ShareAction»

Lankelly Chase

26 October 2020

Institutional Shareholder Services (ISS)
702 King Farm Boulevard, Suite 400
Rockville MD 20850
USA
Via email: policy@issgovernance.com

Dear Sir/Madam,

Re: Proposed Benchmark Policy Changes for 2021

ShareAction and Lankelly Chase are pleased to submit our response on the *Proposed Benchmark Policy Changes for 2021* released by ISS on 14 October 2020. Our response focuses on ISS' proposal to amend its global Director Elections policy to make explicit that ISS has the flexibility to vote against or withhold support from directors due to "demonstrably poor risk oversight of environmental and social issues, including climate change".

Question: Do you support the proposed policy change?

Yes. Crises in the natural world have reached a critical level. Schroders' latest Climate Progress Dashboard projects an average global temperature rise of nearly 4°C by the end of the century[1]. The risks associated with temperatures at or above 4C include a 9-metre rise in sea levels – affecting up to 760 million people – serious food supply disruptions and half of all animal and plant species facing local extinction. These physical impacts present a major systemic risk for banks and their investors[2]. Inaction now threatens the very existence of human society: the Intergovernmental Panel on Climate Change (IPCC) warns that averting the most serious consequences of climate change requires a radical overhaul of the global economy, while the OECD argues biodiversity loss is among the top global risks to society[3].

Institutional investors, as long-term stewards of capital, have a responsibility to ensure that the companies that they finance are made to account for their impact on society. Voting against directors for ESG reasons was identified as a key stewardship tool by the UN Principles for Responsible Investment[4]. Global investors

[1] Schroders (2020). Climate progress dashboard. Available at: https://www.schroders.com/en/about-us/corporate-responsibility/sustainability/climate-progress-dashboard/

[2] The Guardian (2020). Bank of England boss says global finance is funding 4C temperature rise. Available at: https://www.theguardian.com/business/2019/oct/15/bank-of-england-boss-warns-global-finance-it-is-funding-climate-crisis

[3] ShareAction (2020). Point of no returns. Available at: https://shareaction.org/wp-content/uploads/2020/03/Point-of-no-Returns.pdf

[4] UN PRI (2018). A practical guide to active ownership in listed equity. Available here: https://www.unpri.org/download?ac=4151

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such as Blackrock[5], Legal and General Investment Management[6] and BNP Paribas asset management[7], three of the world's largest asset managers, have all started voting against directors for climate-related reasons. However, this stewardship is often underused by investors and tends to be used on a case-by-case basis rather than used systematically across holdings. Indeed, in 2019 the directors of BP, Chevron, ExxonMobil, Shell and Total were all (re-)elected with on average 97% support from shareholders, despite these companies being some of the largest emitting companies on earth and lacking plans to transition to a well-below 2°C world[8].

Whilst shareholder resolutions are a good way for asset managers to express support for specific ESG issues, these tend to be an exception, especially at non-US companies. Voting against directors for ESG reasons nicely complements investors' toolbox to exert stewardship and promote the long-term interests of their clients.

We therefore support ISS' proposal to recommend investors to abstain or vote against directors due to "demonstrably poor risk oversight of environmental and social issues, including climate change", and believe it should go even further (see below.)

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

ISS' proposal 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. However, 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. Therefore, ISS' policy should be broad enough to enable votes on director elections to hold boards accountable for companies' climate performance and impact on climate outcomes[9].

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 1.5C goal of the Paris agreement, this policy should be applied as broadly as warranted by the consideration of the factors set out below rather than arbitrarily limited to a small number of directors each year.

Indeed, we believe that ISS' policy should instead target investors on a systematic basis, and prioritise sectors that contribute significantly to climate change, either via their direct emissions, the emissions of their products, or the emissions embedded in their financing. This should include the oil and gas, power, mining and financial services industry at the very least.

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[5] The Guardian (2020) Blackrock votes against 49 companies for lack of climate crisis progress. Available at: https://bit.ly/3dXliKa

[6] LGIM (2020). LGIM steps up sustainability and governance efforts. Available at: https://www.legalandgeneralgroup.com/media-centre/press-releases/lgim-steps-up-sustainability-and-governance-efforts/

[7] BNP Paribas (2020). Governance and voting policy – 2020. Available at: https://docfinder.bnpparibas-am.com/api/files/4A9D6883-8110-46B2-9560-173E31568323

[8] Landell Mills, N. (14 October 2019). "Asset managers must use their votes to tackle climate change", Financial Times. Available at: https://www.ft.com/content/da38652c-eb75-11e9-aefba946d2463e4b

[9] Majority Action (2020). Letter to U.S. Department of Labor, Re: Proxy Voting and Shareholder Rights NPRM, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights. Available at: http://bit.ly/MajorityActionFiduciaryDutyProxyVoting

We recommend that the following factors be considered when assessing whether a board of directors has demonstrated poor risk oversight with respect to managing climate-related risks and/or their climate performance:

- Does the company disclose in line with the TCFD? Are these included in annual reports or strategic reports, instead of sustainability reports?
- Does the company ensure that its own financial statements take account of the Paris Agreement, and thus – for example - reflect credit risks of loans to fossil fuel related entities in loan loss provisioning assumptions?
- Does the company have a science-based target that is aligned with the 1.5C goal of the Paris agreement? If not, has the company published a credible transition plan and/or emissions reduction targets covering its Scope 1, 2 and 3 emissions aligned with the 1.5C goal of the Paris agreement? Do these targets or plans include short- and medium-term milestones, such as 2025 and 2030 targets?
- Does the company's underlying assumptions rely excessively on the use of negative emission technologies or uncosted carbon capture and storage or offsets, given the IPCC's conclusion that carbon dioxide remove technologies "deployed at scale [are] unproven and reliance on such technology is a major risk in the ability to limit warming to 1.5C"[10]?
- Has the company committed to phasing out its exposure to fossil fuel related assets on a timeline aligned with the 1.5C goal of the Paris agreement?
- Are the company's direct and indirect lobbying activities aligned with the Paris agreement?
- (Mostly relevant to oil and gas) Do the remuneration policies of company executive contain direct or indirect growth metrics[11]?

Question: If the proposed change includes a transition period for the implementation of a policy, is it about right, too short or too long?

We believe this policy should be implemented on time to influence investors' voting decisions for the 2021 AGM season.

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

ISS should expect companies to disclose information about climate-related risks in companies' annual or strategic reports, as these will be audited by third parties. As improved climate-related disclosures do not automatically translate into changes in corporate strategies, it is important that ISS considers the criteria outlined above when deciding its voting recommendations on specific directors.

Furthermore, ISS should research whether some of the company's information is contradicted by third party sources. For example, a recent study published in Nature, which used aircraft measurements over the Canadian oil sands to derive the first top-down measurement-based determination of their annual CO_2 emissions and intensities, found that CO_2 emission intensities for oil sands facilities are 13–123% larger than those estimated using publicly available data. This leads to 64% higher annual GHG emissions from surface mining operations, and 30% higher overall oil sands GHG emissions (17 Mt) compared to that reported by industry, despite emissions reporting which uses the most up to date and recommended bottom-up approaches[12].

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[10] IPCC

[11] ShareAction (2020). Shell and BP's 2020 remuneration policies. Available at: https://shareaction.org/wp-content/uploads/2020/04/BP-Shell-Rem-Final.pdf

[12] Liggio, J., Li, S., Staebler, R.M. et al. (2019). Measured Canadian oil sands CO2 emissions are higher than estimates made using internationally recommended methods. Nature Communications 10, 1863.

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

We would strongly support this. The systemic risk posed by climate change is foreseeable, and made evidently clear by the publication of the IPCC's Special Report on 1.5C in November 2018. 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.

We appreciate the opportunity to provide feedback. Please do not hesitate to get in touch with Jeanne Martin (jeanne.martin@shareaction.org) if you have any questions.

Sincerely,

Wolfgang Kuhn
Director of Financial Sector Strategies
ShareAction

Dominic Burke
Investment Director
Lankelly Chase

Available at: https://doi.org/10.1038/s41467-019-09714-9