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Diligent Market Intelligence

Proxy Season Preview 2024

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Table of contents

Editor's foreword

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More than 100 investors, corporate executives and advisors assembled in New York last month for Diligent Market Intelligence's (DMI) Proxy Season Preview, our first-ever investor summit, bringing together leading stewardship experts to explore the issues dominating the 2024 proxy season.

Across seven sessions, along with an introduction from Diligent President & CEO Brian Stafford, participants got a first look at emerging trends related to shareholder activism, ESG, governance and compensation. In compiling this report, also the first of its kind, we set out to ensure that boards and investor relations teams are kept well-informed and prepared to engage with their shareholders, outlining priorities that are top-of-mind for investors this proxy season.

As outlined in our February special report, *Shareholder Activism Annual Review 2024*, 2023 was a record year for activism, playing host to a 7.8% and 25.5% increase in the number of companies subject to campaigns in the U.S. and Canada, respectively. Globally, the number of companies subject to activist campaigns saw a 4% increase on 2022 levels.

At the Proxy Season Preview event, panelists examined how proxy contests have evolved since the introduction of the universal proxy card (UPC), warning that companies can expect more campaigns in 2024 with a year of the new regime under their belts.

The newfound freedom UPC offers when casting votes has also increased pressure on directors to prove that their skillsets and experience make them best placed to remain on boards.

Shareholder returns also remain a linchpin for activists, with panelists warning that companies may face a push for reforms if returns are seen to be lacking over the short and long term.

ESG was also top of mind for panelists. Despite the Securities and Exchange Commission's (SEC) final Climate Rule omitting Scope 3 reporting, boards must remain cognizant that investors may still expect this disclosure and escalate engagements where reporting is falling short of expectations. Speakers emphasized that Scope 3 emissions disclosure has become "the new normal," and that they are prepared to engage with companies that fall short of their reporting expectations.

Panelist Jake Rascoff, director, climate financial regulation at Ceres, noted that "whatever the SEC decides to do with Scope 3 in the end, it won't change the investor demand for that data and some jurisdictions somewhere will still require it."

Compensation plans will also face continued scrutiny this season, with speakers emphasizing the importance of outlining the rationale behind plan and metric adjustments, helping investors understand a company's compensation journey.

Diligent Market Intelligence is an essential tool for investors, issuers and advisors who are looking to successfully navigate the challenges and complexities of proxy season and beyond. Comprehensive activism, voting, compensation, governance and ESG datasets allows for data assimilation from a single source of truth, generating unique and powerful findings. If you're interested in learning more, please get in touch to arrange a short demo.

If you've enjoyed our focus on investor stewardship and governance in this report, you may also enjoy our recent reports on shareholder activism, proxy voting, ESG or compliance trends.

We are very grateful to the industry experts that contributed their insights at the Proxy Season Preview, as well as all the hard-working Diligent colleagues that helped ensure the event was a success and the attendees that joined us.

A big thank you to our sponsors at Olshan Frome Wolosky, Strategic Governance Advisors, Schulte Roth & Zabel, Davies and Haystack Needle for making this possible.

How can boards best prepare for activism?

At the Proxy Season Preview, panelists revealed how proxy contests have evolved in the age of universal proxy and which governance shortcomings are most likely to foster activist engagement.

Universal proxy places directors under the spotlight

The introduction of the universal proxy card (UPC), which allows investors to freely pick between incumbent and dissident nominees at U.S. proxy contests, has increased pressure on directors to prove their value to investors.

Key takeaways:

- The newfound flexibility UPC offers investors when casting votes makes it easier for shareholder activists to secure minority board representation. To secure their positions, incumbent directors need to showcase that they are best-placed and well-equipped to remain on the board and can unlock shareholder value.
- "When launching proxy contests, activists now have to go for very, very specific seats. In turn, directors are no longer behind the curtain, they have to present their credentials and expertise," said Townsend Belisle, founder and CEO of Haystack Needle.
- Activists with smaller stakes of 1 – 2% are also seeing greater success in their campaigns, opening up the playing field for more investors to seek reforms.
- UPC also prompted companies to amend their director nomination bylaws. In some instances, companies were seen to have advanced requests for information from dissident nominees that were "intrusive" and went "well beyond what is required by law."
- Such amendments may face criticism and even litigation from shareholders, panelists warned. They encouraged boards to talk to proxy advisors or issue press releases where they want to explain why they believe candidates may be unsuitable.
- "It is not up to boards to decide whether a nominee is qualified or has the right skillsets, that's up to the shareholders to decide," said Elizabeth Gonzalez-Sussman, vice-chair of Olshan Frome Wolosky's shareholder activism practice.

> "Universal proxy has turned every single board seat into a political fight."
>
> Townsend Belisle, founder and CEO, Haystack Needle

Poor shareholder returns and a lack of board industry expertise are red flags for activists

Activist panelists emphasized the importance of shareholder returns and board industry experience, warning that companies lacking on either of these fronts may be at risk of activism.

> “When things go wrong and you look at the board and nobody has industry experience outside of the CEO, that is a problem.”
>
> Chris Kiper, managing director, Legion Partners

Key takeaways:

- Activists are likely to target companies with stock trading at a 52-week low and with poor total shareholder returns (TSR) over both the short- and long-term. Panelists noted that proxy advisors may be more likely to see board refreshment as warranted and support cases for change in instances where TSR is low or lagging peers.
- A lack of industry expertise was also identified as a red flag for activists when they assess the composition of a board, while M&A decisions will be scrutinized in periods of market volatility and rising inflation.
- “Generally, companies we target will have a topline problem, declining margins, or will have made questionable decisions in terms of capital allocation and acquisitions,” said Chris Kiper, managing director at Legion Partners. “We know we can do something to get top line growing and do something with the capital that the company is generating.”
- Finding the right board candidates is also considered a linchpin for many activists. “They need industry experience and a shareholder driven mentality,” noted Patrick Sweeney, vice president and senior alternatives analyst at Ancora Advisors.

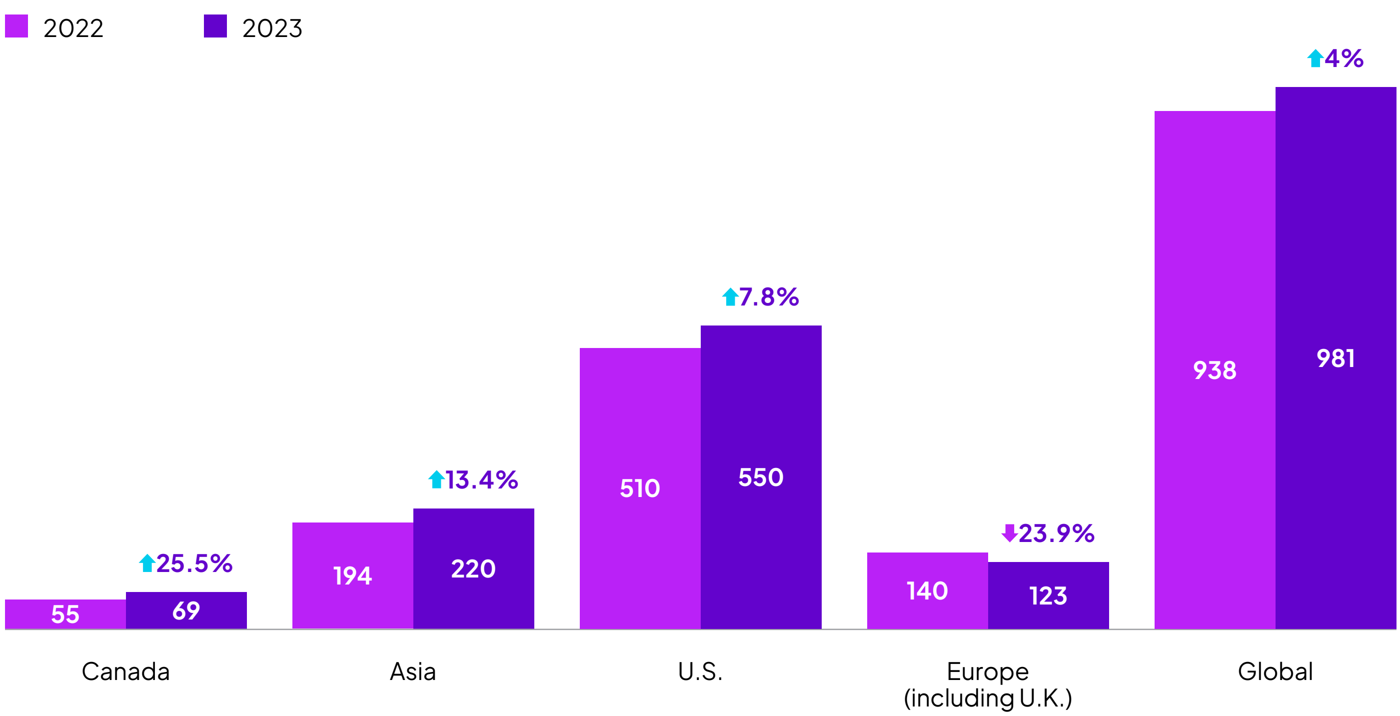
2024 is poised to be a record year for activism

Shareholder activism has returned to pre-pandemic levels, with 981 companies subject to activist campaigns globally in 2023, the highest level since 2019. When companies catch the eye of activist investors, panelists advocated for transparent and meaningful disclosures, noting that companies open to dialogue with their shareholders often see greater operational improvement.

Key takeaways:

- With activists and issuers now familiar with the workings of UPC, industry experts anticipate 2024 will play host to more proxy contests going to a vote. "We now have a great battle for board seats, which is a great thing for shareholder democracy," said Patricia Olasker, partner at Davies.
- As activism levels increase, so too do the number of companies citing activism as a risk. In 2023, 23.4% of Russell 3000 companies mentioned shareholder activism as a risk in the risk factor sections of their 10-K reporting, up from 21.4% a year prior.
- Panelists warned that such disclosure could raise concerns among investors that the company is not committed to meaningful engagement with investors. "If you need to put a risk factor in, it is signalling that you haven't been doing that engagement and are not listening to your shareholder base about why your strategy isn't working," said Gonzalez-Sussman.
- If an activist reaches out looking to engage with your company, transparent and open dialogue help foster successful collaboration. "Do activists have credible arguments as to why you are underperforming? If so, don't be reactive, don't be defensive, embrace it," Gonzalez-Sussman added. "Companies can improve so much more quickly just by listening."

No. companies subject to activist campaigns by region



Source: Diligent Market Intelligence / Activism

Enhancing ESG accountability

Conference speakers advocated for enhanced transparency surrounding corporate emissions reporting and director ESG accountability, warning they will not hesitate to escalate engagements where companies are deemed to be falling short of expectations.

Scope 3 is the new normal

Global regulators are rapidly rolling out ESG reporting requirements, prompting shareholders to seek more ambitious climate disclosure from issuers.

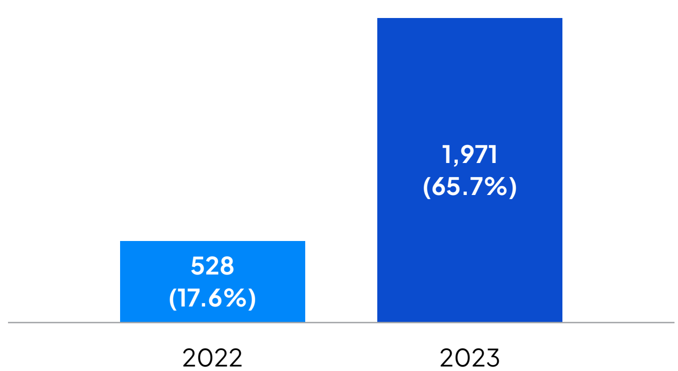
Key takeaways:

- Despite the Securities and Exchange Commission (SEC) omitting Scope 3 emissions reporting from its final Climate Rule, such disclosure is set to become a standardized part of corporate reporting, thanks to legislation at both the international and state level.
- "Scope 1 and 2 are table stakes at this point- if you don't disclose that, that's a huge red flag immediately, even if you aren't on our radar as a high emitter. But companies need to explain why Scope 3 emissions aren't being disclosed," said Edward Apsey, co-head of ESG engagement and stewardship at the Canadian Imperial Bank of Commerce (CIBC).
- Panelists noted that companies need to proactively educate their teams for new emissions reporting standards. As reporting shifts from voluntary to mandatory, disclosures will be reviewed by finance and compliance teams, which may be unfamiliar with sustainability reporting.
- A key benefit of recent legislation for investors is its ability to bring comparability and standardization to emissions reporting. If companies are struggling to know where to start, panelists noted that the Sustainability Accounting Standards Board's (SASB) standards are widely adopted, reliable and trustworthy.

> "If there is some hope that companies can declare victory if the SEC cuts out Scope 3, it won't change the investor demand for that data and some jurisdictions somewhere will still require it of you."

Jake Rascoff, director, climate financial regulation, Ceres

No. top 3000 US-based companies to provide Scope 3 emissions reporting by year



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Source: Clarity AI

Prioritize engagement with proposal proponents

Amid a record number of ESG shareholder proposal filings at U.S.-based companies, corporate commitments are facing increased scrutiny. Institutional investors want to see more companies engaging with proposal proponents and individual directors taking accountability for ESG issues.

Key takeaways:

- In 2024, investors are looking for companies to provide robust oversight and reporting on both director skillsets and human capital management, specifically board industry experience and retention and recruitment rates for broader employees.
- In instances where shareholder proposals have won support from at least one-third of votes cast, panelists advocated for companies to engage with proponents to discuss next steps.
- “Go back to the proponent to see how it is they might suggest implementing that proposal,” Yumi Narita, executive director of corporate governance at the Office of the New York City Comptroller said. “That is one chain in the circle of shareholder proposals that is often missed.”
- Some institutional investors are shifting away from shareholder proposals to focus on withhold campaigns against directors responsible for ESG oversight, in a bid to enhance accountability. “There is a false gentility that a director no-vote is a nuclear option, but you should absolutely deploy it if the company is not doing what you need it to, to protect your investment,” said Sara Murphy, chief strategy officer at The Shareholder Commons.

ESG activism will bear fruit, provided campaigns link to economic returns

The newfound freedom universal proxy offers when casting votes at proxy contests has the potential to encourage nontraditional activists to seek board composition changes to remedy ESG shortcomings. Panelists emphasized that ESG activist campaigns will see success, provided that the focus links back to economic returns and drivers of performance.

Key takeaways:

- ESG activist campaigns that won the favor of investors and proxy advisors were rooted in ESG issues that affected the bottom line or "posed an existential risk to the company," Elizabeth Gonzalez-Sussman, co-chair of Olshan Frome Wolosky's shareholder activism practice, said. "It always goes back to whether or not you're addressing the drivers of performance."
- According to Lauren Taylor Wolfe, co-founder and managing partner at hedge fund Impactive Capital, ESG solutions "can have a compounding effect. For example, a company might enhance its health and wellness services which, in turn, lower its insurance costs. Once a company implements one ESG solution and sees the economic returns, then they are more likely to do the second one, the third one, the fourth one. But it has to link to value and profit."
- Panelists highlighted that board diversity is often top-of-mind for activists, particularly when nominating slates and pushing for board refreshment. A diverse board fosters diversity of thought, setting up companies for success.

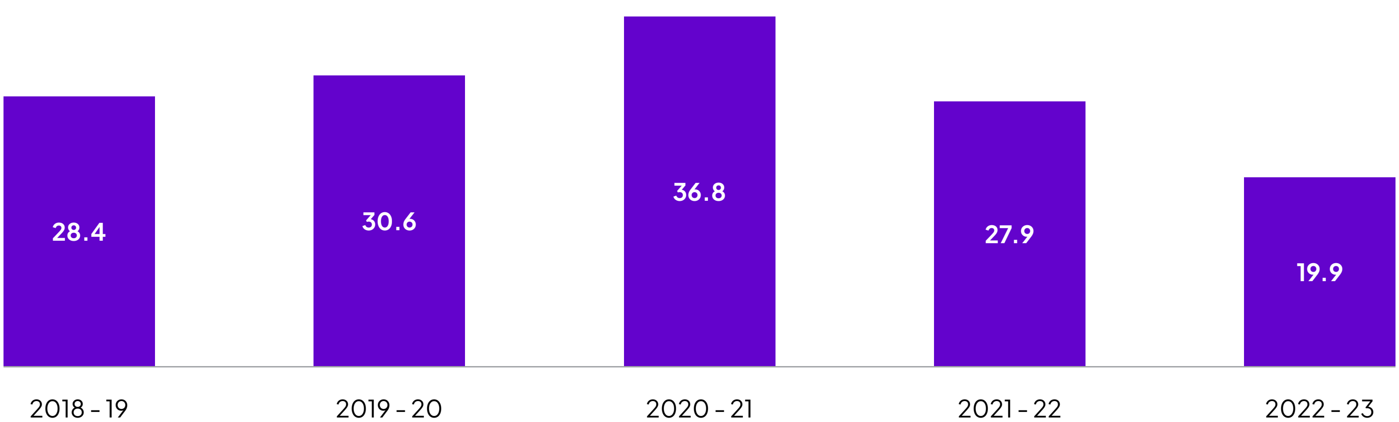
> "We tell companies to ask yourself two things; does this ESG initiative solve a business problem, and does it link to economic returns?"

Lauren Taylor Wolfe, co-founder and managing partner at Impactive Capital

No. and average support for (%) environmental and social shareholder proposals at US-based companies by year

No. proposals				
2018 - 19	2019 - 20	2020 - 21	2021 - 22	2022 - 23
158	149	148	281	338

Average support (%)



Source: Diligent Market Intelligence / Voting

Crafting successful compensation plans

At the Proxy Season Preview, panelists revealed how activists factor compensation into their engagements and emphasized the importance of compensation plans having robust long-term and performance-based targets.

Investors advocate for transparent disclosure and engagement

Institutional investors, shareholder activists and ESG advocates alike review compensation plans to understand whether a board supports its stated strategy with incentives aligned to those goals. Panelists reinforced the importance of robust and transparent disclosures, alongside the importance of performance-based pay drawing from a variety of metrics.

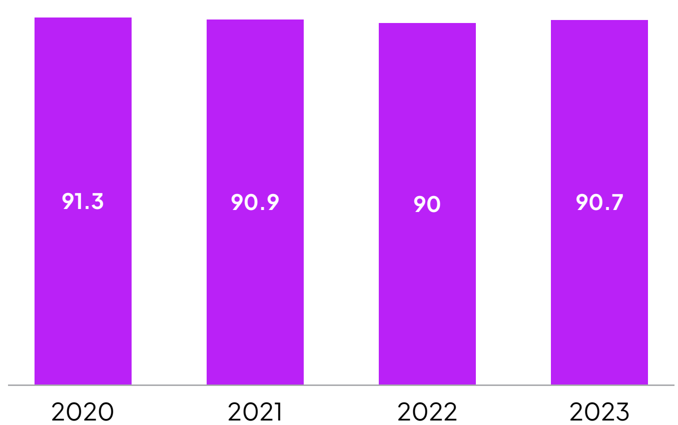
Key takeaways:

- Stewardship executives emphasized that "disclosure is king." Outlining the rationale behind plan and metric adjustments is equally as important as disclosing the specifics of what has changed, helping investors understand a company's compensation journey.
- Investors are generally supportive of pay plans focused on fostering long-term growth. Panelists advocated for long-term incentive plans (LTIP) that are over 50% performance-based across three-to-five-year periods. Shareholders are also keen to understand how key performance indicators (KPIs) and metrics drive shareholder returns.
- Panelists cited concerns regarding performance-based pay being wholly reliant on total shareholder returns (TSR) and the frequency of outsized one-off grants outside of the normal equity cycle.
- Post-proxy season is the time to win investor support, giving issuers the opportunity to demonstrate that they are proactively listening to and responding to investor feedback. According to one panelist, speaking on a Chatham House Rules panel, some investors "may pause the escalation process if a company is seen to be responsive."

"You can't win support, you either meet our guidelines or you don't. To play it correctly, companies should be clear and transparent in their disclosures. If they are making changes, run it by investors."

Stewardship executive, speaking on Chatham House Rules panel

Average support for (%) "say on pay" proposals at Russell 3000 companies by year



Source: Diligent Market Intelligence / Voting

Striking a balance between incentivizing directors and maximizing returns

Activists are enhancing scrutiny of remuneration policies, looking for companies to be prepared to weather the challenges brought on by rising costs and slowing economic growth. Panelists also emphasized that companies need to establish a fair balance between incentivizing directors and maximizing shareholder returns.

Key takeaways:

- Activist investors are looking for directors to have “more skin in the game,” with compensation plans that are long-term vesting and have sufficiently stretching goals. While stock-based compensation plans can help incentivize directors, Chris Kiper, managing director at Legion Partners, noted that investors want to see directors that have “taken cash out of their own pocket and bought stock.”
- Panelists advocated for free cash flow per share metrics in pay plans, noting such metrics drive stock value. According to Lauren Taylor Wolfe, co-founder and managing partner at Impactive Capital, a focus on long-term metrics “incentivizes the CEO and leaders to really develop and build executives who are focused on maximizing returns for the long-term.”
- When selecting potential targets, activists may evaluate investor support for director re/elections to gauge shareholder appetite for board refreshment. Panelists noted that compensation committee members commonly face revolts, signaling that institutional investors and proxy advisors may be supportive of an activist’s case for change.

> “I love when CEOs make a ton of money as long as other owners are making a ton of money alongside them.”

Lauren Taylor Wolfe, co-founder and managing partner, Impactive Capital

Ensure ESG metrics are material and quantifiable

Panelists advocated for ESG metrics in pay plans where they are seen to have meaningful alignment to a company's strategic objectives, recognizing them as a useful tool for incentivizing decarbonization and assessing corporate climate targets. To ensure such measures are impactful, it is crucial for companies to implement metrics that are quantifiable and closely linked with business strategy.

Key takeaways:

- Where ESG metrics are present in compensation plans, shareholders want to see accompanying disclosure to understand why such metrics have been included. Companies that adopt ESG metrics without due consideration or linking to their value-creation strategy may raise investor concerns.
- Panelists also emphasized the need for more ESG metrics and targets that are quantifiable and cover the short-, medium- and long-term.

- Metrics should link to the most pressing and material ESG risks that companies face. Analyzing metrics used by industry peers can help companies understand what constitutes robust and relevant metrics and appropriate weighting.

About Diligent Market Intelligence

Diligent Market Intelligence is the leading provider of corporate governance, shareholder engagement and investor stewardship data. Trusted by advisors, investors and issuers globally, the Diligent Market Intelligence platform equips firms with the necessary information to proactively manage shareholder pressures, mitigate governance risks, and maintain a competitive edge in the market.

For more information or to request a demo:

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