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ISS Publishes Proxy Voting Policies for 2022 Relating to Climate Matters and Racial Equity Audits

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On December 7, Institutional Shareholder Services published its 2022 benchmark policy changes for the United States. The changes are generally effective for shareholder meetings that occur on or after February 1, 2022. This Alert discusses new ISS policies on three climate proposal topics: (1) climate accountability by boards; (2) management-sponsored say on climate proposals; and (3) shareholder-sponsored say on climate proposals. This Alert also discusses the corresponding Glass Lewis policies. Also discussed is a new ISS policy relating to racial equity audit proposals. The updates reflect the expected increase – and shareholder interest – in all of these types of proposals.

Climate Accountability

In connection with this policy change, ISS noted that, in response to its 2021 Climate Policy Survey, a high percentage of investor respondents supported establishing minimum criteria for companies considered to be strongly contributing to climate change. The new policy on board accountability applies to "significant greenhouse gas emitters," which are the 167 Climate Action 100+ Focus Group list companies.

For companies that are deemed to be significant GHG emitters, whether through their own operations or value chain, ISS generally will recommend voting against the incumbent chair of the responsible committee if ISS determines the company is not taking the minimum steps needed to understand, assess and mitigate risks related to climate change. The minimum steps identified by ISS include robust disclosure and adoption of GHG emissions targets.

- ***Disclosure.*** ISS requires detailed disclosure of climate risks that includes board governance measures, corporate strategy, risk management analyses and metrics and targets, such as in accordance with the Task Force on Climate-related Financial Disclosures framework.
- ***Targets.*** ISS requires that companies adopt "appropriate GHG emissions reductions targets." The policy updates are not prescriptive as to what constitutes appropriate targets, stating that any well-defined GHG reductions targets that cover at least a significant portion of the company's direct emissions will be acceptable. Scope 3 emissions targets are not required for 2022.

Notably, ISS stated that its expectations for what constitutes minimum steps to mitigate climate change-related risks will increase over time.

The Glass Lewis Approach

On a case-by-case basis, Glass Lewis will consider supporting well-crafted proposals requesting that companies report their GHG emissions and adopt a reduction goal for the emissions. Glass Lewis believes, particularly for companies operating in carbon- or energy-intensive industries (such as those in the basic materials, integrated oil and gas, iron and steel, transportation, utilities and construction industries), that managing and mitigating carbon emissions are important to ensuring long-term financial and environmental sustainability.

When reviewing these proposals, Glass Lewis takes into account the following:

- The industry in which the company operates;
- The existence of robust risk management of environmental issues as evidenced by all relevant facts and circumstances, including material fines, lawsuits or reputational damage; and
- The disclosure and GHG reduction targets adopted by the company's peers.

Management-Sponsored Say on Climate Proposals

ISS is codifying the framework it developed over the last year for analyzing climate transition plans advanced by management. The policy incorporates feedback received from ISS' climate policy survey.

ISS will consider on a case-by-case basis management proposals that request shareholders approve the company's climate transition action plan. This policy also relates to variations of this type of request, specifically proposals relating to climate transition-related ambitions or a commitment to reporting on the implementation of a climate plan.

ISS will consider the completeness and rigor of the plan. Specific factors that will be considered when available include the following:

- The extent to which the company's climate-related disclosures are in line with TCFD recommendations and meet other market standards;
- Disclosure of the company's operational and supply chain GHG emissions (scopes 1, 2 and 3);
- The completeness and rigor of the company's short-, medium- and long-term targets for reducing operational and supply chain GHG emissions (scopes 1, 2 and 3 if relevant);
- Whether the company has sought and approved third-party approval that its targets are science-based;
- Whether the company has made a commitment to be net zero for operational and supply chain emissions (scopes 1, 2 and 3) by 2050;
- Whether the company discloses a commitment to report on the implementation of its plan in subsequent years;
- Whether the company's climate data has received third-party assurance;
- Disclosure of how the company's lobbying activities and its capital expenditures align with company strategy;
- Whether there are specific industry decarbonization challenges; and
- The company's related commitment, disclosure, and performance compared to its industry peers.

The policy notes this is not an exhaustive list of the criteria that will be considered.

The Glass Lewis Approach

When evaluating these proposals, Glass Lewis takes into account a variety of factors, including:

- The request of the resolution (e.g., whether companies are asking shareholders to approve its disclosure or its strategy);
- The board's role in overseeing the company's climate strategy;
- The company's industry and size;
- Whether the company's GHG emissions targets and the disclosure of these targets appear reasonable in light of its operations and risk profile; and
- Where the company is on its climate reporting journey (e.g., whether the company has been reporting and engaging with shareholders on climate risk for a number of years or if this is a relatively new initiative).

Consistent with the foregoing, when evaluating management-sponsored proposals seeking approval of climate transition plans, Glass Lewis believes that companies should provide information concerning the board's role in setting strategy in light of the vote and how the board intends to interpret the vote results for the proposal. It also believes that companies should be engaging with investors prior to and after the vote and will favorably view disclosure concerning these engagement efforts.

If disclosure concerning the governance of the say on climate vote is not present, Glass Lewis will either recommend that shareholders abstain or, depending on the quality of the plan presented, will recommend that shareholders vote against the proposal.

Regardless of disclosure concerning the governance of a company's say on climate vote, Glass Lewis will evaluate the quality of climate transition plans on a case-by-case basis. Since say on climate votes are relatively nascent and best practices or the standardization of the proposals or underlying disclosures have not been developed, Glass Lewis looks to companies to clearly articulate their climate plans in a distinct and easily understandable document aligned with the TCFD recommendations. Glass Lewis notes, in this disclosure, it is important for companies to clearly explain their goals, how their GHG emissions targets support achievement of broader goals (i.e., net zero emissions goals) and any foreseeable obstacles that could hinder their progress on these initiatives.

Shareholder-Sponsored Say on Climate Proposals

ISS also will consider shareholder-sponsored say on climate proposals on a case-by-case basis. This policy applies to proposals requesting that a company report on GHG emissions levels, reduction targets and/or an upcoming climate transition plan and provide shareholders with the opportunity to express approval or disapproval of the GHG emissions reduction plan.

In making a recommendation of these proposals, ISS will take the following non-exhaustive factors into account:

- The completeness and rigor of the company's climate-related disclosure;
- The company's actual GHG emissions performance;
- Whether the company has been the subject of recent significant violations, fines, litigation or controversy related to its GHG emissions; and
- Whether the proposal's request is unduly burdensome (scope or timeframe) or overly prescriptive.

The Glass Lewis Approach

Glass Lewis generally will recommend against shareholder proposals requesting that companies adopt a say on climate vote. Glass Lewis is broadly supportive of companies' providing robust disclosure concerning their climate strategies. However, it has concerns regarding the implications of these votes. Generally, Glass Lewis believes that the setting of a company's business strategy is a function best served by the board, which has a fiduciary duty to shareholders. Glass Lewis has indicated that, by allowing shareholders to weigh in on a company's long-term climate strategy, it believes the board may be abdicating some of this responsibility. Additionally, Glass Lewis notes it has observed that shareholders are being asked to make informed voting decisions associated with the setting of companies' long-term business strategy – as is the case with the establishment of net zero emissions goals to 2050 – with potentially incomplete information relating to operational changes and related costs.

When evaluating say on climate proposals by shareholders, Glass Lewis makes note of and potentially considers the following:

- The request of the resolution;
- The company's existing climate governance framework, initiatives and reporting;
- The company's industry and size; and
- The company's exposure to climate-related risks.

As noted above, although Glass Lewis has concerns regarding companies adopting a say on climate vote sponsored by shareholders, it is supportive of companies providing disclosure concerning their climate-related risks and opportunities.

Racial Equity Audit Proposals

Racial equity audit proposals were introduced in 2021, following the 2020 Black Lives Matter protests. Of the twelve proposals submitted for 2021, eight came to a vote, averaging approximately 30% support. These proposals are likely to become an increasing part of the E&S shareholder proposal landscape.

ISS will consider on a case-by-case basis proposals that ask a company to conduct an independent racial equity and/or civil rights audit. ISS will take into account the following factors:

- The company's established process or framework for addressing racial inequity and discrimination internally;
- Whether the company has issued a public statement related to its racial justice efforts in recent years, or has committed to internal policy review;
- Whether the company has engaged with impacted communities, stakeholders and civil rights experts;
- The company's track record in recent years of racial justice measures and outreach externally;
- Whether the company has been the subject of recent controversy, litigation or regulatory actions related to racial inequity or discrimination; and
- Whether the company's actions are aligned with market norms on civil rights and racial or ethnic diversity.

Additional FAQs

ISS has indicated it plans to release FAQs with more information concerning the application of these policies before they go into effect.

Other Issues Addressed

The 2022 ISS policy updates address additional topics not discussed in this Alert, including board diversity, companies with high vote/low vote stock and requests to increase authorized share capital and valuing equity awards.

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