September 5, 2024

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Via email

Re: Inclusion of Environmental and Social Topics in ISS's Annual Benchmark Policy Survey and Review

Dear Mr. Retelny and Ms. Kelly,

We, the undersigned State Financial Officers, have an interest in protecting and maximizing the respective pension funds and investments of our states. Based upon this interest and our duty to steward taxpayer assets, we urge ISS to make a much-needed course correction following a recent report showing that your benchmark policy is fundamentally out-of-step with the larger market. The report reviewed 192 climate-related shareholder proposals that your benchmark policy appeared to recommend voting "for." Only 17% of these proposals received majority support, which means the ISS benchmark supported these ESG proposals at 500% the rate of the market. Furthermore, the average overall market support for these proposals was only 37%.[1]

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[1] Consumers' Research, *Analysis: Are Asset Managers Blindly Following ISS on ESG?* at 2 (July 2024), https://consumersresearch.org/wp-content/uploads/2024/07/CR-ISS-Analysis.pdf.

These results directly conflict with ISS's claim that its benchmark policy is "pretty centrist."[2] Rather, ISS's benchmark policy appears to be "activist" by any reasonable definition of the term, and this is highly problematic. First, these 192 proposals were *all* opposed by company management, and second ISS's recommendation to overrule management in these cases does not appear to be backed by any specific financial analyses of how the proposals enhance or maximize shareholder value.[3]

Further, the disparity identified above is indicative of a wider problem with ISS's benchmark policy, and ISS should immediately reevaluate the policies in the benchmark for environmental and social proposals generally. Market support for such proposals has dropped, but these changes have not been reflected in the benchmark policy.[4] In addition, the U.S. Supreme Court issued its decision in *Students for Fair Admissions v. Harvard*, and many DEI initiatives have been struck down or ended through settlement.[5] The risks associated with these legal developments[6] also have not been reflected in your benchmark policy.

This important reassessment should be done in advance of the 2025 proxy season as part of ISS's review of its benchmark policy survey. The remainder of this letter 1) addresses ISS's statements about its benchmark policy which compel an immediate review of certain portions relating to environmental and social issues and 2) lists the provisions that should be included in the review with an explanation of why they appear to conflict with your own statements. Finally, we request that our views, as expressed in this letter, be considered as part of your survey findings and reflected, as applicable, in your annual Summary of Results which should be used to inform and adjust your benchmark policy for 2025.

You Have Consistently Represented that Your Benchmark Policy Is Designed to "Enhance," "Protect," and Maximize" Shareholder Value, But the Benchmark Lacks Financial Analysis Before Recommending "For" Environmental and Social Proposals.

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[2] *See* https://www.cnbc.com/video/2024/03/11/theres-less-investor-support-for-esg-proposals-this-year-says-iss-lorraine-kelly.html (Statement of Ms. Kelly at approximately 2:50).

[3] If it is your practice to perform specific financial analyses, then we believe your benchmark policy must be amended to make clear that is a requirement before recommending "for" on an environmental or social proposal.

[4] *See, e.g.*, Heidi Welsh, *Environmental & Social Policy Issues in the 2024 U.S. Proxy Season* (April 24, 2024), https://corpgov.law.harvard.edu/2024/04/24/environmental-social-policy-issues-in-the-2024-u-s-proxy-season/.

[5] *See Students for Fair Admissions v. Harvard*, 600 U.S. 181 (2023); *American Alliance for Equal Rights v. Fearless Fund Management, LLC*, 103 F.4th 765 (11th Cir. 2024).

[6] Ishan K. Bhabha, et al., *One Year Later: The Implications of SFFA for Corporate America*, Harv. L. Sch. F. on Corp. Governance (Aug. 6, 2024), https://corpgov.law.harvard.edu/2024/08/06/one-year-later-the-implications-of-sffa-for-corporate america/?utm_campaign=Fiduciary%20Focus&utm_source=hs_email&utm_medium=email&_hsenc=p2ANqtz--CI351SWdQjo4KN1CNGvqSowgUIIYlwo9yAOh8ipkP9L6yi551AbAqIj4Fa-LLExB4i1Tg.

You annually issue "Benchmark Policy Recommendations"[7] and a related "Procedures & Policies"[8] document. Those documents make specific representations. For example, your benchmark policy states under "Social and Environmental Issues":

- "While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations focuses on how the proposal may enhance or protect shareholder value in either the short or long term."[9]
- "General Recommendation: Generally vote case-by-case, examining primarily whether implementation of the proposal is likely to ***enhance or protect shareholder value***."[10]

Similarly, your Procedures & Policies states in response to "What is ISS' general approach on environmental and social-related shareholder proposals?" that "***Maximizing and protecting shareholder value*** in the long term is the ultimate goal of ISS' benchmark policy."[11]

Given these representations (and the outsized role ISS's benchmark policy plays in the marketplace), it is critical that the benchmark policy focus solely on enhancing, protecting, and maximizing shareholder value. Yet it appears that no financial analysis is being performed before the benchmark policy recommends "for" on environmental and social proposals. We reach this conclusion based on ISS's own description of developing the policies as a "bottom-up policy formulation process [that] collects feedback from a diverse range of market participants through multiple channels: an annual Policy Survey of institutional investors and corporate issuers, roundtables with industry groups, and ongoing feedback during proxy season."[12]

There thus does not appear to be a requirement of a financial analysis in the policy development or implementation stages, and we have not found any indication that financial analyses are being performed. While a financial analysis may be less relevant in the context of certain general governance proposals (such as eliminating poison pills or staggered terms for boards of directors), environmental and social proposals are fundamentally different in kind because they often prescribe specific company actions, such as emissions targets or minimum racial or gender representation on boards of directors. And the need to tread carefully to ensure a proposal is in the financial interests of shareholders is especially acute when your policy recommends "for" on such a proposal *over the company management's opposition*—as was the case in the 192 climate-related proposals analyzed in the report discussed at the beginning of this letter. An immediate review and policy adjustment is therefore needed on this front.

From our review of the benchmark policy and Procedures & Policies, we believe that ISS should reverse the following environmental provisions as part of its upcoming annual review and in the Proposed ISS Benchmark Policy Changes for 2025. ISS's Annual Review Should Reverse the Following Environmental and Social Related Policies.

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[7] *See* https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1
[8] *See* https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf
[9] 2024 Benchmark Policy Recommendations at 66 (emphasis added).
[10] 2024 Benchmark Policy Recommendations at 66 (emphasis added).
[11] 2024 Procedures & Policies at 39.
[12] ISS, *Policy Formulation & Application*, https://www.issgovernance.com/policy-gateway/policy-formulation-application/.

- The policy to "generally vote against" relevant directors at certain "companies that are significant [GHG] emitters," which you define as companies that are "on the current Climate Action 100+ [(CA100+)] Focus Group list," "in cases where ISS determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy."[13]
- When evaluating "Say on Climate (SoC) Management Proposals," your policy to consider "[w]hether the company has made a commitment to be 'net zero' for operational and supply chain emissions (Scopes 1, 2, and 3) by 2050."[14]
- The policy to "use[] ISS ratings such as the E&S Quality Score and the Climate Awareness Scorecard and external ratings such as the CPA Zicklin Index, the Corporate Human Rights Benchmark, and the CDP scorecard."[15]
- When "evaluating the merits of a shareholder proposal with requests related to greenhouse gas (GHG) emissions," the policy to consider whether "the company has set emissions reductions targets that are aligned with Paris Agreement goals of limiting warming to well below 2 degrees C," whether "the company has realistic strategies and incentives in place to achieve those targets," whether "the company reports according to the TCFD framework and/or whether it answered the CDP climate-related survey, and the company's CDP rating."[16]

These climate-related benchmark policies are problematic for multiple reasons. Without attempting to be exhaustive, we outline a few problems to show the necessity of reversal. First, the continued reliance on CA100+ contrasts with multiple recent departures from that group.[17] According to State Street, CA100+'s recent "Phase 2" changes "are not consistent with [its] independent approach to proxy voting and portfolio company engagement"[18] and also carry "potential legal risks."[19] CA100+ is also not designed to maximize shareholder value but instead is "committed to the global effort [of] ensuring that 170 of the largest greenhouse gas emitters take the necessary action on the global climate crisis."[20] As a result, many of the companies on the "focus list" are energy producers, and CA100+'s pressure campaign is designed to limit their sales of current products, not maximize their value. In contrast, ISS's benchmark policy expressly represents it is designed to maximize and enhance shareholder value.

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[13] 2024 Benchmark Policy Recommendations at 17–18 & n.10.
[14] 2024 Benchmark Policy Recommendations at 70.
[15] 2024 Procedures & Policies at 39.
[16] 2024 Procedures & Policies at 41.
[17] *See, e.g.*, Patrick Temple-West and Brooke Masters, "JPMorgan and State Street Quit Climate Group as BlackRock Scales Back," Financial Times (Feb. 15, 2024), https://www.ft.com/content/3ce06a6f-f0e3-4f70-a078-82a6c265ddc2; Brooke Masters, "Pimco joins exodus from climate investor group," Financial Times (Feb. 16, 2024), https://www.ft.com/content/135762a0-0314-43fe-8c4c-bde0b2278715.
[18] Temple-West and Masters, *supra*.
[19] David Gelles, "More Wall Street Firms Are Flip-Flopping on Climate. Here's Why." N.Y. Times (Feb. 19, 2024), https://www.nytimes.com/2024/02/19/business/climate-blackrock-state-street-jpmorgan-pimco.html.
[20] Ceres, "Ceres Statement on Climate Action 100+ Investor Departures" (Feb. 22, 2024), https://www.ceres.org/news-center/press-releases/ceres-statement-climate-action-100-investor-departures.

Second, policies of assessing a company's Scope 1, 2, and 3 emissions and evaluating whether it has targets "aligned with Paris Agreement goals of limiting warming to well below 2 degrees C" and "strategies and incentives in place to achieve those targets" are facially imprudent and ineffective at driving shareholder value.[21] There has been substantial evidence that, despite pledges, countries are not taking the actual necessary steps to comply with the Paris Agreement and that any emissions reductions are being offset by increases in China and India.[22] Therefore, it is inappropriate to have a voting policy based on the premise that complying with these goals will necessarily enhance, protect, and maximize shareholder value, rather than waste resources and distract management's focus from shareholder value creation issues.

From our review of your benchmark policy and Procedures & Policies, we believe that ISS should also reverse the following social provisions as part of the upcoming annual review and subsequent Proposed ISS Benchmark Policy Changes for 2025.

- The policy to "[g]enerally vote against" relevant directors of companies "where there are no women on the company's board."[23]
- The policy to "generally vote against" relevant directors of companies "where the board has no apparent racially or ethnically diverse members."[24]
- When evaluating "proposals asking a company to increase the gender and racial minority representation on its board," the policy to consider "[t]he degree of existing gender and racial minority diversity on the company's board and among its executive officers," and "[t]he level of gender and racial minority representation that exists at the company's industry peers."[25]
- The policy to "[g]enerally vote for requests for reports on a company's efforts to diversify the board."[26]
- The policy to "[g]enerally vote for proposals requesting a company disclose its diversity policies or initiatives, or proposals requesting disclosure of a company's comprehensive workforce diversity data, including requests for EEO-1 data."[27]
- The policy to "generally recommend support for proposals requesting a median gender/racial/ethnicity pay gap report" when it is determined that a company "is lagging in its efforts to improve the median pay gap."[28]
- When evaluating "Gender/Racial/Ethnic Pay Gap shareholder proposals," the policy to consider "the company's . . . diversity and inclusion initiatives," especially "whether the

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[21] 2024 Procedures & Policies at 41.
[22] *See* International Energy Agency, *CO2 Emissions in 2023* at 16-17 (Feb. 2024) (reporting that China increased emissions by 565 million metric tons and India increased emissions by 190 million metric tons in 2023), https://iea.blob.core.windows.net/assets/33e2badc-b839-4c18-84ce-f6387b3c008f/CO2Emissionsin2023.pdf; BlackRock, *Managing the Net-Zero Transition* (illustrating the "implementation gap" and "ambition gap"), https://www.blackrock.com/corporate/insights/blackrock-investment-institute/publications/net-zero-transition.
[23] 2024 Benchmark Policy Recommendations at 12.
[24] 2024 Benchmark Policy Recommendations at 12.
[25] 2024 Benchmark Policy Recommendations at 72.
[26] 2024 Benchmark Policy Recommendations at 72.
[27] 2024 Benchmark Policy Recommendations at 72.
[28] 2024 Procedures & Policies at 42.

> company is actively trying to improve the representation of women and people of color and people from different ethnic backgrounds in senior leadership and technical positions and whether it is making progress in these efforts."[29]

These social-related benchmark policies are problematic as well. Again, without attempting to be exhaustive, these policies are specific and prescriptive such as "[g]enerally vot[ing] against" relevant directors of companies "where there are no women on the company's board."[30] They also appear to be based on unlawful race and sex quotas, such as stating when evaluating "proposals asking a company to increase the gender and racial minority representation on its board," the policy to consider "[t]he degree of existing gender and racial minority diversity on the company's board and among its executive officers," and "[t]he level of gender and racial minority representation that exists at the company's industry peers."[31] Companies may open themselves up to legal liability by implementing proposals that ask them to expressly make hiring decisions based on race or sex, or to meet certain quotas for diversity.[32] Additionally, new research has questioned the methodology of a prominent prior study that concluded diversity is linked to profits.[33] It is therefore important that ISS adjust your social policies in light of these developments and your express representation that the benchmark policy is focused on maximizing, protecting, and enhancing shareholder value.

Thank you for your prompt attention to these matters. We request confirmation that we, as State Financial Officers, will be included as respondents to your annual benchmark policy survey, so our concerns can be considered in ISS's annual policy development process.

Sincerely,

Alaska Commissioner of Revenue Adam Crum

Arizona Treasurer Kimberly Yee

Idaho Treasurer Julie Ellsworth

Indiana Comptroller Elise Nieshalla

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[29] 2024 Procedures & Policies at 42.
[30] 2024 Benchmark Policy Recommendations at 12.
[31] 2024 Benchmark Policy Recommendations at 72.
[32] *See, e.g.*, Clara Hudson & Riddhi Setty, Firms From KKR to Coors Flag DEI as Business, Legal Risk, Bloomberg Legal News (March 11, 2024), https://news.bloomberglaw.com/daily-labor-report/firms-from-kkr-to-coors-flag-dei-as-a-risk-to-their-bottom-lines.
[33] James Mackintosh, *Diversity Was Supposed to Make Us Rich. Not So Much*, Wall Street Journal (Jun. 28, 2024), https://www.wsj.com/finance/investing/diversity-was-supposed-to-make-us-rich-not-so-much-39da6a23.

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