How are Large Shareholders Preparing to Vote Their Proxies in 2020?

ESG Global Advisors

The 2020 proxy voting season is fast approaching and both institutional investors and issuers are getting ready. As discussed in our previous article Demystifying Proxy Voting: How Do Institutional Investors Vote Shares?, it is critically important for issuers to understand how their largest investors vote their shares. As a result, issuers need to be aware of the key changes made to institutional investors' proxy voting guidelines in advance of the 2020 proxy voting season to avoid surprises at their annual general meetings (AGMs).

The beginning of 2020 saw high-profile announcements related to proxy voting from some of the world's largest investors. BlackRock, State Street Global Advisors, and Allianz Global Investors all committed to more actively voting their shares in support of their ESG priorities. These investors, and many others, are seeking enhanced disclosure and more consistent reporting on ESG factors, such as climate-related risks and opportunities.

Institutional investors have started releasing their updated 2020 proxy voting guidelines. This article highlights some notable areas where investors are strengthening their guidelines.

ESG Risk Management

Investors are becoming increasingly vocal about the need for portfolio companies to identify and understand their material ESG factors and provide disclosure that allows for a meaningful assessment of their ESG-related risks and opportunities. Several the world's largest investors have updated their proxy voting guidelines to clearly state their expectations for companies' ESG disclosure and to specify what actions they will take in instances where disclosure is deemed inadequate.

Vanguard updated the environmental and social disclosure section of its proxy voting guidelines to state that it is likely to support proposals that seek enhanced ESG disclosure when the company's disclosure lags market norms and peers. BMO Global Asset Management (BMO GAM) added a new section to its proxy voting guidelines stating that it may oppose certain management resolutions where the company does not provide adequate ESG disclosure.

BlackRock made several updates to its proxy voting guidelines after releasing Larry Fink's 2020 Letter to CEOs,[1] including a significant expansion and a re-write of its ESG section. BlackRock is asking for companies to provide ESG disclosure that is aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB). BlackRock expects companies to disclose in line with the relevant industry specific SASB standards by the end of 2020. Further, it expects TCFD disclosure to include the company's strategy in a 2°C climate change scenario. In the absence of robust ESG disclosure, BlackRock has stated it will increasingly conclude that the company is not managing the ESG risk adequately and will seek to hold directors accountable. Language has been added to the ESG section to state that BlackRock may vote against the election of directors or support a relevant shareholder proposal if it has concerns that the company is not effectively managing a material environmental or social issue.

State Street Global Advisors' CEO also released a letter describing the firm's 2020 proxy voting agenda,[2] which includes a commitment to vote against board members at companies listed on major global indices that have been identified by the firm as "ESG laggards". This assessment will be based on the firm's proprietary R-Factor, which is a new scoring system that measures the company's performance on material ESG issues leveraging the SASB Standards. State Street Global Advisors will also vote against board members of companies with poor R-Factor scores that are unable to demonstrate how they plan to improve that score over time.

Investors appear to be prepared to take voting action against boards that are not disclosing appropriate oversight of material ESG risks and opportunities as they seek consistent, comparable, decision useful ESG disclosure from portfolio companies. The SASB Standards and TCFD Recommendations have emerged as the clear investor-preferred frameworks for ESG disclosure.

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1 https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter
2 https://www.ssga.com/us/en/institutional/ic/insights/informing-better-decisions-with-esg

Board Diversity

In recent years, board diversity has been a top investor concern. This issue does not appear to be going away anytime soon. Many investors have updated their proxy voting guidelines to strengthen their view on the importance of board diversity. It is now common for investors to vote against the chair of the nominating committee if there are no female directors on a company's board. Investors are also beginning to apply this guideline in all geographic markets. For many investors, it is no longer acceptable to have an all-male board, regardless of local market norms.

Furthermore, investors want to see continued progress on board diversity. As discussed in the article Board diversity: One and we're done? Think again, some of Canada's largest investors have strengthened their proxy voting guidelines in recent years to require more than just one female director. In Canada, this includes Ontario Teachers' Pension Plan (OTPP), British Columbia Investment Management Corporation, Alberta Investment Management Corporation and RBC Global Asset Management (RBC GAM).

The Financial Times recently reported that RBC GAM has further strengthened its guideline on board diversity, stating that it will oppose directors of the nominating or governance committees if the board does not consist of 25% female directors.[3] As part of its 2020 proxy guideline update, Legal and General Investment Management (LGIM) reaffirmed its expectation that all companies globally should have at least one female director on the board and added an expectation that companies in "well-governed" markets should have at least 25% female directors on the board.

Overboarding

Investors are increasingly focused on a director's ability to discharge board duties and responsibilities and perceive excessive board membership (or "overboarding") to be an obstacle to effective board service. As with board diversity, the issue of overboarding is not new but investors are strengthening their proxy voting guidelines on this issue.

On average, investors with overboarding guidelines generally seek a limit of five boards for directors and a limit of two boards for directors that are also CEOs (i.e. their own board plus one other board). AllianceBernstein introduced a guideline on overboarding in its 2020 proxy voting update to limit non-CEO directors to four boards and CEO directors to two boards. OTPP updated its guidelines to state that its preference is for CEOs to sit on no additional boards, however it will not vote against the CEO director if they sit on no more than two boards (i.e. their own board plus one other).

Climate Change

As investors increasingly recognize the systemic risks that climate change poses to their portfolios, many are updating their proxy voting guidelines to clarify how they are approaching the issue. In general, guideline updates in advance of the 2020 proxy voting season commonly include:

- Addressing how the investor will vote on climate-related shareholder proposals
- Discussion of expectations and voting practices related to disclosure of climate-related risk
- Discussion of expectations and voting practices related to accountability for oversight by the board of climate change-related issues

Increasingly, investors are adopting guidelines that are supportive of climate-related shareholder proposals and enhanced climate-related disclosure:

- Morgan Stanley will support climate-related shareholder proposals that seek the reduction or mitigation of a company's impact on the climate or that seek disclosure aligned with SASB and the TCFD.
- BNP Paribas will support climate-related shareholder proposals that are aligned with its climate change policy (e.g. seeking carbon disclosure or disclosure on business strategy in alignment with a 1.5°C world). BNP Paribas also includes in its guidelines that it will vote against directors at companies that have not appropriately disclosed their carbon footprint.
- Schroders' proxy voting guidelines now state that it seeks disclosure aligned with the recommendations of the TCFD.
- BMO GAM updated the climate change section of its proxy voting guidelines and endorsed reporting aligned with the Carbon Disclosure Project (CDP) and the TCFD. It also added a guideline stating that it will consider opposing certain management resolutions if the company operates in a high emitting sector and fails to provide adequate climate-related disclosure.

3 https://www.ft.com/content/cf8b3278-5137-4163-bbbe-186d8d4a2193

BlackRock also added a section to its proxy voting guidelines on climate risk reiterating that it seeks disclosure aligned with the TCFD. For companies operating in sectors that are highly exposed to climate-related risks, BlackRock expects the board to demonstrate oversight including an understanding of how climate risk affects the business and how management is dealing with the risk. Its guidelines still say that climate-related shareholder proposals will be voted on a case-by-case basis, but the language was strengthened and in an earlier section, BlackRock removed the sentence that states that it takes an engagement first approach. The strengthened language could signal a change in BlackRock's willingness to support climate-related shareholder proposals in 2020. Given BlackRock's size and influence as the largest asset manager in the world, this shift could be significant.

Investors are seeking appropriate oversight of climate-related issues and a few have updated their guidelines to directly address this issue. OTPP has added a new section on board accountability for climate change oversight to its proxy voting guidelines. OTPP will now consider opposing relevant director(s), chair(s) or committee(s) when it determines that the board has not demonstrated appropriate oversight of climate-related risks. Schroders has also added a section to its guidelines stating that it will oppose directors where it determines that the board is not demonstrating sufficient preparedness in overseeing and addressing key climate risks.

Finally, Allianz Global Investors made headlines in February 2020 with an announcement that it was updating its Global Corporate Governance guidelines to pressure companies to do more to manage climate-related risk.[4] Allianz Global wants its portfolio companies to use the TCFD to assess the impact of climate risks on their business. At the time of writing, updated guidelines have not been released.

Social Issues

Although shareholder proposals have increasingly been focused on social issues, investors have historically been less likely to have guidelines addressing specific social issues. This year, there have been a few guideline updates in this area. The California Public Employees' Retirement System (CalPERS) introduced an additional guideline stating that boards should have oversight of the potential risks related to corporate culture. LGIM also made significant updates to its guidelines detailing its expectations on disclosure related to culture. LGIM will now look for disclosure of how culture is measured and how it relates to business strategy, how mission statement values are communicated and reinforced, any key performance indicators that are linked to culture and any relevant data linked to the workforce. Most investors' voting guidelines only address how they will vote on social shareholder proposals, however the "S" of ESG is a fast-growing area that should be monitored by companies.

Conclusions

Overall, investors' stewardship activities are becoming more sophisticated as their approaches to ESG integration continue to evolve. While the majority prefer to engage with companies when ESG concerns exist, there is increasing appetite to hold boards accountable for a lack of progress and to reinforce ESG priorities through the exercise of shareholder voting rights. Companies should be prepared to answer investor questions about how ESG factors are being identified and monitored within their business and expect more active shareholder voting on the issues of board diversity, director overboarding, corporate culture and climate change.

About ESG Global Advisors

ESG Global Advisors bridges the gap between companies and investors on environmental, social and governance (ESG) factors. A multi- disciplinary team with significant investor and corporate experience, we are uniquely positioned to offer expert advice to companies and investors on material ESG factors that drive long-term value, including climate change. We assist companies and boards of directors with:

- Understanding how investors integrate ESG factors into investment processes and stewardship
- Developing strategies for managing material ESG factors to generate superior long-term value
- Developing approaches to ESG-related disclosure and engagement with shareholders

Learn more at www.esgglobaladvisors.com.

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4 https://www.reuters.com/article/us-climate-change-allianz-idUSKBN2090E0