MORROW SODALI 50 YEARS 1972-2022

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PROXY UPDATE

SUMMARY:
ISS 2022 GLOBAL BENCHMARK POLICY SURVEY

ISS recently released the results of a Global Benchmark Policy Survey it conducted between August 3, 2022 and August 31, 2022. The full Benchmark Policy Survey results can be viewed **here**. (Last year's equivalent survey was reported by ISS in two parts, with climate related survey questions in one part, and the others in a separate part.)

Climate survey questions addressed how to deal with significant greenhouse gas (GHG) emitters, priorities for determining whether transition plans are adequate, climate risk as a critical audit matter, the financing of new oil and gas development by banks and insurance companies, and expectations for increased climate-related disclosures. For U.S. companies, the survey also focused on problematic governance structures and racial equity audits. For non U.S. companies, questions were asked about share issuances by cross-market companies, frequency of audit committee meetings, executive pay increases, unequal voting rights, virtual-only shareholder meetings, and the authorization of share repurchases.

A summary of the 2022 ISS Global Benchmark Policy Survey follows.

KEY FINDINGS – CLIMATE POLICY

Relating to ISS Benchmark Voting Policies:

CLIMATE BOARD ACCOUNTABILITY

ISS asked when it should recommend against directors at significant greenhouse gas (GHG) emitters for a "material governance failure" over poor climate change risk management. *Significant emitters* are defined as those in the Climate 100+ Focus Group, which are about 160 companies worldwide with 45 based in the US (**list here**).

Disclosure. A significant majority of both investor and non-investor respondents supported ISS action if *significant emitters* did not provide adequate disclosure using a framework such the one developed by the Task Force on Climate-related Financial Disclosures (TCFD).

Targets. Investor respondents generally agreed that *significant emitters* need to take steps to address emissions, with support for different triggers ranging from 45%-50% among: (i) not setting realistic medium-term targets (through 2035) for Scope 1 & 2 only (50% of investors), (ii) not declaring a net-zero by 2050 ambition (47% of investors), and (iii) not setting realistic medium-term targets (through 2035) for Scope 1, 2 & 3 if Scope 3 is relevant (45% of investors). Most investor respondents (69%) chose at least one of those "targets" responses; it was 43% of the non-investor respondents.

For 2022, ISS policy on this topic only applied to the U.S., U.K. & Ireland, Continental Europe, and Russia. Most investor respondents (66%) supported applying this policy across all markets; while non-investor respondents favored continued differentiation by market (60%).

COMPANY CLIMATE TRANSITION PLANS

ISS asked for the top three priorities when determining if a company's transition plan is adequate, with the following results:

Investor respondents:

1. Having comprehensive and realistic medium-term targets for reducing operational and supply chain emissions (Scopes 1, 2 & 3) to net zero by 2050 (42%)
2. Aligning short- and medium-term capital expenditures with long-term company strategy (41%)
3. Whether the company's climate-related disclosures are in line with TCFD recommendations and meet other market standards (38%)

Non-investor respondents:

1. Whether the company's climate-related disclosures are in line with TCFD recommendations and meet other market standards (54%)
2. Committing to report on the implementation of its plan in subsequent years (35%)
3. Having comprehensive and realistic medium-term targets for reducing operational and supply chain emissions (Scopes 1, 2 & 3) to net zero by 2050 (23%)

CLIMATE RISK AS CRITICAL AUDIT MATTER

A substantial majority of investor respondents (75%) favored seeing commentary by auditors in the audit report on climate-related risks for *significant emitters*. 64% of investor respondents supported climate-related risks being included by auditors in Critical Audit Matters / Key Audit Matters (CAMs). Most investor respondents (52%) would favor supporting a related shareholder proposal on this issue, while 42% supported voting against re-election of audit committee members. *Significant emitters* are defined as those in the Climate 100+ Focus Group, which are about 160 companies worldwide with 45 based in the US (**list here**). Non-investor respondents tended to not support seeing auditors comment on climate-related risk.

FINANCED EMISSIONS

ISS asked what banking and insurance companies should do to reduce the GHG emissions associated with their financing activities, with the following results from investor respondents about *targets* for emission reduction:

- 51% - clear long-term and intermediary targets for high emitting sectors
- 49% - a net-zero by 2050 ambition including financed portfolio emissions
- 29% - cease financing new fossil fuel projects
- 12% - only for emissions from their own operations

Also included in the survey were expectations for related *disclosures*, with the following results from investor respondents:

- 54% - fully disclose financed emissions
- 45% - join a collaborative group such as **PCAF** or **GFANZ**
- 4% - only for their direct emissions (Scope 1 & 2)

Non-investor respondents showed lesser support for these measures, with 40% saying that companies should not be expected to comply with shareholder requests regarding financed emissions.

CLIMATE EXPECTATIONS

Most respondents, both investors and non-investors, expect investors' minimum expectations on thresholds for climate-related disclosure and performance to increase over time, with the four most common responses being:

- Targets being aligned with net-zero
- Disclosure of more climate-related information driven by regulatory changes and industry practices
- Greater disclosure of Scope 3 emissions
- Greater investment in low-carbon products

POTENTIAL EXCEPTIONS TO ADVERSE RECOMMENDATIONS UNDER ISS POLICY ON MULTI-CLASS CAPITAL STRUCTURES – U.S.

Beginning in 2023 ISS will recommend against directors at companies with multi-class capital structures with unequal voting rights, with exception when public shareholders are not meaningfully disenfranchised. When asked what the appropriate threshold for exemption should be for this exemption, most investor respondents agreed that there should be an exception but were split on what that threshold should be. "No more than five percent" was the most popular threshold chosen by investor and non-investor respondents. Though 32% of investors respondents indicated that there should be no exception.

PROBLEMATIC GOVERNANCE STRUCTURES – U.S.

For newly-public companies, ISS policy has been to allow a "reasonable sunset provision" for classified boards but for no more than seven years from the IPO. In response to ISS's survey, there was consensus for reducing this period of time.

For investors, 43% chose “between 3 and 7 years” and 35% chose “3 years;” for non-investors, 37% chose “between 3 and 7 years” and 19% chose “3 years.” There was also strong support from investors (72%) not to exempt smaller companies from negative ISS recommendations for maintaining a classified board or having supermajority vote requirements.

DIVERSITY, EQUITY & INCLUSION (DEI) – U.S.

This topic deals with shareholder proposals that ask companies to commission an independent audit to assess potential racial bias throughout their business practices. 42% of investor respondents supported these audits generally, and 45% in specific circumstances. 56% of non-investors supported these audits in specific circumstances. For investors these specific circumstances included significant diversity-related controversies (83%) and not providing detailed workforce diversity statistics, such as EEO-1 type data (59%).

SHARE ISSUANCE MANDATES AT CROSS-MARKET COMPANIES UNDER ISS COVERAGE

This topic deals with foreign incorporated companies listed only in the US which are *not foreign private issuers* under SEC rules, with questions about how new share issuances should be authorized. (These companies often include U.S. companies that have re-incorporated in jurisdictions such as Ireland.) Investor respondents split 57% to 36% between (i) keeping current ISS policy of recommending against share issuances without preemptive rights in excess of 10% of issued capital, and (ii) developing a new ISS policy. Non-investor respondents split 30%/44% on this question. 54% of those investor respondents who favored a new ISS policy supported issuances of up to 20% of issued capital without requiring preemptive rights. 89% of investor respondents (and 68% of non-investor respondents) supported having the same policy apply to dual-listed companies (those listed both on a U.S. exchange and an exchange in the market of incorporation) as to those solely listed in the US.

AUDIT RELATED MATTERS – UK & IRELAND

Most survey respondents agreed that ISS should note the frequency of audit committee meetings held each year and consider adverse vote recommendations when the number of meetings is insufficient – 74% for investors and 61% for non-investors.

EXECUTIVE PAY INCREASES – UK & IRELAND

With inflation increasing, ISS raised concern that justifying percentage increases in executive base salaries as being “in line” with percentage increases for the general workforce may not be appropriate because executive base salaries are typically much larger and because they are often also used to set targets for executive incentive compensation plans. Most survey respondents either thought “in line” was fine or that the board should determine executive pay in the context of the company’s specific needs. 34% of investor respondents thought that executive salaries should be rising more slowly in percentage terms.

UNEQUAL VOTING RIGHTS/MULTI-CLASS SHARE STRUCTURES – CONTINENTAL EUROPE

ISS surveyed whether it should consider issuing adverse voting recommendations for corporate governance structures considered poor, with strong investor support in the cases of unequal voting rights (93%), anti-takeover protective measures (71%), and supermajority vote requirements (66%). Non-investor respondents showed similar support and was higher for loyalty shares where 67% supported ISS using adverse voting recommendations, versus 54% for investor respondents.

VIRTUAL MEETINGS – CONTINENTAL EUROPE

ISS notes the growing interest in Continental Europe in allowing virtual-only Annual General Meetings, with Germany now allowing them subject to shareholder approval every five years. ISS surveyed whether use of virtual-only AGMs could lead to a problematic diminution in shareholder rights, with a majority consensus responding *no* so long as there are safeguards such as time limits and participation rights.

SHARE REPURCHASES – SUB-SAHARAN AFRICA

Companies in Sub-Saharan African (SSA) markets such as Botswana, Ghana, Kenya, Nigeria, Namibia and Zimbabwe, regularly seek approval for share repurchases that exceed the ISS limit of up to 10 percent. ISS surveyed what its response should be to this discrepancy, but the results were split among the different options proposed by ISS, with a consensus supporting that allowances should be made for repurchases of up to 20 percent with different options, but ISS specifically cites that “keeping 10%” got the most votes from investor respondents.

Morrow Sodali will continue to monitor changes in ISS policies
and how those changes may affect our clients and will keep you informed
as ISS announces their updated policies for 2022 which should be released in late November.

Please contact your Morrow Sodali representative with any questions.