THE TOP THREE TRENDS SHAPING THE 2022 PROXY SEASON

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Authors: Alyson Slater, *Senior Director, Sustainable Finance, Global Risk Institute*
Yibo Bu, *Climate Research Analyst, Global Risk Institute*

Proxy season casts a spotlight on key issues of growing importance to investors, and shareholder resolutions are a tool that continues to be used to drive change across sectors. Environmental, Social and Governance (ESG) themes have long been a prominent part of investor engagement and shareholder resolutions, but this year's proxy season has seen an uptick in action. In this briefing, the top three trends in Canada and globally are discussed along with actions issuers can take to stay ahead of investor expectations on ESG.

1. RESOLUTIONS ARE UP AND ARE TARGETING BOARDS

The number of shareholder resolutions filed in 2022 is unprecedented with a year over year increase of 25 percent in major markets. The top issues this year have been climate risk management and transition plans, climate related disclosures, and themes related to diversity, equity and inclusion (DEI). The number of ESG shareholder proposals filed at Canada's big six banks has roughly doubled from last year. Resolutions on general approaches to sustainability reporting and management have dropped in light of advances toward mandatory sustainability disclosure requirements in major markets, as well as the rise of more targeted requests on specific issues.

In the United States (U.S.), the Securities and Exchange Commission (SEC) scaled back the basis on which a company could exclude a resolution ahead of this year's proxy season. Previously, if there was no clear and direct link between the issue of concern and ordinary business operations, the proposal could be excluded. The SEC clarified that the focus is now on the social policy significance of the issue and whether it may transcend the ordinary business of the company. This is contributing to a record number of resolutions making it through to vote in the U.S.

Traditional corporate governance-related resolutions - such as the separation of Board Chair and CEO roles or rules for special meetings - have long dominated the ESG shareholder resolution space, but a marked shift toward board accountability, capability, and oversight of social and environmental risks is occurring. For example, this season saw resolutions targeted at enhancing the skills and competency matrix of director nominees.

Most proxy firms updated their guidance to generally recommend shareholders vote against board members, with a focus on the Board Chair or the relevant Committee Chair, if the board's approach to ESG oversight, as well as the company's overall ESG strategy, management and disclosure is not evident. For example, Glass Lewis recommends voting against the Chair of the Governance Committee of S&P/TSX 60 listed issuers that fail to provide explicit disclosure concerning the board's role in overseeing environmental and social issues.

2. CLIMATE-RELATED PROPOSALS HOLD ISSUERS TRUE TO TARGETS

Building on momentum over the past two years, climate and environment related proposals are taking up a greater share of the overall percentage of all proposals this proxy season. Examples of resolutions commonly seen this year include:

- Adopt a policy and/or report on net-zero emissions reduction targets
- Limit or end fossil fuel financing or underwriting
- Adopt a policy and/or report on the alignment of lobbying activities with climate goals
- Report on risks to company operations associated with climate change

Shareholders are holding larger banks and emission-intensive issuers accountable for their publicly-announced targets on climate. The uptick in shareholder proposals related to climate risk disclosure, transition plans, and sustainable finance investment criteria indicates increasing expectations for banks and other issuers to deliver on climate commitments, such as net-zero emissions by 2050.

In Canada, all big six banks saw resolutions this year seeking more stringent criteria for sustainability-linked loans and bonds, which could be viewed as a consequence of the sustainable finance market that is growing at a rate that is far ahead of standards and regulation. Despite these proposals only garnering 6-8 percent support, they surpassed the 5 percent minimum threshold, allowing investors to table this issue in future years. This level of voting is on par with other first-time resolutions, such as requests for ESG reporting, that have gone on to attract majority votes as the issue matures.

It is anticipated that climate-related shareholder proposals will continue to grow in dominance and mature to become more business focused with a higher level of voting coordination among institutional investors. An initiative called Climate Engagement Canada was formed in 2022 and is expected to become active in issuer engagement and shareholder resolutions in 2023. It is comprised of 29 institutional investors with C$3.6 trillion in assets. These investors have announced 40 target companies listed on the TSX where they will advance climate risk and low-carbon transition issues.

3. RACIAL JUSTICE AND GENDER DIVERSITY DRIVE DEI PROGRESS

In light of the increased urgency and profile of indigenous reconciliation, ethnic diversity and inclusion, and gender balance in corporate Canada, a look at how proxy-voting guidance has evolved demonstrates where investor expectations are headed. In this year's guidance, proxy advisory firms like ISS and Glass Lewis advised investors give companies "wide discretion" on how to implement and accomplish plans, and instead focus on results. The clear expectation is for an overall diversity, equity and inclusion human-capital strategy with articulated business-related goals, related targets for diversity in the employee base and board, information about how these targets will be met, and how the board will oversee progress.

Some themes reflected in shareholder resolutions this season include requests for issuers to publish median gender pay ratios and to include worker representation on the board. Key diversity issues arising in Canada this year include:

- **Diversity on the board:** Proxy firms and some institutional investors recommend a vote against the Board Nominating Committee Chair for TSX listed companies where at least 30 percent of board members are not women. Glass Lewis notably replaced all references in their 2022 proxy voting guidelines to 'female' directors with the term 'gender diverse directors', defined as women as well as people that identify with a gender other than male or female.

- **Impacts on non-white stakeholders:** Dozens of companies received shareholder resolutions focused on racial justice, some requesting a Racial Equity Audit – which is a third-party review of the issuers' employment, compensation and business practices, including how it sells products and services. The audit is meant to provide a "reality check" on the company's progress in dismantling systemic discrimination across operations, and is intended to be made public upon completion. TD is thought to be the first major Canadian bank to agree to a racial equity audit across its North American operations after a request from an institutional investor this year.

OUTLOOK AND ACTION ISSUERS CAN TAKE

Proxy season provides strategic insight into the issues of concern among shareholders. Although climate and DEI were the top issues this year, environmental topics, such as biodiversity and water, were also on the radar. Other key proposals that made it to vote in the U.S. and Canada include resolutions on political influence, internet content, and the financialization of housing. In addition to DEI, other issues on the upswing in the 'social' category include human rights and decent work. Investors are requesting evidence of alignment with management and reporting standards to mitigate human-rights risks mainly in issuers' value chains. On decent work, proposals seeking disclosure of fair pay and working conditions have become one of the mainstays of proxy season, and have surged to their highest levels in 2022 from almost nil a decade ago.

The majority of resolutions that were filed with banks in Canada were withdrawn after management demonstrated they had achieved expectations, already had efforts underway, or committed to action and agreed to keep investors apprised of progress.

Key actions issuers can take to stay ahead of investor expectations on ESG matters include:

- **Risk oversight and risk management:** The board should monitor management actions to ensure all material social and environmental risks have been identified and subject to risk management action, metrics and targets.
- **Disclosure:** Treat climate and other material ESG disclosures with the same level of quality and scrutiny that applies to other financial or business disclosures and follow generally-accepted reporting frameworks in the absence of mandatory requirements for these topics.