Detailed disclosure** of climate-related risks, including board governance measures, corporate strategy, risk management analysis, and metrics and targets. Disclosure that complies with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations should satisfy this expectation; and
- Appropriate **GHG emissions reduction targets**, being the 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). Such targets are expected to apply to the "vast majority" of the company's direct emissions.

In support of this new voting policy, ISS will also include additional data and information in their research reports for Climate Action 100+ Focus Group companies.

## Director compensation and commitments will also be considered

### Non-employee director deferred share unit plans

ISS' policy with respect to deferred share unit (DSU) plans is being amended to reflect Canadian market expectations. For both TSX and venture issuers, ISS will recommend in favour of non-employee director (NED) DSU plans if DSUs may only be granted in lieu of cash fees on a non-discretionary, value-for-value basis. Issuers may still adopt DSU plans that allow for discretionary grants provided that:

TSX Issuers	Venture Issuers
<ul style="list-style-type: none"> <li>• Potential dilution (taking into account all other equity-based compensation) is equal to or less than 10% of the outstanding common shares or the shareholder value transfer (SVT) cost of the plan does not exceed the company's allowable cap (if the plan includes a matching or top-up feature);</li> <li>• NED participation is acceptably limited; and</li> <li>• Shareholder approval is required for certain plan amendments (increased number of shares, increased NED participation, and amendment to plan amendment provisions).</li> </ul>	<ul style="list-style-type: none"> <li>• Potential dilution (taking into account all other equity-based compensation) is equal to or less than 10% of the outstanding common shares; and</li> <li>• Average annual burn rate is no more than 5% per year.</li> </ul>

ISS will continue to assess whether a DSU plan is beneficial to shareholders taking into account director share ownership guidelines (TSX issuers only), vesting schedules, compensation mix and other forms of equity-based compensation available to directors.

### Venture issuer overboarding

As previewed in its voting policies from 2022, for the 2023 proxy season, ISS will align its venture issuer overboarding policy with its equivalent TSX policy. As such, ISS will generally recommend a withhold vote for an individual director nominees for venture issuers as follows:

Director Type	Number of Public Company Boards	Voting Recommendation
Non-CEO Director	More than <b>five</b> public company boards	Withhold
Public Company CEO	More than <b>two</b> outside public company boards	Withhold <b>only</b> at their outside boards

In its assessment, ISS will not include a board where it has been publicly-disclosed that the director is stepping down at the next annual meeting. However, ISS will include the new board that the director is joining even if the applicable shareholder meeting where s/he will be elected has yet to occur.

### Next steps

As we head into the 2023 proxy season, we encourage you to contact BLG if you have any questions related to the ISS updates, or for more information on any other corporate governance initiatives.

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