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Via email to policy@issgovernance.com

Re: Comment on Proposed 2025 Benchmark Voting Policy Changes

Dear Mr. Retelny and Ms. Kelly,

As National Chairman and Vice Chairman of the State Financial Officers Foundation, we are writing to express our appreciation for your agreement to discuss the important issues raised by our colleagues across the country in our letter dated September 5, 2024. We remain deeply troubled by issues we raised and are looking forward to discussing them with your team. We have attached the September 5th letter to this comment and included an overview of our concerns below.

ISS will benefit from basing the Benchmark Policy's recommendations solely on financially material factors. Since our September 5th letter, the U.S. held an election. The Benchmark Policy should consider the likelihood of significant regulatory changes on environmental and social issues under the new administration. This comment addresses the one environmental change actually proposed, which is in the wrong direction—to adopt the Taskforce on Nature-related Financial Disclosures ("TNFD") framework as a standard for certain environmental proposals. Finally, this comment again lists 11 environmental and social policies in the 2024 Benchmark Policy that need to be reversed or substantially revised for 2025.

I. ISS's Benchmark Policy on Environmental and Social Issues is not Based on Financial Considerations, and it is Out-of-Step with the Market

ISS represents that its benchmark policy is designed to "maximiz[e] and protect shareholder value." However, a report that reviewed 192 environmental shareholder proposals opposed by company management but nonetheless recommended by ISS's benchmark policy calls into question whether ISS is performing any specific financial analysis before recommending voting "for" these proposals. As 24 state attorneys general noted, these recommendations would require companies to: 1) cut off lending or insurance to customers based on achieving emissions-reduction targets, 2) cut off energy production based on emissions-reduction targets, and 3) limit their speech with policymakers to prevent them from expressing negative views about or providing counter-arguments against the Paris Agreement and trying to achieve net zero by 2050.[1] All of these categories of proposals appear *harmful* to the financial interests of the subject companies, yet ISS recommended voting "for" over the objection of company management. Our September 5th letter asked for evidence that ISS is performing specific financial analyses before making these recommendations. If ISS is not performing such an analysis, then it needs to change its policies so they are based on financial return, as it represents to its customers and others. This change needs to be made urgently.

The Procedures & Policies cite a single journal article by Bassen, Busch & Friede.[2] But that article is from 2015. No citation or analysis of newer works is provided. For example, in a 2019 *Journal of Finance* article, Hartzmark and Sussman compared the performance of investment funds that focused on ESG investments to funds that were not focused on ESG. They found that ESG-focused funds *underperformed* the unconstrained funds by 2.16% or 5.76% annually.[3] This is not only a newer study but also appears to be more directly relevant to the actual question of fund performance—the specific issue for which ISS represents its benchmark policy seeks to "maximiz[e]." ISS need not only rely on academic studies. Actual practitioners such as Vanguard have stated, "[o]ur research indicates that ESG investing does not have any advantage over broad-based investing."[4] ISS must, therefore, justify its recommendations over the objections of company management with specific financial analyses—or admit that its Benchmark's recommendations are about political ideology, not maximizing shareholder value.

In addition to the apparent lack of financial analyses, the market has changed substantially since 2021, but ISS has not updated its policy. This cannot continue for the 2025 proxy season. As noted, a recent study found that the ISS Benchmark Policy recommended voting "for" environmental proposals opposed by company management at 500% the rate of the market. Other data similarly shows that ISS's policy must be updated if it is to reflect the current market. An October 15, 2024, article on the Harvard Law School Forum on Corporate Governance stated that "[a]cross both retail and institutional segments of shareholders, there was...a continued decrease in support for Environmental and Social proposals.... The cooling shareholder support for 'E' and 'S' proposals continues a downward annual trend since the highwater support mark in the 2021 proxy season."[5] This article further reports, "[b]ased on the number of proposals that went to a vote (166), there were more environmental and social proposals this season than last. Overall support decreased to 21.2% of the votes on average this season from 25.5% the prior season, the lowest in at least 8 years. This was due to a decline in both institutional support and retail support, both of

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[1] https://content.govdelivery.com/attachments/MTAG/2024/08/29/file_attachments/2982180/Asset%20Managers%20-%20ISS%20Recs%20Letter%20Final.pdf

[2] 2024 Procedures & Policies at 41 & n.2, https://www.issgovernance.com/file/policy/active/americas/US-Procedures-and-Policies-FAQ.pdf.

[3] https://doi.org/10.1111/jofi.12841.

[4] Chris Flood et al., Vanguard Chief Defends Decision to Pull Asset Manager Out of Climate Alliance, Financial Times (Feb. 20, 2023), https://www.ft.com/content/9dab65dd-64c8-40c0-ae6e-fac4689dcc77.

[5] Chuck Callan & Mike Donowitz, Broadridge, *2024 proxy season review* (Oct. 15, 2024), https://corpgov.law.harvard.edu/2024/10/15/2024-proxy-season-review/.

which are at historical lows."[6] Ms. Kelly has represented that the benchmark policy is "pretty centrist," but that is clearly not true when comparing the benchmark policy to the more recent eroding support for environmental and social issues, for which ISS has continued to recommend voting "for."

One major problem is that ISS's benchmark policy is expressly labeled as "*United States* Proxy Voting Guidelines Benchmark Policy Recommendations," but ISS's process appears to rely heavily on global input, which does not reflect the U.S. market,[7] and a global "peer group" of companies.[8] This is very likely skewing the survey results and resulting in a biased policy. An analysis at Morningstar explained in February 2024 that "U.S. managers' voting record [on ESG resolutions] stands in stark contrast to that of European managers."[9] Similarly, this difference was illustrated by multiple high-profile departures from Climate Action 100+ ("CA100+") by U.S. entities such as J.P. Morgan Asset Management, State Street Global Advisors, PIMCO, and Invesco.[10] State Street noted "potential legal risks," and stated Phase 2 of CA100+ was "not consistent with [its] independent approach to proxy voting and portfolio company engagement."[11] Yet, while many U.S. asset managers continue to move away from supporting ESG shareholder proposals, European asset managers continue to push ESG. By not addressing this obvious mismatch, ISS is failing to live up to its representations that the Benchmark Policy is supposed to reflect the "United States" market.

II. ISS's Benchmark Policy Purports to Consider the Regulatory Environment; therefore, it must Account for and Adapt to Changes Stemming from the 2024 Election

There has been a seismic shift in the U.S. regulatory environment, but there is no reflection of that in the Benchmark proposed policy changes for 2025. The policies and procedures specifically claim "***the regulatory environment*** and international investment community continue to push for improved disclosure, as most recently shown by the commitments made to the UN's Principles for Responsible Investment (PRI)."[12] Similarly, your policy again expressly looks to whether "emissions reductions targets are aligned with Paris Agreement goals of limiting warming to well below 2 degrees C."[13] If ISS is in fact basing its policy on the regulatory environment, then it

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[6] *Id.*
[7] Lindsey Stewart, *Voting on ESG: Ever-Widening Differences* (Feb. 7, 2024), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1
[8] *See* 2024 Procedures & Policies at 41 ("If the company is a large, multinational company, it may be most appropriate to compare the company to multinational peers."). But there is no indication of regulatory differences between the U.S. and Europe when determining a "peer group." This is an increasingly significant problem with ISS's benchmark policy.
[9] https://corpgov.law.harvard.edu/2024/02/07/voting-on-esg-ever-widening-differences/.
[10] *See April 3, 2024, Letter from 17 State Attorneys General to Climate Action 100+ members* at 3 & n.13, https://attorneygeneral.utah.gov/wp-content/uploads/2024/04/2024-04-03-State-letter-to-asset-managers-re-CA100.pdf.
[11] *Id.* at 3 n.14.
[12] 2024 Procedures & Policies at 41 (emphasis added).
[13] 2024 Procedures & Policies at 42.

needs to take changes to the regulatory environment into account. For example, not even countries are on track to meet the Paris Agreement's climate goals.[14]

More fundamentally, different energy policies and deregulation in the U.S. will likely lead to significant increases in energy production. However, even though the open comment period is after the 2024 election, there is no acknowledgement of that fact in the proposed policy changes. This is resulting in a fundamentally flawed process if it is not corrected.

III. Adopting the TNFD Framework for Environmental Proposals Would be a Harmful Change that is not Based on Financial Factors

The one environmental change actually considered in the Proposed Benchmark Policy Changes for 2025 is to adopt the TNFD framework and other international frameworks as a metric for evaluating environmental proposals relating to environmental impacts of company operations.[15] This change should be rejected because it doubles down on the failed approach of allowing non-US entities to dictate what is purportedly a "United States" benchmark policy. Moreover, TNFD does not represent its framework is aligned with the fiduciary duty to maximize the value of the target companies. Rather, it is part of a larger international push to redefine "materiality" in financial reports to include "material information needs of stakeholders focused on impacts."[16] Requiring corporations to expend scarce resources and distracting senior management with reporting on items that are not financially material is not a way to maximize shareholder value. It is a way to misuse the financial system to advance an activist agenda.

IV. ISS Must Address Specific Provisions in its Benchmark Policy on Environmental and Social Issues

As we explained, the disparity between the ISS Benchmark Policy and the market is indicative of a wider problem with that policy. The September 5th letter identified four specific environmental provisions and seven specific social provisions in the Benchmark Policy that need to be reconsidered before the 2025 proxy season. These are:

- 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."[17]

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[14] Max Bearak, *The World Is Falling Short of Its Climate Goals. Four Big Emitters Show Why.* (Nov. 8, 2022), https://www.nytimes.com/interactive/2022/11/08/climate/cop27-emissions-country-compare.html.
[15] Page 17, https://www.issgovernance.com/file/policy/2024/Benchmark-Policy-Changes-For-Comment-2025.pdf.
[16] https://tnfd.global/wp-content/uploads/2023/08/Recommendations_of_the_Taskforce_on_Nature-related_Financial_Disclosures_September_2023.pdf?v=1695118661
[17] 2024 Benchmark Policy Recommendations at 17–18 & n.10, https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1.

- 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."[18]
- 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."[19]
- 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."[20]
- The policy to "[g]enerally vote against" relevant directors of companies "where there are no women on the company's board."[21]
- The policy to "generally vote against" relevant directors of companies "where the board has no apparent racially or ethnically diverse members."[22]
- 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."[23]
- The policy to "[g]enerally vote for requests for reports on a company's efforts to diversify the board."[24]
- 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."[25]
- 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."[26]
- When evaluating "Gender/Racial/Ethnic Pay Gap shareholder proposals," the policy to consider "the company's . . . diversity and inclusion initiatives," especially "whether the company is actively trying to improve the representation of women and people of color and

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[18] 2024 Benchmark Policy Recommendations at 70.
[19] 2024 Procedures & Policies at 39.
[20] 2024 Procedures & Policies at 41.
[21] 2024 Benchmark Policy Recommendations at 12.
[22] 2024 Benchmark Policy Recommendations at 12.
[23] 2024 Benchmark Policy Recommendations at 72.
[24] 2024 Benchmark Policy Recommendations at 72.
[25] 2024 Benchmark Policy Recommendations at 72.
[26] 2024 Procedures & Policies at 42.

people from different ethnic backgrounds in senior leadership and technical positions and whether it is making progress in these efforts."[27]

A copy of our prior letter explaining the need to reevaluate these specific policies is available at https://sfof.com/wp-content/uploads/2024/09/Financial-Officer-Letter-to-ISS.pdf, and incorporated by reference.

In conclusion, your new policy does not need to take effect until February 1, 2025, which is two months away. There is sufficient time for ISS to evaluate the material facts identified in the September 5th letter and reiterated in this letter and fix the Benchmark Policy, so it is focused solely on financially material factors. Thank you for the opportunity to comment and we look forward to our upcoming meeting.

Sincerely,

Alaska Commissioner of Revenue Adam Crum

Utah Treasurer Marlo Oaks

[27] 2024 Procedures & Policies at 42.