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ISS Releases Surveys for 2022 Policy Updates

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On July 28, 2021, the proxy advisory firm Institutional Shareholder Services ("ISS") opened its Annual Benchmark Policy Survey (available here), covering a broad range of topics relating to non-financial environmental, social and governance ("ESG") performance metrics, racial equity, special purpose acquisition corporations ("SPACs") and more. In addition, noting that climate change "has emerged as one of the highest priority ESG issues" and that "many investors now identify it as a top area of focus for their stewardship activities," this year ISS also launched a separate Climate Policy Survey (available here) focused exclusively on climate-related governance issues.

The Annual Benchmark Policy Survey includes questions regarding the following topics for companies in the U.S. and will inform changes to ISS's benchmark policy for 2022:

- **Non-financial ESG performance metrics.** Citing an "upward trend" of inclusion of non-financial ESG-related metrics in executive compensation programs, a practice ISS notes "appears to have been fortified by the recent pandemic and social unrest," the survey asks whether incorporating such metrics into executive compensation programs is an appropriate way to incentivize executives. The survey then asks which compensation components (long-term incentives, short-term incentives, both, or other) are most appropriate for inclusion of non-financial ESG-related performance metrics.
- **Racial equity audits.** Noting increased shareholder engagement on diversity and racial equity issues in the wake of social unrest following the death of George Floyd and others, the survey asks whether and when companies would benefit from independent racial equity audits (under any set of circumstances, only depending on certain company-specific factors, or not at all). The survey then asks respondents who indicated that a company would benefit depending on company-specific factors which factors would be relevant, including, for example, whether the company has been involved in significant racial and/or ethnic diversity–related controversies or does not provide detailed workforce diversity statistics, such as EEO-1 type data.
- **Virtual-only shareholder meetings.** This year's survey seeks information on the types of practices that should be considered problematic in a virtual-only meeting setting. This question follows a "vast majority" of investor respondents indicating last year that they prefer a hybrid meeting approach absent COVID-19-related health and social restrictions. Among the potentially problematic practices ISS identifies in the survey are: the inability to ask live questions at the meeting; muting of participants during the meeting; the inability of shareholders to change votes at the meeting; advance registration requirements or other unreasonable barriers to registration; preventing shareholder proponents from presenting and explaining a shareholder proposal considered at the meeting; and management unreasonably "curating" questions to avoid addressing difficult topics. The survey also asks what would be an appropriate way for shareholders to voice concerns regarding any such problematic practices, including casting votes "against" the chair of the board or all directors or engaging with the company and/or communicating concerns.

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- **CEO pay quantum and mid-cycle changes to long-term incentive programs.** For companies in the U.S. and Canada, ISS's quantitative pay-for-performance screen currently includes a measure that evaluates one-year CEO pay quantum as a multiple of the median of CEO peers. The survey asks whether this screen should include a longer-term perspective (e.g., three years). The survey also seeks respondents' views on mid-cycle changes to long-term incentive programs for companies incurring long-term negative impacts from the pandemic. ISS noted that such changes were generally viewed by ISS and investors as problematic given the view that long-term incentives should not be adjusted based on short-term market disruptions (i.e., less than one year), but it acknowledged that some industries continue to experience significant negative impacts from the pandemic.
- **Companies with pre-2015 poor governance provisions – multi-class stock, classified board, supermajority vote requirements.** ISS's policy since 2015 has been to recommend votes "against" directors of newly public companies with certain poor governance provisions, including multiple classes of stock with unequal voting rights and without a reasonable sunset, classified board structure, and supermajority vote requirements for amendments to governing documents. Companies that were publicly traded before the 2015 policy change, however, were grandfathered and so are not subject to this policy. The survey asks whether ISS should consider issuing negative voting recommendations on directors at companies maintaining these provisions regardless of when the company went public, and if so, which provisions ISS should revisit and no longer grandfather.
- **Recurring adverse director vote recommendations – supermajority vote requirements.** For newly public companies, ISS currently recommends votes on a case-by-case basis on director nominees where certain adverse governance provisions – including supermajority voting requirements to amend governing documents – are maintained in the years subsequent to the first shareholder meeting. The survey asks whether, if a company has sought shareholder approval to eliminate supermajority vote requirements, but the company's proposal does not receive the requisite level of shareholder support, ISS should continue making recurring adverse director vote recommendations for maintaining the supermajority vote requirements, or whether a single or multiple attempts by the company to remove the supermajority requirement would be sufficient (and if multiple attempts are sufficient, how many).
- **SPAC deal votes.** ISS currently evaluates SPAC transactions on a case-by-case basis, with a main driver being the market price relative to redemption value. ISS notes that the redemption feature of SPACs may be used so long as the SPAC transaction is approved; however, if the transaction is not approved, the public warrants issued in connection with the SPAC will not be exercisable and will be worthless unless sold prior to the termination date. Acknowledging that investors may redeem shares (or sell them on the open market) if they do not like the transaction prospects, and noting that these mechanics may result in little reason for an investor not to support a SPAC transaction, the survey asks whether it makes sense for investors to generally vote in favor of SPAC transactions, irrespective of the merits of the target company combination or any governance concerns. The survey also asks what issues, "dealbreakers," or areas of concern might be reasons for an investor to vote against a SPAC transaction.
- **Proposals with conditional poor governance provisions.** ISS notes that one way companies impose poor governance or structural features on shareholders is by bundling or conditioning the closing of a transaction on the passing of other voting items. This practice is particularly common in the SPAC setting where shareholders are asked to approve a new governing charter (which may include features such as classified board, unequal voting structures, etc.) as a condition to consummation of the transaction. In light of these practices, the survey asks about

the best course of action for a shareholder who supports an underlying transaction where closing the transaction is conditioned on approval of other ballot items containing poor governance.

The Climate Policy Survey includes questions regarding the following topics and will inform changes to both ISS's benchmark policy as well as its specialty climate policy for 2022:

- **Defining climate-related "material governance failures."** The survey seeks input on what climate-related actions (or lack thereof) demonstrate such poor climate change risk management as to constitute a "material governance failure." Specifically, the survey asks what actions at a minimum should be expected of a company whose operations, products or services strongly contribute to climate change. Among the "minimum actions" identified by ISS are: providing clear and appropriately detailed disclosure of climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets, such as that set forth by the Task Force on Climate-Related Financial Disclosure ("TCFD"); declaring a long-term ambition to be in line with Paris Agreement goals for its operations and supply chain emissions (Scopes 1, 2 & 3 targets); setting and disclosing absolute medium-term (through 2035) greenhouse gas ("GHG") emissions reductions targets in line with Paris Agreement goals; and reporting that demonstrates that the company's corporate and trade association lobbying activities align with (or do not contradict) Paris Agreement goals. The survey also asks whether similar minimum expectations are reasonable for companies that are viewed as not contributing as strongly to climate change.
- **Say on Climate.** In 2021, some companies put forward their climate transition plans for a shareholder advisory vote (referred to as "Say on Climate") or committed to doing so in the future. The survey asks whether any of the "minimum actions" (referred to above) could be "dealbreakers" for shareholder support for approval of a management-proposed Say on Climate vote. The survey then asks whether voting on a Say on Climate proposal is the appropriate place to express investor sentiment about the adequacy of a company's climate risk mitigation, or whether votes cast "against" directors would be appropriate in lieu of, or in addition to, Say on Climate votes. Finally, the survey asks when a shareholder proposal requesting a regular Say on Climate vote would warrant support: never (because the company should decide); never (because shareholders should instead vote against directors); case-specific (only if there are gaps in the current climate risk mitigation plan or reporting); or always (even if the board is managing risk effectively, the vote is a way to test efficacy of the company's approach and promote positive dialogue between the company and its shareholders).
- **High-impact companies.** Noting that Climate Action 100+ has identified 167 companies that it views as disproportionately responsible for GHG emissions, the survey asks whether under ISS's specialty climate policy these companies (or a similar list of such companies) should be subject to a more stringent evaluation of indicators compared to other companies that are viewed as having less of an impact on climate change.
- **Net Zero initiatives.** Citing increased investor interest in companies setting a goal of net zero emissions by 2050 consistent with a 1.5°C scenario ("Net Zero"), the survey asks whether the specialty climate policy should assess a company's alignment with Net Zero goals. The survey also asks respondents to rank the importance of a number of elements in indicating a company's alignment with Net Zero goals, including: announcement of a long-term ambition of Net Zero GHG emissions by 2050; long-term targets for reducing its GHG emissions by 2050 on a clearly defined scope of emissions; medium-term targets for reducing its GHG emissions by between 2026 and 2035 on a clearly defined scope of emissions; short-term targets for reducing its emissions up to 2025 on a clearly defined scope of emissions; a disclosed strategy and capital expenditure program in line with

GHG reduction targets in line with Paris Agreement goals; commitment and disclosure showing its corporate and trade association lobbying activities align with Paris Agreement goals; clear board oversight of climate change; disclosure showing the company considers impacts from transitioning to a lower-carbon business model on its workers and communities; and a commitment to clear and appropriately detailed disclosure of its climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets, such as that set forth by the TCFD framework.

While the two surveys cover a broad range of topics, they do not necessarily address every change that ISS will make in its 2022 proxy voting policies. That said, the surveys are an indication of changes ISS is considering and provide an opportunity for interested parties to express their views. Public companies and others are urged to submit their responses, as ISS considers feedback from the surveys in developing its policies.

Both surveys will close on Friday, August 20, at 5:00 p.m. ET. ISS will also solicit more input in the fall through regionally based, topic-specific roundtable discussions. Finally, as in prior years, ISS will open a public comment period on the major final proposed policy changes before releasing its final 2022 policy updates later in the year. Additional information on ISS's policy development process is available at the ISS policy gateway (available here).

The following Gibson Dunn lawyers assisted in the preparation of this client update: Elizabeth Ising, Lori Zyskowski, and Cassandra Tillinghast.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these issues. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work in the Securities Regulation and Corporate Governance and Executive Compensation and Employee Benefits practice groups, or any of the following practice leaders and members:

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