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Benchmark Policy Survey Feedback Signals an Increased Focus on Non-Financial Metrics and Audits for the 2022 Proxy Season

Responses to ISS' annual policy survey suggest that a variety of modifications may be on the way heading into the 2022 proxy season — from ESG performance metrics in executive compensation to racial equity audits and a longer-term view of pay for performance.

In early October, Institutional Shareholder Services (ISS) released the results of [two policy surveys]— the traditional Benchmark Policy Survey and a new Climate Policy Survey, which we will discuss in more detail in a separate alert.

The Benchmark Policy Survey is conducted annually to solicit broad governance feedback on key policy changes for the year ahead. Similar to prior benchmark surveys, there were a greater number of responses from companies and corporate-affiliated organizations, and more than 150 responses from investors.

Below is a summary of key Benchmark Policy Survey results that are relevant for companies based in the United States.

Key Benchmark Policy Survey Results

Non-Financial ESG Performance Metrics in Executive Compensation

Most investors and companies agreed that non-financial environmental, social and governance (ESG) performance metrics are an effective way to incentivize executives to achieve company ESG goals. However, opinions diverged when digging deeper; over half of investors believed non-financial ESG metrics should be specific and measurable. In contrast, one quarter of companies agreed with this view and almost half of company respondents noted that ESG-related metrics that are not financially measurable can be an effective way to drive positive outcomes. Both groups of respondents agreed that short- or long-term incentive programs can be the appropriate place for ESG-related metrics depending on the circumstance.

Racial Equity Audits

With the increased shareholder focus on diversity, equity and inclusion (DE&I), ISS asked about third-party racial equity audits. Roughly half of all survey responses agreed that the benefits of these audits would depend on a

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company’s unique circumstances, including their programs and outcomes. Almost half of the investors took the view that companies would benefit from an independent racial equity audit regardless of circumstance or the presence of specific controversies. Most respondents said an audit would be beneficial in cases where there is a controversy or the possibility that a company has not undertaken steps aimed to enhance workplace DE&I through trainings or pay disclosure.

A Longer-Term View on Pay-for-Performance and Pay Quantum

Noting the increasing focus on pay quantum, ISS asked if a longer-term view of pay for performance would be appropriate. For example, ISS questions if its Multiple of Median review, which looks at one-year CEO pay, should extend to three years. Both investors and companies were supportive of this by a wide margin, at 85% and 67%, respectively.

Mid-Cycle Changes to Long-Term Incentive Programs

The challenges and uncertainty of the coronavirus (COVID-19) global pandemic led some companies to implement changes to incentive programs. In general, more adjustments were made to short-term incentive programs. Changes to long-term incentive programs were more closely scrutinized by proxy advisors and investors, many of whom viewed these negatively. A little more than half (53%) of investors viewed mid-cycle changes to long-term incentives as problematic. Only 40% of investors said such changes may be reasonable where a company has experienced long-term impacts from the pandemic compared to 76% of company respondents.

Pre-IPO Governance Provisions

In 2015, ISS instituted a policy to recommend votes against directors at newly public companies with perceived problematic governance practices, such as classified boards, multiple classes of stock and super-majority vote requirements. At the time, ISS grandfathered companies with these provisions that went public prior to 2015. Both investors and companies were supportive of ISS revisiting the exemption for these companies, though by a much stronger margin for investors than companies (94% vs. 57%). Both groups greatly supported revisiting the exemption for companies with dual-class shares.

Recurring Adverse Director Recommendations

For companies not currently grandfathered as described above, ISS sought more information regarding the circumstances under which recurring negative vote recommendations against directors should continue. Forty-five percent of investors believed that ISS should continue to recommend against directors every year when there is no management proposal on the ballot to reduce or eliminate the governance provision in question. In contrast, 56% of company respondents believed that a single attempt by the company to remove the governance provision is sufficient. The views of both groups were more aligned in cases where a company did not obtain shareholder approval and committed to resubmitting the proposal. Here only 35% of investors and 29% of companies believed ISS should continue to issue negative vote recommendations against directors.

SPACs

ISS’ current policy regarding transactions, whereby a special purpose acquisition company (SPAC) seeks shareholder approval to combine with a target company, is determined on a case-by-case basis. However, ISS is now considering a change to this policy due to the evolving SPAC investor voting practices and the mechanics of SPACs. Therefore, ISS wants to know whether companies view SPACs as favorable transactions for investors, regardless of the target company's merits or governance concerns. The majority of responses indicated either no opinion (more so from company responses) or that their organization does not own SPACs.

Virtual-Only Meetings

Considering the continuing global pandemic, ISS is interested in the long-term effects of virtual-only annual general meetings and is reviewing potentially problematic practices. The biggest concerns included the inability to ask live questions, questions left unanswered and management's power to determine which and how many questions to address, allowing for the potential avoidance of difficult questions. Appropriate ways for shareholders to address these issues varied. Investors believed that either the chair of the board or all responsible directors should receive negative votes. Contrastingly, companies felt that targeting directors would be inappropriate, and leaned towards engagement as a better course of action to communicate concerns.

Next Steps

This month, ISS is expected to release draft policy updates and open a public comment period on proposed changes to its voting policies for the 2022 proxy season. The 2022 policy updates should be announced in November, and then followed up in December with the publication of the final policy guidelines. The 2022 updated policies will be applicable to shareholder meetings occurring on or after February 1, 2022.

For questions about the topics in this alert or to speak with one of our experts, please write to humancapital@aon.com.

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