ACCR

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Via email: policy@issgovernance.com

26 October 2020

Dear Sir/Madam

Re: Proposed Benchmark Policy Changes for 2021

We are pleased to provide our comments on the *Proposed Benchmark Policy Changes for 2021* released by ISS on October 14, 2020.

In general, ACCR supports changes to policy seeking to advance the aims of racial and gender equity, though we note that these policy changes are only intended to apply in specific regional contexts, excluding Australia. We would support broader application in all benchmark policies, or their extension to Australia.

The only proposed change applicable in the Australian market is the change to “Director Elections: Material E&S Risk Oversight Failures” (pages 31-32).

Specific comments on inclusion of climate change in all benchmark policies on director elections, relating to material risk oversight failures

The proposed change is to include “demonstrably poor risk oversight of environmental and social issues, including climate change” in “examples of failure of risk oversight” which give rise to the general recommendation, to, “under extraordinary circumstances, vote against or withhold from directors individually, committee members, or the entire board.”

Question: Do you support the proposed policy change?

Climate scientists, economists, and financial regulators agree that the systemic risk of climate change to investors’ portfolios is large, material, and undiversifiable, therefore this proposed policy change is warranted and is supported by ACCR.

Question: Do you have any concerns with the proposed policy change?

The proposal could and should be strengthened.

ISS proposes to consider failures of risk oversight with respect to climate-related issues only where it is likely to have a "large negative impact" on future company operations at the specific company in question, and where "directors fail to make their company more resilient". This construction casts all companies as the 'victims' of climate change, ignoring the *causal* role played by companies which are systemically significant emitters.

Climate change is a systemic risk that has the potential to negatively impact the entire portfolio value of investors, and as such the climate performance and greenhouse gas emissions of individual companies can have an impact on the value of other investments as well. The policy should be broad enough to enable votes on director elections to hold boards accountable for companies' climate performance and impact on climate outcomes.

Question: If the proposed change contemplates ISS adverse vote recommendations, are they targeted appropriately?

ISS indicates that it expects this policy change to impact only a small number of directors each year. However, given the systemic risk posed by climate change and the failure of many companies to align their operations with the scientific recommendations to limit warming to 1.5°C over preindustrial levels by the end of the century, this policy should be applied as broadly as warranted by the consideration of the factors set out below rather than limited to a small number of directors each year.

In targeting the application of this policy, focus should be placed on companies that have the largest impact on climate outcomes, including companies that are responsible for driving the demand and supply of fossil fuels in industries such as coal, oil and gas extraction and transportation, electric power production, automotive manufacturing, and financial services.

In Australia, the majority of directors are only subject to re-election every three years, rather than annual re-election as is the case in the United States and elsewhere. For that reason, there are fewer opportunities to vote against directors of specific committees that should be held responsible for oversight failures relating to environmental and social risks. A 'second chance' for a poor-performing director in the Australian market may mean another three years of inadequate governance. ISS should take a proactive and assertive approach towards the re-election of directors in Australia, especially when material risks have been mismanaged.

Question: Are there any other factors that ISS should consider when contemplating the proposed policy change?

Defining a material oversight of risk management is subjective, but ISS must not simply accept that improved disclosure on environmental and social risks is an indication that such risks are being managed effectively. For example, in recent years investors have been inundated with TCFD-style disclosures, yet few companies have translated that analysis into a significant change in corporate strategy. This is particularly relevant for the energy and utilities sectors, where improved disclosure is not effective risk mitigation.

Question: What factors would your organization consider as evidence that the board has demonstrated poor risk oversight of environmental and social concerns?

ACCR recommends the following factors be considered in assessing whether a board has demonstrated poor risk oversight with respect to managing climate performance:

- whether the company has set a science-based net-zero emissions target that is aligned with the goal of limiting global warming to 1.5°C over preindustrial levels by the end of the century;
- whether the company is prioritising emissions reductions post-2030 over reducing emissions in

the short to medium term;
- whether the company has made public its net-zero transition plan and taken steps to ensure that its capital expenditure plans are consistent with implementing such emissions targets;
- whether the company's financial statements reflect climate change risks and impacts, the consistency of the assumptions and estimates used in preparing the financial statements with those underpinning the transition plan, and the robustness of the company's disclosures on climate-related risks;
- whether there are one or more directors on relevant board committees whose previous experience or actions are inconsistent with robust oversight of climate change risk;
- whether the company has aligned its political and public policy activity, *including through industry associations or think tanks,* with its net-zero transition, including a public commitment to not lobby to oppose or weaken action on climate change or to contribute dues or other funds to organisations that engage in such lobbying; and
- whether the incentive compensation arrangements applicable to named executive officers, including the selection of metrics and targets by the compensation committee, are consistent with the transition plan.

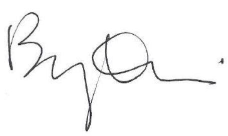
Question: In the past, ISS has generally applied the material governance failures policy in a retrospective fashion. Would your organization support establishment of criteria that would allow ISS benchmark policies to proactively identify boards that fail to prepare for foreseeable future risks?

ISS should proactively identify boards that have failed to prepare for future risks. The systemic risk posed by climate change is foreseeable, and companies have been on notice since the release of the 2018 International Panel on Climate Change Report[1] that in order to avoid the worst impacts of climate change on the financial and economic system, global carbon emissions must halve by 2030, and fall to net-zero by 2050 at the latest. The failure to prepare for these foreseeable future risks is a material governance failure and waiting until such risks are fully realised to hold boards accountable for risk oversight of these issues is not in the best interests of shareholders.

In ACCR's view, ISS should incorporate competence on climate risk into its assessment of skills and qualifications of board directors. While transition risks are particularly relevant for directors of companies in the energy and utilities sectors, companies exposed to acute or chronic physical risks of climate change must have directors capable of understanding the nature of those risks, and how they should be managed.

We appreciate the opportunity to provide this feedback.

Sincerely,



Brynn O'Brien, Executive Director
Australasian Centre for Corporate Responsibility

[1] *Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty*, October 6, 2018, https://www.ipcc.ch/sr15/