Cooley

ISS Releases Results of 2021 Policy Surveys

October 12, 2021

Background

This alert summarizes the results from ISS's 2021 policy surveys, which were released on October 1, 2021. As we explained **in our previous alert**, ISS collects information each year from institutional shareholders, corporate issuers, corporate directors and other market constituents in the form of a survey to inform its policymaking decisions for the following year. The survey questions are interesting because they provide a first glance into policies that ISS is considering changing or adopting – although of course not all of the questions translate into policy updates, and there are typically policy updates that weren't reflected in the survey.

This year, ISS solicited feedback via its Benchmark Policy Survey and a separate Climate Policy Survey. There were 409 respondents to the Benchmark Policy Survey, including 159 investors and 250 non-investors (consisting mostly of corporate issuers and a smaller number of corporate directors and other market constituents). Approximately one-third of investor respondents held more than $100 billion in assets under management, with about another one-third holding between $10 billion and $100 billion. The Climate Policy Survey had slightly lower participation levels, with 329 total respondents comprised of 164 investors and 165 non-investors.

Compensation-related questions

Mid-cycle changes to long-term incentive plans

In response to a question about the reasonableness of mid-cycle changes to long-term incentives made by companies that continue to incur severe negative impacts from the COVID-19 pandemic, a majority of investors still viewed such changes as problematic. Specifically, 53% of investors responded that such changes should continue to be viewed as a problematic response to the COVID-19 pandemic, while 40% said that such changes may be reasonable. In contrast, 76% of non-investors responded that such changes may be reasonable. Changes to compensation programs attributable to the COVID-19 pandemic are likely to continue to be a source of divergence for companies and investors, and companies should, where possible, provide robust disclosure around any such changes.

ESG metrics in compensation

On the topic of incorporating nonfinancial environmental, social and governance (ESG) related metrics into executive compensation programs, only a small minority of investors (4%) and non-investors (16%) responded that they did **not** believe ESG metrics were appropriate drivers of executive compensation. Among the investors who said that ESG metrics **were** appropriate drivers of executive compensation, a majority agreed that "such metrics should only be used in compensation programs if the metrics selected are specific and measurable, and their associated targets are communicated to the market transparently." Among non-investors who said that ESG metrics were appropriate, a majority agreed that "even ESG-related metrics that are not financially measurable can be an effective way to incentivize positive outcomes that may be important for a company."

CEO pay evaluation timeframe

Investors (85%) and non-investors (67%) agreed that a longer-term perspective of CEO pay would be relevant and helpful for ISS's quantitative pay evaluation, which currently utilizes a one-year timeframe. It would come as no surprise if ISS extended its pay magnitude test to three years for the 2022 proxy season and beyond.

Governance-related questions

IPO governance provisions

As discussed in **our earlier alert**, extension of ISS's IPO governance policy to companies that became public prior to the 2015 policy change would be a major change. Starting in 2015, ISS began recommending against directors of newly public companies with multiclass stock, a classified board, **or** supermajority voting provisions to amend governing documents (or any combination of such provisions) in all director elections until all such provisions are removed.

The results from the survey indicate that investors prefer to hold all companies accountable for what they view as unfavorable governance practices. 94% of investors (and 57% of non-investors!) responded that ISS should revisit the "problematic provisions" and consider issuing adverse recommendations for all companies that maintain these provisions, irrespective of when they went public.With respect to the offending provisions, investors who responded that ISS should revisit its policy ranked multiclass stock structures as the most offensive – 92% said that ISS should revisit and consider no longer granting exceptions for more mature companies – followed by supermajority voting requirements to amend governing documents (86% favored revisiting) and then a classified board (80% favored revisiting).

Treatment of failed shareholder vote to eliminate IPO governance provisions

Unsurprisingly, a majority of non-investors (56%) believed that a single attempt by a company to remove supermajority requirements should be considered sufficient and representative of shareholder votes. However, the most popular answer from investors (45%) was that ISS should continue to issue adverse recommendations **every year** that there's not a management proposal on the ballot to reduce the supermajority vote requirements. Meanwhile, 23% of investors supported ISS continuing to issue negative recommendations as long as such provisions remained in place, and 35% responded that ISS should not continue issuing negative recommendations **if** the company in question has submitted proposals to eliminate supermajority vote requirements in multiple years **or** committed to resubmit such a proposal in future years.

Virtual-only shareholder meetings

The top three problematic practices identified by investors and non-investors were:

1. Management unreasonably curating which and how many questions to answer during the meeting.
2. The inability to ask live questions with no option to submit questions in advance of the meeting.
3. Question-and-answer opportunities being completely omitted, or questions submitted not being answered.

Investors also expressed concerns about the inability of a shareholder proponent to present and explain a shareholder proposal, and about participants being muted and only given the option to watch the meeting. Non-investors were concerned about the inability of shareholders to vote or change their vote during the meeting.

Companies continuing to hold virtual-only meetings should make detailed plans in advance with respect to these issues. Although criticism of virtual meeting practices can occur after a shareholder meeting, the main way to mitigate concerns over virtual meeting practices is to include detailed, transparent disclosure about these and other process-related topics. As COVID-19-related restrictions ease, it may also make sense for some companies to consider a hybrid meeting, where shareholders can attend online or in person.

Racial equity audits

A significant majority of investors (91%) and non-investors (72%) believed that companies could benefit from an independent racial equity audit, at least under certain circumstances. Investors were split, however, between favoring racial equity audits for "most companies" and favoring racial equity audits depending on "company-specific factors including outputs and programs." A majority of non-investors preferred racial equity audits only based on company-specific factors, not for all companies.

SPAC-related questions

Evaluation of SPAC transactions

In response to questions about ISS's case-by-case approach to evaluating SPAC transactions, most investor respondents stated that their organizations do not own SPACs, and most non-investors responded that they have "no opinion" as to whether ISS should continue to evaluate SPAC transactions on a case-by-case basis or to generally recommend voting in favor of such transactions. Of those who did respond , their responses were almost evenly split, with a slight preference for the proposition that SPAC transaction votes should be made on a case-by-case basis, taking into consideration the merits of the target company combination or specific governance concerns (in other words, making no change to the current ISS policy).

Climate-related questions

Climate oversight at companies with a large climate impact

When asked which practices should be expected of companies whose operations, products or services are considered to be strongly contributing to climate change, a majority of investors chose the following:

- Clear and appropriately detailed disclosure of climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets, such as under the Task Force on Climate-Related Financial Disclosures (TCFD) framework (88%).
- Declaration of a long-term ambition to be in line with Paris Agreement goals for operations and supply chain emissions (72%).
- Demonstrated improvement in disclosure and performance, even if not yet in line with peers or Paris Agreement goals (66%).
- Reporting to show that its corporate and trade association lobbying activities are in alignment or not in contradiction with limiting global warming in line with Paris Agreement goals (65%).
- Disclosure of a strategy and capital expenditure program in line with greenhouse gas (GHG) reductions targets that could reasonably be seen to be in line with Paris Agreement goals (63%).
- Targets and emissions reductions that are at least in line with industry peers (55%).
- Setting and disclosing absolute medium-term (through 2035) GHG emissions reductions targets for its operations and supply chain emissions (Scope 1, 2 and 3 targets) that could reasonably be seen to be in line with Paris Agreement goals (54%).

Among non-investors (excluding nonprofits and academics), only two of the listed expectations reached majority support:

- Clear and appropriately detailed disclosure of climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets, such as under the TCFD framework (73%).
- Demonstrated improvement in disclosure and performance, even if not yet in line with peers or Paris Agreement goals (63%).

Say-on-climate

Similar to the results observed in the questions about climate oversight for companies with a large climate impact, investors have much higher expectations around climate transition plans than non-investors. Specifically, a majority of investors responded that each of the following would be a “dealbreaker” in a company’s management-proposed “say-on-climate” transition plan (warranting voting against such a plan):

- A lack of clear and appropriately detailed disclosure of its climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets, such as under the TCFD framework (81%).
- A lack of a long-term ambition to be in line with Paris Agreement goals for its operations and supply chain emissions (Scope 1, 2 and 3 targets) that could reasonably be seen to be in line with Paris Agreement goals (76%).
- A lack of a strategy and capital expenditure program in line with GHG reductions targets that could reasonably be seen to be in line with Paris Agreement goals (63%).
- A lack of reporting showing that its corporate and trade association lobbying activities are in alignment or not in contradiction with limiting global warming in line with Paris Agreement goals (60%).
- A lack of improvement on disclosure and performance, even if it is not yet in line with peers or Paris Agreement goals (58%).
- A lack of targets and emissions reductions at least in line with industry peers (52%).
- A lack of absolute medium-term (through 2035) GHG emissions reductions targets for its operations and supply chain emissions (Scope 1, 2 and 3 targets) that could reasonably be seen to be in line with Paris Agreement goals (50%).

Non-investors, meanwhile, only reached majority consensus on the following issues:

- A lack of clear and appropriately detailed disclosure of its climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets, such as under the TCFD framework (63%).
- A lack of improvement on disclosure and performance, even if it is not yet in line with peers or Paris Agreement goals (52%).

Treatment of high-impact companies in specialty policy

A significant majority of investors (83%) and 69% of non-investors (excluding nonprofits and academics) said that “high-impact companies” (as identified by Climate Action 100+ as being disproportionately responsible for contributing to climate change) should be subject to a more stringent evaluation of additional indicators compared to companies that make a less substantial contribution to climate change.

Net zero initiatives

A significant majority of investors (86%) and 52% of non-investors (excluding nonprofits and academics) responded that ISS’s Climate Policy should assess a company’s alignment with net zero goals. Respondents also indicated which elements should be considered in assessing such alignment, including net zero ambitions, GHG emissions reductions targets and board oversight.

Questions?

If you have any questions about this alert or any ISS policy guidelines, please contact one of the Cooley attorneys listed below. We will continue to keep you apprised of relevant developments.

Key Contacts

Vince Flynn San Diego	vflynn@cooley.com +1 858 550 6119
Dionne A. Thomas San Diego	dthomas@cooley.com +1 858 550 6180