

November 16, 2021

Via email: policy@issgovernance.com

In re: Proposed Benchmark Changes for 2022

I am writing on behalf of the Council of Institutional Investors (CII) to respond to certain matters put forward by the ISS comment solicitation for its 2022 benchmark voting recommendation policies.¹ CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, and other employee benefit plans, foundations and endowments with combined assets under management exceeding \$4 trillion. Our member funds include major long-term shareholders with a duty to protect the retirement savings of millions of workers and their families. As an association of primarily U.S.-based investors, our responses address potential changes to benchmark voting recommendations at U.S. companies.

Board Accountability—Unequal voting rights

CII supports “one-share, one-vote” equity structures as a bedrock principle of corporate governance. Since 2016, we also have encouraged companies going public with multi-class structures to establish a clear and reasonable path to equal voting rights, achieved through charter provisions adopted in connection with the initial public offering to automatically convert to a single class of common shares within seven years.²

Despite significant public attention to the proliferation of unequal voting rights, newly public companies generally continue to follow the principle of proportionate control according to economic interest. In the first half of 2021, about three in four newly public companies (including traditional IPOs, de-SPAC mergers and direct listings) opted for equal voting rights, and the majority of those that chose unequal structures incorporated time-based sunset provisions in their charters.³ Seven years was the most popular sunset length, and no time-based sunset provision extended beyond 10 years.⁴

We acknowledge that most directors serving on the boards of companies with unequal voting rights had no involvement in pivotal decisions made at the time of the IPO on how to assign voting rights to shareholders of similar economic interest. CII agrees that the greatest culpability among directors lies with those individuals who agreed to insert unequal voting rights into the charter at the time of the IPO. We maintain a “Dual-Class Enablers” list of those directors to help investors bring accountability to those individuals, even as they move on to other boards.⁵

¹ Proposed Benchmark Policy Changes for 2022: Request for Comments, available at <https://www.issgovernance.com/file/policy/proposed-benchmark-policy-changes-2022.pdf>

² See CII member-approved statement *Investor Expectations for Newly Public Companies*, available at https://www.cii.org/ipo_policy

³ See examples of time-based sunset provisions at https://www.cii.org//Files/issues_and_advocacy/DualClassStock/7-22-21%20Time-based%20Sunsets.pdf.

⁴ See CII Dual-Class IPO Snapshot: First Half of 2021, at [https://www.cii.org/Files/issues_and_advocacy/Dual%20Class%20post%206-25-19/Dual-Class%20IPO%20Snapshot%20First%206%20months%20of%202021_GD%20comments%20\(002\).pdf](https://www.cii.org/Files/issues_and_advocacy/Dual%20Class%20post%206-25-19/Dual-Class%20IPO%20Snapshot%20First%206%20months%20of%202021_GD%20comments%20(002).pdf).

⁵ See CII Dual Class Enablers List at <https://www.cii.org/dualclassenablers>

Directors who joined the board after the IPO are empowered as a group to propose charter amendments to recapitalize the company to establish equal voting rights across classes of equity with similar economic rights. CII views recapitalization without an automatic sunset as the least optimal of the three routes to equal voting, given the substantial costs required to make high-vote holders whole. But this route remains the only viable option for the vast majority of companies with unequal voting rights, and it may be picking up momentum; recent examples include Blue Apron, KKR and Shell, the last of which remains subject to shareholder approval in December.

We recognize that the contemplated voting policy would function as a signaling mechanism rather than a device to directly alter board composition, considering that the holder(s) of high-vote classes generally control the outcomes of director elections. CII does not view this distinction as a sufficient reason to dismiss the contemplated policy. Whether voting on uncontested director elections with a plurality standard, non-binding shareholder proposals or advisory votes on executive compensation, investors are familiar with proxy votes that function solely as a communication tool. Though these proposals effect no legal change, the outcomes help boards better understand the sentiment of the company's owners, and the board's level of responsiveness to those outcomes may help inform investment decision-making.

With these considerations in mind, we strongly support the proposed benchmark recommendation to withhold support from, or vote against, incumbent directors at companies with unequal voting rights. We support all exclusions proposed, including the *de minimus* exception. We further suggest granting relief to incumbent directors to the extent the company has committed in an SEC filing to undertake a recapitalization in the near term to achieve equal e voting rights. Such recapitalizations are significant undertakings that require extensive planning, outside legal and financial advice, fair economic consideration to holders of high-vote classes⁶, possible contemporaneous governance changes and active solicitation for approval at a shareholder meeting. In this context, CII supports the proposed one-year grace period.

Another way to help investor clients communicate concern with long-term multi-class structures would be to modify the ISS definition of director independence. For directors who sit on the boards of companies whose total voting power is majority-controlled by CEOs with superior voting rights, there is no chance of re-election without maintaining the good graces of the chief executive. Such directors' contributions to the board can still be valuable, but we ask how their contributions can realistically be categorized as an independent check on management.

Board Diversity

CII supports a diverse board, and our member-approved corporate governance policies emphasize diversity by “background, experience, age, race, gender, ethnicity and culture.” We believe nominating committees should monitor board composition “for the distribution of skillsets, backgrounds and tenure on the board, and heed the results of board evaluations to ensure the board equips itself with competencies

⁶ As recapitalizations to achieve equal voting rights may proliferate in the coming years, we underscore the importance of proxy advisors and their clients monitoring the fairness of consideration offered to high-class shareholders in connection with unwinding multi-class structures. While progress toward equal voting rights is encouraging, it should not come at the expense of overcompensating high-class holders. CII takes no position on the fairness of recent recapitalizations, but notes recent coverage, e.g. C. Oguh and J. DiNapoli , Reuters, *Giving Up Control Pays Big for Private Equity Executives* (Oct. 13, 2021), <https://www.reuters.com/business/finance/giving-up-control-pays-big-private-equity-executives-2021-10-13/>.

and experiences that will further the company’s strategic goals.”⁷ We note these expectations apply to all companies, regardless of size.

With regard to the proposed benchmark recommendation to expect U.S. companies below the S&P 1500 and Russell 3000 indexes to include at least one female director by 2023 and at least one racially or ethnically diverse director by 2022, we are generally supportive. We would characterize the proposed revision as reasonable, while taking into consideration that very small companies tend to have smaller boards, more challenges attracting new directors and less resources to promptly adapt to investors’ current governance expectations. We, however, believe diverse boards can be achieved without quotas which may result in ‘check-the-box’ diversity.

Climate—Board Accountability and “Say on Climate” voting

CII views board consideration of firm-specific and system-wide risks as an integral part of overseeing business strategy.⁸ We further support clear, comparable and reliable disclosure on sustainability-related performance.⁹

We generally support the proposed climate-related board accountability policy, in particular the recommendation against the re-election relevant directors at companies that decline to make appropriate climate-related disclosures, such as those that align with TCFD. We question whether the other prong of the new policy—the presence of *any* GHG reduction target—is a useful test; it echoes the deference taken by ISS with respect to the performance-based pay design, which opens the door to deficiencies in rigor.

As ISS contemplates adopting an extensive set of factors to guide when it will recommend in favor of proposals seeking Say on Climate voting, we would like to share that we have heard broad skepticism among investor members as to whether an advisory vote on climate can deliver its intended salutary effect. Moreover, CII has heard informally from a broad range of proxy voting and stewardship professionals that Say on Climate presents considerable new hazards for investors, such as:

- “Splitting shareholder voice” risk—A segment of proxy voters with concern about the company’s strategy on climate may oppose certain directors and vote affirmatively on the advisory vote, while another segment with nearly identical concerns may support certain directors and vote negatively on the advisory vote. We ask whether shareholder voice would be better served by a system that concentrates climate concerns on the election of directors.
- Cleansing risk—In the absence of clear evidence to vote against, which is not a narrow concern given the developing landscape in standardized sustainability disclosure, many investors may default to voting in favor, which may blunt company momentum toward moving boldly on climate-related strategic reforms that could benefit the firm in the long-term.
- Delegation risk— Say on Climate may result in some C-suites and boardrooms taking a more reactive stance than otherwise, if they interpret the advisory vote as putting investors in the “driver’s seat” on whether and when to embrace climate-aware strategies. While shareholder responsibility is certainly important, as a practical matter, managers and boards have distinct advantages to lead. They have the time, resources, access to complete information and day-to-day power to effect change.

⁷ Section 2.8 of CII’s Corporate Governance Policies, Board/Director Succession Planning and Evaluation, https://www.cii.org/corp_gov_policies#BOD

⁸ Section 2.7 of CII’s Corporate Governance Policies, Board’s Role in Strategy and Risk Oversight, https://www.cii.org/corp_gov_policies#BOD

⁹ CII member-approved *Statement on Corporate Disclosure of Sustainability Performance*, https://www.cii.org/sustainability_performance_disclosure

...

We commend ISS for expending the resources and efforts to conduct a formal and transparent process to solicit market participants' views on pending changes to benchmark voting guidelines. We believe this engagement strengthens the value of proxy advisors to the capital markets, insofar as it contributes to further aligning benchmark policies with the interests of long-term investors. Please feel free to contact me at glenn@cii.org with any questions.

Sincerely,

A handwritten signature in cursive script that reads "Glenn Davis".

Glenn Davis
Deputy Director