GOVERNANCE

June 2022 Issue 334

Remaking capitalism

'The profound benefits of introducing ecological governance for shareholders, society and the wellbeing of our planet and humanity provide a compelling basis for voters to support governments to provide tax incentives for their introduction.'

Dr Shann Turnbull

Governance and climate change

'Good governance relies more than ever on developing and maintaining mechanisms for effective information flow between the board and its committees and between senior management and non-execs. TCFD is an opportunity to revisit these mechanisms to ensure they are fit for purpose as "bolt-on" structures are incorporated to allow for decision-useful disclosures to be made.'

Tom Proverbs-Garbett

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Feature

Early trends from US 2022 AGM season

Hannah Orowitz and **Lee Anne Hagel** look at early US annual meeting voting trends which suggest muted support for proposals on environmental and social issues.

An early examination of the 2022 US proxy season voting data (covering meetings held between 1 July 2021 and 16 May 2022) showed a record-breaking amount of ESG proposal submissions this season (924 so far in 2022, compared to 837 last year and 754 across 2020). Despite the increase, the data suggest more muted support for environmental and social (E&S) issues. Only 20% of environment proposals so far in 2022 have passed (6 of 30) compared to 35% (14 of 40) last year, and only 9% of social proposals have passed (10 of 107), compared to 18% (21 of 118) in 2021.

2022 YTD PROPOSALS VOTED AND PASSED

	Environmental	Social	Governance
Number Voted	30	107	149
Number Passed	6	10	28
Passage Rate	20%	9%	19%

2021 PROPOSALS VOTED AND PASSED

	Environmental	Social	Governance
Number Voted	40	118	277
Number Passed	14	21	46
Passage Rate	35%	18%	17%

Environmental Social Governance

However, we do not believe that the decline in E&S proposals so far this year indicates decreased focus. It more likely reflects the investor response to a shift in emphasis in some proposals and heightened ambitions of others.

Notably, we found twice as many proposal submissions from three primary proponents – Steven Milloy, The National Legal and Policy Center and the National Center for Public Policy Research – that are often critical of the evolving ESG landscape (52 in 2022 so far compared to 26 in 2021).

Climate as a key environmental focus area

Climate remains a key focus area in the 2022 proxy season with a 39% increase in environmental proposal submissions (172 YTD compared to 124 last year).

Thematically, we have seen several new environmental proposal trends in 2022 gaining prominence: requests for Scope 3 emissions reduction targets, alignment with the International Energy Agency's (IEA's) Net Zero scenario, and cessation of financing to fossil fuel projects.

Across the proposals, we've observed heightened demands on companies, reflecting greater proponent ambitions. For example, the majority of 2022 shareholder proposals related to greenhouse gas emissions reduction targets explicitly seek targets that include Scope 3 emissions.

We've also observed a number of proposals across companies within financial services requesting an end to financing or underwriting of new fossil fuel projects, with 13 out of 14 such proposals specifically referencing the IEA's Net Zero by 2050 scenario. As of 16 May, all seven proposals that went up for a vote failed to pass, and none received support above 12.8%.

Diversity, equity and inclusion dominate social proposals

Consistent with the 2021 annual general meeting season, diversity, equity and inclusion remains a major theme for shareholders in 2022, with 50 related proposals identified. Shareholder proposals seeking equal employment opportunity (EEO-1) disclosure decreased dramatically in 2022 compared to 2021 (7 v 47), likely reflecting the increased disclosure of this data, particularly across S&P 500 companies.

One notable trend this year is that shareholders are demanding information beyond EEO-1 workforce diversity data, such as disclosure of recruitment, retention and promotion workforce diversity data. Shareholders are also asking for more detail on how companies implement their stated diversity and inclusion initiatives. So far this season, 25 proposals have been withdrawn. Six have gone to a vote so far, and only one passed. The average support has been 36% for these proposals. Seventeen proposals remain pending as of 16 May 2022.

Many US companies have made meaningful strides in diversifying their boards and disclosing board diversity. Eighteen proposals addressing board diversity matters were filed this year, a slight decline from the 21 proposals filed in 2021. We continue to see institutional investors revising their proxy voting guidelines to provide for votes against directors where companies fall short of their diversity expectations.

Other areas of shareholder focus for social issues in the US include civil rights and racial equity audits, workforce harassment, human and labour rights, political lobbying and contributions, worker classification and the pay gap. Interestingly, this year new types of social proposals are

Feature

focusing on companies' impacts on broader systems, for example, the public health costs of protecting vaccine technology at healthcare companies and external costs of misinformation at technology companies.

We have also seen several types of social proposals that attracted majority support for the first time this season, including shareholder proposals addressing racial equity and civil rights audits, sexual harassment concerns and gender pay equity.

Withdrawn proposals suggest meaningful engagement

While overall passage rates of proposals YTD may be indicative of somewhat muted support compared to 2021, we saw a significant number (206) of withdrawn proposals focused on specific E&S areas:

- Scope 3 emissions reduction targets (31 withdrawn of 56).
- Requests for audited reports on the impact of the IEA's Net Zero by 2050 scenario on financial statements (four of the six).
- Diversity, equity and inclusion-related proposals (25 of the 50).

The withdrawal of these E&S proposals suggests that companies were particularly engaged with their shareholders on these topics to garner support or understanding this year. For example, 23 of the 31 withdrawn Scope 3 proposals specifically reference one of the following reasons: reaching an agreement, making a commitment or engaging in constructive dialogue. Notably, As You Sow was named as a filer or co-filer in 17 of the 31 withdrawn proposals.

Investors adapting to changing ESG regulation

Proponents seem to be evolving their approach and adapting to the landscape by increasing co-ordination with others on submissions this year, likely in response to changes to Rule 14a-8, which now limits a proponent to filing only one shareholder proposal at a given company's meeting.

In particular, we have observed increasing co-ordination among Chevedden group members, who historically focused on governance matters, with proponents and advocacy groups across the ESG spectrum, including The Shareholder Commons, As You Sow and various Interfaith Center for Corporate Responsibility members.

Governance

The volume of governance-focused proposals appears to have decreased slightly in 2022, to 353, compared to 392 in 2021. Of the 149 governance proposals voted upon to date, 28 passed.

Many of the governance proposals are perennial topics.

Thirty-five Russell 3000 companies have failed to receive majority support for their Say on Pay proposals in the 2022 AGM season so far, with 27 failed votes. 4.8% of Russell 3000 received 'red zone' (50 to 70%) vote support to-date. Average support for Say on Pay proposals to date is roughly in line with support experienced in the 2021 proxy season (90% in 2022 compared to 91% in 2021).

So far this season, 15 director nominees from Russell 3000 companies have failed to receive at least 50% shareholder support. Seven failed because of a majority vote standard for director elections at their respective companies. The remaining eight directors were elected (or re-elected) where plurality vote standards were in place, meaning that a director only needed to receive one more vote to win.

What's next for ESG?

Unlike prior proxy seasons, the 2022 proxy season so far is characterised by increased scrutiny towards ESG matters. In recent years, there has been an expansion of proposals opposing ESG initiatives from proponents who believe that they are overly prescriptive and question whether certain proposals would promote long-term shareholder value.

Much of this newfound attention focuses on ESG's impact on voting and investing decisions from state pension funds and politicians alike. States like Texas, Utah, and West Virginia have made public statements suggesting that ESG's influence on fossil fuel companies is inappropriate.

With several weeks remaining in the 2022 proxy season, it remains to be seen whether the number of shareholder proposals passing in 2022 will surpass the record-breaking levels experienced in the 2021 season (as of 16 May 286 proposals received a vote and 335 remain pending). Once the 2022 season is complete, we expect shareholder proponents and advocacy groups to scrutinise individual investors' voting decisions.

Hannah Orowitz is the US Head of ESG at Georgeson. She works closely with clients across all market capitalisations and industries to develop proactive ESG strategies and shareholder engagement programmes. Previously, Hanna was VP/Associate GC and Asst. Secretary for XL Group, responsible for securities and corporate governance matters.

Lee Anne Hagel is a Director on Georgeson's ESG advisory team. A former equity analyst, Lee Anne understands how different investors approach ESG assessments of companies.

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Final thoughts

Good governance relies more than ever on developing and maintaining mechanisms for effective information flow between the board and its committees and between senior management and non-execs. TCFD is an opportunity to revisit these mechanisms to ensure they are fit for purpose as 'bolt-on' structures are incorporated to allow for decision-useful disclosures to be made.

Written records of a board's decision-making are crucial as the basis of future reporting. Corporate governance and culture are two sides of the same coin: corporate governance seeks to embed (as far as possible) sensible business practice, while culture is the approach taken in and by a business to promoting that agenda and the willingness do so. A culture that supports the mechanics of governance not only benefits the company itself, leading to better relationships with shareholders, but also the wider stakeholders whose interests should be considered by the board. Combined with a culture of climate concern, TCFD-aligned reporting will be a natural outcome of operations.

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Tom writes regularly on governance matters and corporate law and works closely with clients to address governance needs, including in the context of wider ESG matters.

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Designed and printed by WithPrint
Riverside Studio, Gills Lane, Rooksbridge, Somerset, BS26 2TY
www.with-print.co.uk

ISSN 1358-5142

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The Old Stables, Market Street, Highbridge, Somerset TA9 3BP, UK
Tel: +44 (0) 1278 793300
Email: info@governance.co.uk Website: www.governance.co.uk