Kingsdale Governance Advisory Update

October 8, 2021

ISS Publishes Results of 2021 Policy Surveys

On Oct. 1, Institutional Shareholder Services ("ISS") unveiled the results of two online global surveys that the proxy advisor conducted this summer with market participants to inform its voting policy development.

ISS said it expects to release key draft policy updates this month and open a public comment period on key proposed changes to its voting policies. The policy updates will be announced in November and will become effective for shareholder meetings taking place on or after February 1, 2022.

It is important for public companies to closely monitor the evolution of proxy advisors' proxy voting policies. This is because their voting recommendations both inform and guide the voting practices of many institutional shareholders.

This year's ISS surveys solicit feedback about several issues that are emerging or in focus. One of the ISS surveys covered a broad range of corporate governance topics, including aspects of executive compensation, the use of third-party racial equity audits and the future of virtual-only shareholder meetings. The other survey was focused on climate change, which has emerged as one of the highest priority matters within the Environmental, Social and Governance ("ESG") umbrella for companies and the investment community alike.

The survey results are both global and country specific. Kingsdale has focused our analysis on findings that are either global or relevant to our corporate clients in North America. The respondents were from a mix of investors, companies and academic/non-profit entities. Our summary highlights the views of investors, who are the main users of ISS' proxy voting policies.

Results of ISS' 2021 Global Benchmark Policy Survey

Below are Kingsdale's key takeaways from the results of ISS' 2021 Global Benchmark Policy Survey.[1]

Executive Compensation

- 86% of investor respondents said the use of non-financial ESG metrics is an appropriate way to incentivize executives. Of these investors, 52% said the metrics should be specific, measurable and communicated transparently.
  - Respondents overwhelmingly agreed (81%) that such metrics should be included in both short- and long-term incentive plans, depending on the circumstances.
- 85% of investors said including a longer-term perspective (e.g., three years) of CEO pay quantum is relevant to ISS' pay-for-performance screen versus the one-year assessment currently utilized by the proxy advisor.

[1] *Note: There were 409 respondents, of which 159 were investors. The majority of investor respondents are asset managers, with 66% of investor respondents managing US$10 billion or more. Some investors did not respond to all questions.*

- 40% of investors said mid-cycle changes to long-term incentive programs may be "reasonable" for companies experiencing long-term negative impacts from the COVID-19 pandemic.

The main takeaway for Boards of Directors is that including non-financial ESG metrics as performance targets in executive compensation plans is not enough for most investors. The metrics should be specific, measurable and properly disclosed.

Racial Equity Audits

- A large majority of investors said either that companies would benefit from racial equity audits or that they would consider it depending on company-specific factors, especially when a company is involved in a diversity controversy and does not disclose detailed workforce diversity statistics. Only 9% of investors said most companies would not benefit from such an evaluation.
- Note: Racial equity audits are a relatively new type of shareholder proposal that calls on companies to commission an independent audit to assess racial bias throughout their organization and business practices.

Virtual-Only Shareholder Meetings

- According to at least 90% of investors, the top three most concerning practices related to virtual-only company meetings are: 1) unreasonable curation of questions to avoid difficult ones, 2) the inability to ask live questions at a virtual-only meeting or submit questions in advance, and 3) no Q&A opportunity was provided or submitted questions were not addressed.
  - Most investors (70%) said problematic virtual-only meetings that restrict shareholder rights may warrant adverse votes AGAINST either the board chair alone (38%) or all responsible directors (32%).

Pre-2015 Poor Governance Provisions (U.S.)

- Note: ISS revised its policy in 2015 to recommend AGAINST directors at newly public U.S. companies that went to market with certain poor governance practices. Companies that went public before the policy was enacted were not issued negative recommendations, even when they maintained the same inadequate policies for which ISS would penalize newly public companies.
- Most investors (94%) support ISS revisiting its policy to penalize companies that went public before ISS instituted its 2015 policy and continue to maintain these inadequate governance practices.
  - Investor respondents said the top three features that ISS should reconsider grandfathering are:
    1. A multiple class capital structure with unequal voting rights (92%)
    2. Supermajority vote requirements to amend governing documents (86%)
    3. A classified board structure (80%)

Recurring Adverse Director Recommendations (U.S.)

- 68% of investor respondents say that ISS should continue to make recurring adverse director recommendations for maintaining the supermajority vote requirements even when a management-sponsored proposal to eliminate them failed to receive the requisite level of shareholder support needed for approval.

Special Purpose Acquisition Corporations ("SPACs") & Proposals with Conditional Poor Governance Provisions (U.S. & Canada)

- Most investor respondents (62%) neither own nor have an opinion about SPACs.
  - Note: A SPAC is a shell company created to raise money through a public financing vehicle to eventually acquire another company with operations of some kind.

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- The remaining investor respondents were equally split between whether it makes sense for investors to generally vote in favour of SPAC transactions, irrespective of the merits of the target company combination or any governance concerns.
- The majority of investor respondents said ISS' current voting policy is the right way forward. Its policy is to support the SPAC transaction but make note of disapproval with any poor governance practices.

Results of ISS' 2021 Climate Policy Survey

The results of ISS' climate survey will inform both its Benchmark and Specialty Climate policies. Questions were asked about the minimum expectations for companies with respect to climate-related disclosure, goals and processes, as well as the burgeoning Say on Climate shareholder vote.

Below are Kingsdale's key takeaways from the results of ISS' 2021 Global Policy Survey – Climate[2]:

Climate-Related Board Accountability

- 88% of respondent investors expect a company that is a "strong contributor to climate change" to be providing clear and detailed disclosure on its climate change emissions governance, strategy, risk mitigation efforts, and metrics and targets.
  - It notes that investors expect such company to adopt, for example, the Task Force on Climate-related Financial Disclosures (TCFD) framework.
- 72% of respondent investors expect companies to be declare an objective of aligning with the Paris Agreement goals with respect to their operations and supply chain emissions (Scope 1, 2 and 3 targets)
- A majority of investors believe the minimum expectations for companies that are not contributing as much to climate change, such as service industries, should be lower than for companies that are high contributors. At the same time, 33% of investor respondents say the minimum expectations should be the same for every company.

Say on Climate

- According to investor respondents, the top 5 dealbreakers for shareholder support for approval of a management-proposed climate transition plan are as follows:
  - A lack of clear and detailed disclosure, such as according to the TCFD framework (81% of investor respondents).
  - A lack of long-term declared objective to be aligned with the goals of the Paris Agreement (76%).
  - A lack of a strategy and capital expenditure program in line with GHG reductions targets (63%).
  - A lack of reporting showing that its corporate and trade association lobbying activities are aligned with the goals of the Paris Agreement (60%).
  - A lack of improvement on climate-related disclosure and performance (58%).
- When a management-sponsored climate transition plan is on the ballot for shareholder approval, the majority of investor respondents (62%) consider such item as the primary method to express their views about the adequacy of the company's climate risk mitigation strategy at this time, but also note that voting AGAINST directors may be required in the future if improvements are not realized over several years.
- 42% of investor respondents say that a shareholder-sponsored Say on Climate proposal requesting a regular advisory vote on a company's climate transition plan always warrants shareholder support, whereas 36% say it is case-specific. 15% say this proposal should never warrant shareholder support.

[2] There were 329 respondents, of which 164 were investors. The majority of investor respondents are asset managers, with 65% of investor respondents managing US$10 billion or more. Some investors did not respond to all questions.

ISS Specialty Climate Voting Policy

- 83% of investor respondents say that high-polluting companies should be subject to a more stringent evaluation under ISS' Specialty Climate Policy compared to companies deemed to make a less substantial negative contribution to climate change.
    - Note: ISS flags that Climate Action 100+ has identified 167 companies that are disproportionately responsible for GHG emissions and are also responsible for urgent emissions reductions if 1.5-degree goals are to be met.
- 86% of investor respondents agree that ISS' Specialty Climate Voting Policy should assess a company's alignment with Net Zero goals to offset emissions by 2050 as a sign that the risks and opportunities of climate change are being appropriately managed.

If you have any questions about this update, please feel free to contact Kingsdale's experts listed below to discuss directly.

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