The Shareholder Commons' Answers to the ISS 2023 Policy Survey

The Shareholder Commons has provided its responses to the ISS 2023 Policy Survey.

The TSC responses are largely based on the observation that the ISS benchmark voting guidelines are not designed to serve the average institutional investor, who holds a diversified portfolio or is managing assets on behalf of diversified beneficiaries.

For diversified investors, the intrinsic value of the economy is by far the greatest determinant of overall financial returns. These investors need proxy voting advice that will optimize the returns of their entire portfolios, not the returns of the individual companies where the votes take place. This is a critical distinction, because it is not in the interest of a diversified investor for a company to engage in practices that threaten social and environmental systems, even if those practices maximize the returns of the individual company: those systems underpin the broad economy upon which diversified portfolios depend.

Despite the diversified nature of most investors, the ISS benchmark voting guidelines operate under an assumption that voting recommendations should be calculated to optimize the returns at the individual company at which shares are being voted, without regard to systemic or portfolio impact.

But because the voting choices that maximize returns at individual companies may not adequately address systemic risks that companies create, such a policy is not fit for the purpose of optimizing the return of the diversified portfolios of most institutional asset owners.

The Shareholder Commons provided the following answers to ISS's 2023 Policy Survey in light of this gap. Questions and answers have been edited for context.

Section 2

ISS Question 1: *Should companies disclose a line-item reconciliation of non-GAAP adjustments to incentive pay metrics in the proxy statement?*

TSC response: While this is an important question, it needs to be asked only after a more fundamental question: is the pay metric (GAAP or non-GAAP) adjusted to reflect the costs and risks that company activities impose on the systems that underpin the diversified portfolios owned by most investors? If performance pay does not include guardrails or parameters to ensure the company is not burdening social and environmental systems, the true cost of its operations to investors remains undisclosed, allowing company management to engage in a shell game with its owners' capital.

ISS Question 2: *Do you think it is appropriate for ISS to resume the application of the ROE policy [voting against directors when ROE falls below 5% five-year average] for Japanese companies?*

TSC Response: Such a policy should be reimposed only if the policy includes adjustments for burdens that a company imposes on social and environmental systems. Financial returns that flow to an individual company are illusory from the perspective of its diversified investors if they are dependent on practices that create costs and risks for the capital markets overall.

Section 4

ISS Questions 1 and 2: *In your organization's view, on globally-applicable environmental and social topics, particularly climate change, biodiversity, and human rights, should ISS benchmark policy and policy application aim for global consistency (to the extent possible), or should it take a market-specific approach where relevant due to differing country and/or region-specific standards, regulations or practices? Please respond with respect to each issue.*

TSC Response: The most important factor influencing long-term investor return is the overall value of the economy. Accordingly, a company's impact on environmental and social topics relevant to long-term economic health must be accounted for in judging the financial success of the company on behalf of its investors. This calls for globally consistent principles. For example, investors may determine that all companies should be acting in accordance with the goal of limiting global warming to 1.5 degrees. But this may call for different practices in different regions based on historical emissions, level of economic development, and other factors.

ISS Question 3: *A "double" or "dynamic" materiality approach that is focused both on effects on the company from external sources and on company's externalities or impacts on the environment and society has been embedded in some regulatory regimes and corporate governance guidelines, such as the EU's Corporate Sustainability Reporting Directive, the Global Reporting Initiative, and the OECD Corporate Governance Principles (2023 version). How does your organization consider such "double materiality" in assessing E&S topics?*

TSC Response: E&S topics should be assessed on a basis that includes impacts on society and the environment to the extent that such impacts are likely to affect the return of diversified portfolios. Most investors today (at the economic owner level) are diversified because such diversification allows investors to benefit from the returns of risky securities like common stock, while limiting the idiosyncratic risk from concentrated positions in individual companies and sectors. Many asset owners are required by law to diversify. For these investors, overall market (and thus overall economic) performance is the single most important factor in determining portfolio return. Accordingly, in order for these investors to steward companies in their portfolios in a manner that will optimize long-term returns, they need information as to how those companies' activities are impacting the critical systems that underpin diversified portfolios. This may be more important to an investor than the interaction between a company's E&S performance and its individual financial performance.

This has important implications for the voting advice these investors need, as well. In order to meet their financial objectives, these investors require advice as to how to vote in order to maximize the returns of their diversified portfolios, not how to maximize the return of individual companies. This is a critical distinction with respect to voting at companies that have business models that rely on externalizing costs in order to maintain high profitability.

ISS Question 5: *In 2023, for boards of companies considered to be high emitters of greenhouse gases (GHGs), ISS benchmark policy considers a board to be materially failing in its risk oversight responsibilities if the company did not have an overall ISS assessment of at least "Meets Standards" on climate-related disclosure. A possible policy change that is being considered for the future would be to consider that each ISS "climate disclosure pillar" assessment – specifically "Governance," "Strategy," "Risk Management," and "Metrics and Targets" – should individually be at the level of "Meets Standard", as well as the overall assessment. Do you consider boards of such companies to be materially failing if not assessed to be at least "Meets Standards" on each ISS climate disclosure pillar – specifically "Governance," "Strategy," "Risk Management," and "Metrics and Targets"?*

TSC Response: As discussed in our answers to questions 1-3 of this section, it is critical that disclosure be linked to real world impacts on the climate system that create costs or risks for a diversified portfolio. While we believe that it is important that companies meet a minimum standard under each pillar, it is critical that each pillar be linked to systemic impact as well as company performance.

ISS Question 6: *Which guidelines, standards, and frameworks does your organization consider relevant to use when drafting (for issuers) /assessing (for investors) a company's climate transition strategy or plan?*

TSC Response: While The Shareholder Commons does not endorse specific standards, we maintain that standards must account for systemic impact in order to be decision useful to diversified shareholders engaged in systemic stewardship. Accordingly, any standard that is limited to concepts of company materiality is not fit for purpose.

ISS Question 9: *Which scenario does your organization consider to be an acceptable target level for a company's GHG emission reduction target-setting purposes?*

TSC Response: The work of climate scientists, economists, and financial analysts consistently shows that the 1.5°C scenario will optimize the intrinsic value of the global economy in the coming decades and beyond. Accordingly, diversified investors, and the asset managers, consultants, and advisors who serve them, should use that target level for companies, in order to optimize portfolio returns. See answers to Questions 1-3.

Question 10: *Please indicate which GHG emission reduction targets if any your organization expects a company's climate strategy to include.*

TSC Response: Scope 3 emissions are a large part of a company's impact on the climate system and are consequently critical to diversified portfolio returns. Accordingly, diversified investors (and those working on their behalf) should insist that companies include Scope 3 targets in their climate plans. See answers to Questions 1-3.