Diligent Market Intelligence

Diligent

Investor Stewardship 2023

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Editor's foreword

Josh Black, Editor-in-Chief, Diligent Market Intelligence

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The disclosure of investor voting records from the previous proxy season, which requires a sprint relay from our research team to upload into the Diligent Market Intelligence (DMI) platform, is an unparalleled opportunity to reflect on how investors and issuers engaged in 2023 and the challenges that will need to be bridged in 2024.

As a companion piece to our *Proxy Season Review*, released in August, DMI's *Investor Stewardship* report dives deeper into the key issues on which greater collaboration is needed to mitigate risks and ensure alignment between the global economy's most important actors and their owners. We have combined our compensation and proxy voting reports from last year to provide a more comprehensive overview of this nexus, while also moving the report forward to give both sides more time to prepare for the upcoming (fast-approaching) proxy season.

One reading of the data is that the shock effect of the three proxy seasons from 2018 to 2021, when support for environmental and social proposals soared, is that the relationship between companies and their shareholders is returning to normal.

During this period of upheaval, the rise of ESG funds, a pandemic, polarization surrounding the 2020 U.S. presidential election and social movements centered on diversity, equity and inclusion (DEI) forced investors to ask tougher questions and demand greater transparency over how companies treated business risks. Strides made in reporting practices and better communication of how boards oversee ESG risks have mitigated some of these concerns.

An alternative reading is that ESG activism slammed into the furthest extent of asset managers' level of comfort, leading to a backlash. Regulations to prevent greenwashing have become more prevalent, forcing greater clarity of thinking and communication around what constitutes an ESG fund, not to mention political heat in the run-up to the 2024 election.

As has been well-publicized, BlackRock and Vanguard – two of the world's largest investors – have dialled back their support for environmental and social proposals. At the same time, anti-ESG shareholder proposals have won some of the lowest support levels on record.

Those broad-brush explanations belie the hard work and intense scrutiny that defines proxy season.

Certainly, disclosure and engagement has produced some tangible results. Support for compensation plans is up in a tough market and investors are now ready to judge companies on their actions with regard to the climate, rather than their promises.

"As has been well-publicized, BlackRock and Vanguard – two of the world's largest investors – have dialled back their support for environmental and social proposals."

Employee recruitment and retention challenges have led to a number of shareholder proposals in new areas becoming unexpected successes, while public companies are needing to consider and account for an ever-evolving number of risks, such as cybersecurity and AI, to navigate new challenges.

To help clarify some of the key takeaways from this report for our two audiences, we have included a one-page executive summary. Readers will also find the insights of Alliance Advisors on how to build a robust investor engagement strategy a very helpful addition.

The ability of the DMI platform to provide cross-analysis of these different datasets gives busy stewardship teams more effective tools to monitor for risks in their portfolios. Issuers, as well as benefitting from access to the same data as their owners, can benchmark their performance against peers.
Contact us for a demonstration today.

Executive summary

Key trends to emerge from the 2023 proxy season.

1. Support for “say on pay” proposals increased for the first time in five years this season, as asset managers acknowledged that companies had enhanced disclosure of compensation programs and policies. Fewer out-of-plan pay awards also helped, as average realized compensation fell.

2. Employee welfare, diversity and CEO pay gained prominence as investor attentions were redirected to recruitment and retention as key organizational risks and new human rights due diligence regulations began to be incorporated into engagement priorities.

3. Corporate climate transition plans are facing voting revolts across the globe as investors and policymakers increase expectations on what constitutes a robust and actionable net-zero plan. The International Financial Reporting Standards Foundation’s (IFRS) climate reporting framework is set to establish a new baseline for corporate climate reporting standards.

4. Regulators on both sides of the Atlantic are tightening policies on greenwashing, which may require investors managing funds constructed around ESG themes to be clearer in the naming of funds or in the descriptions of engagement policies provided to asset owners.

5. A new crop of anti-ESG activists advocates for companies and investors alike to focus on the financials and steer clear of making political or social statements that could potentially alienate portions of their stakeholder base. While environmental and social proposals from these groups have won little support, they advanced a number of proposals calling for the separation of the chair and CEO roles that have received backing from investors.

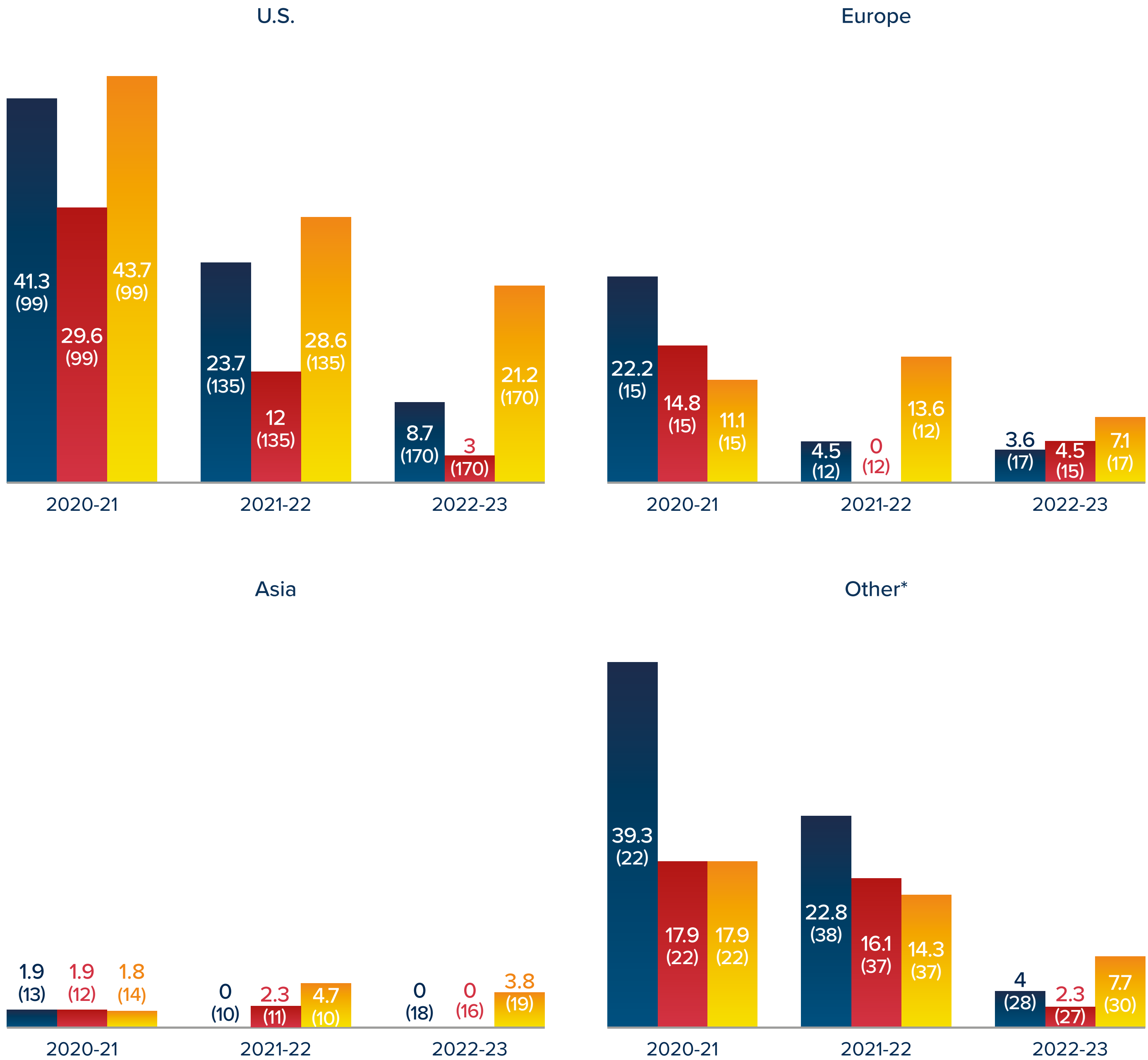
Big Three voting

The voting trends of BlackRock, Vanguard and State Street Corp. in the 2022-23 proxy season.

Big Three support for (%) environmental and social shareholder proposals by region

Figures in parentheses represent the number of meetings where proposal types were voted on.

BlackRock Vanguard Group State Street Corp.



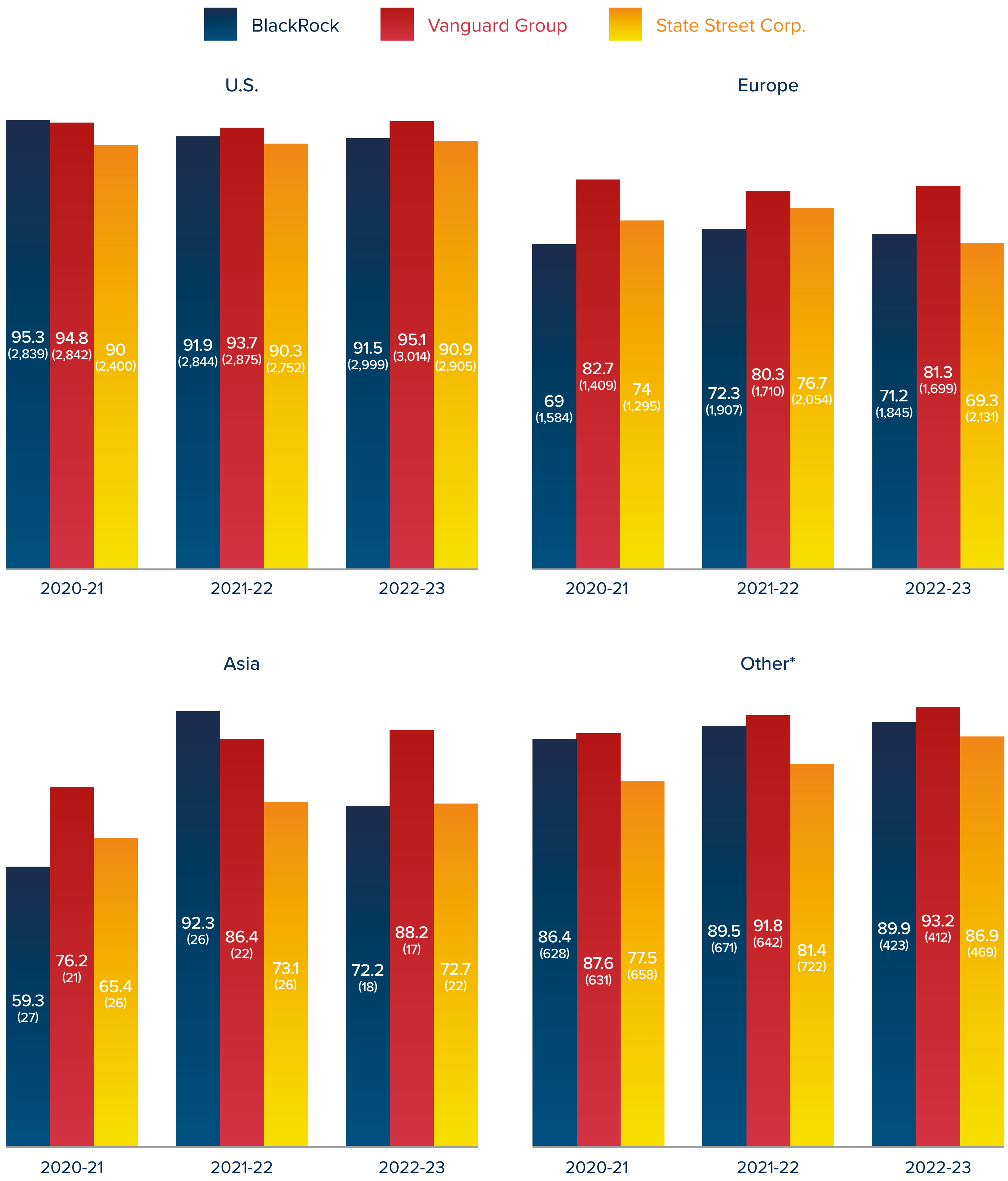
*Africa, Australia, Canada, South America and Mexico

**For % is calculated from a denominator that includes meetings where the investor may have abstained or split its vote. Split votes are not included in support for a proposal.

Source: Diligent Market Intelligence / Voting

Big Three support for (%) advisory "say on pay" proposals by region

Figures in parentheses represent the number of meetings where proposal types were voted on.



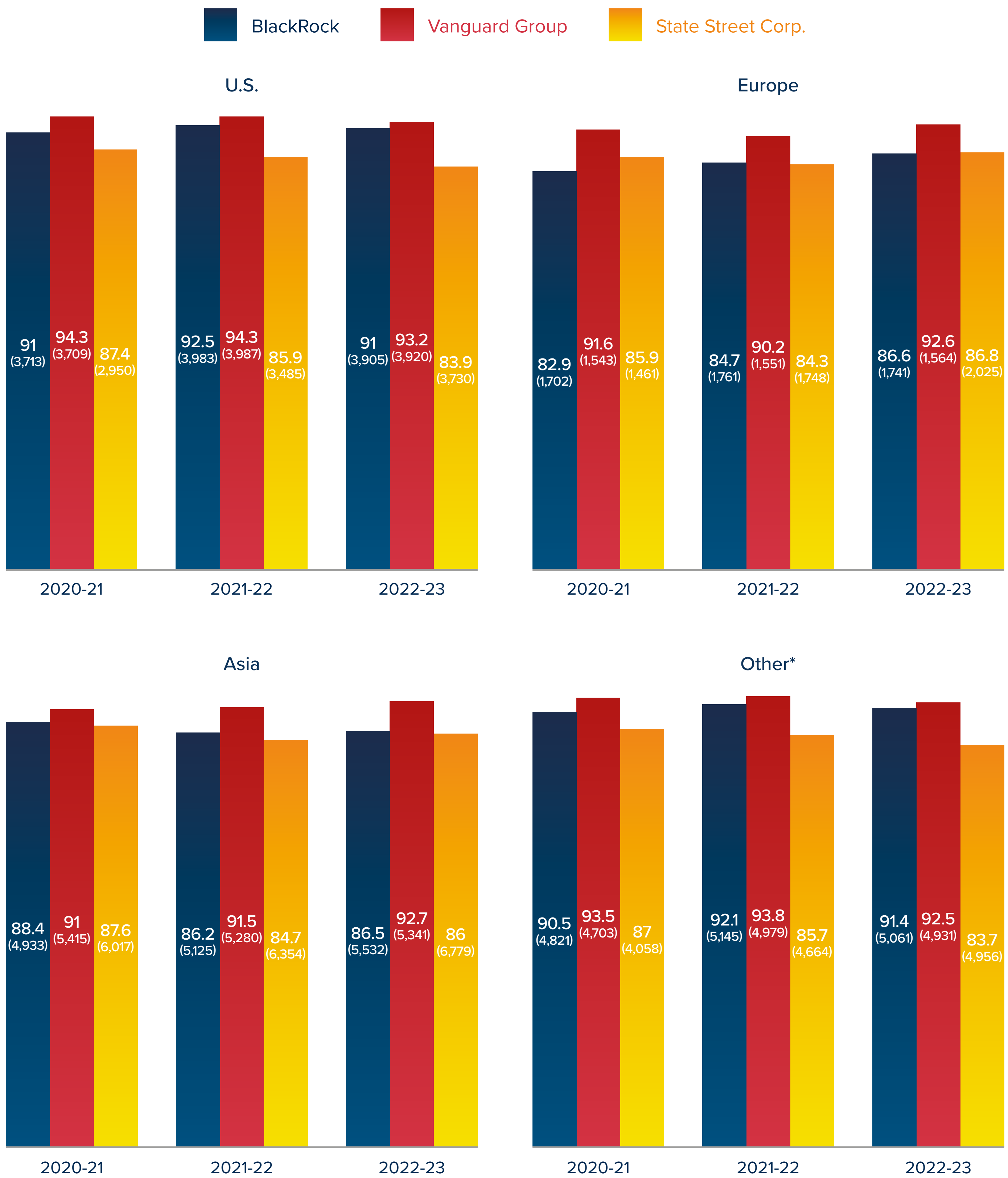
*Africa, Australia, Canada, South America and Mexico.

**For % is calculated from a denominator that includes meetings where the investor may have abstained or split its vote. Split votes are not included in support for a proposal.

Source: Diligent Market Intelligence / Voting

Big Three support for (%) director re/election proposals by region

Figures in parentheses represent the number of meetings where proposal types were voted on.



*Africa, Australia, Canada, South America and Mexico.

**For % is calculated from a denominator that includes meetings where the investor may have abstained or split its vote. Split votes are not included in support for a proposal.

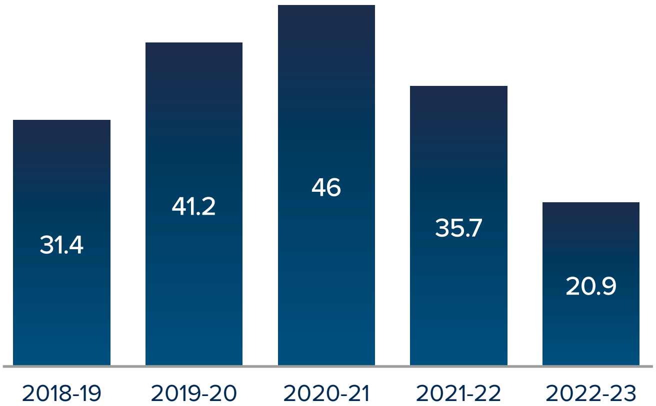
Source: Diligent Market Intelligence / Voting

Voting trends at a glance

All data is for the period July 1 – June 30.

No. and average support for (%) S&P 500 climate change shareholder proposals

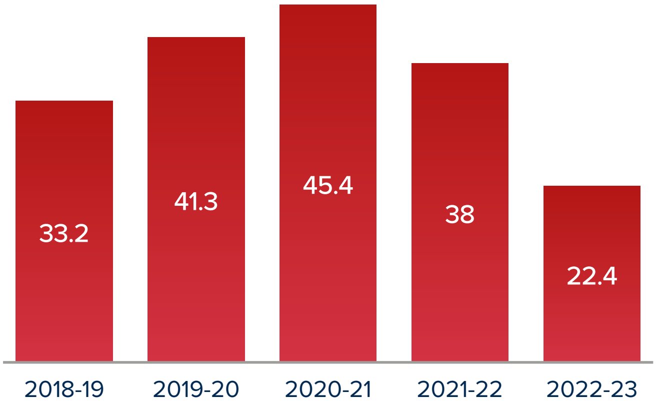
Proxy season	No. proposals
2018-19	4
2019-20	9
2020-21	22
2021-22	42
2022-23	62



Source: Diligent Market Intelligence / Voting

No. and average support for (%) Russell 3000 climate change shareholder proposals

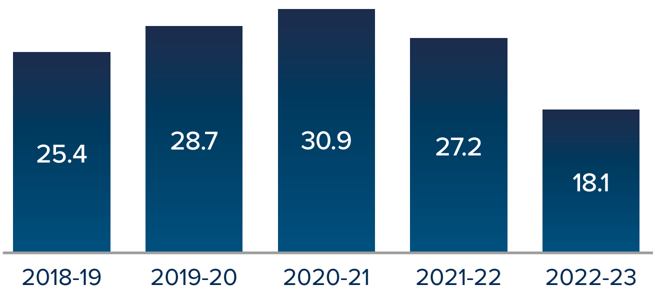
Proxy season	No. proposals
2018-19	7
2019-20	11
2020-21	24
2021-22	46
2022-23	74



Source: Diligent Market Intelligence / Voting

No. and average support for (%) S&P 500 social shareholder proposals

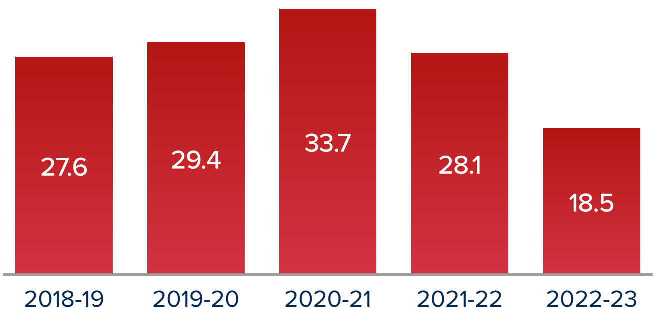
Proxy season	No. proposals
2018-19	96
2019-20	95
2020-21	88
2021-22	168
2022-23	209



Source: Diligent Market Intelligence / Voting

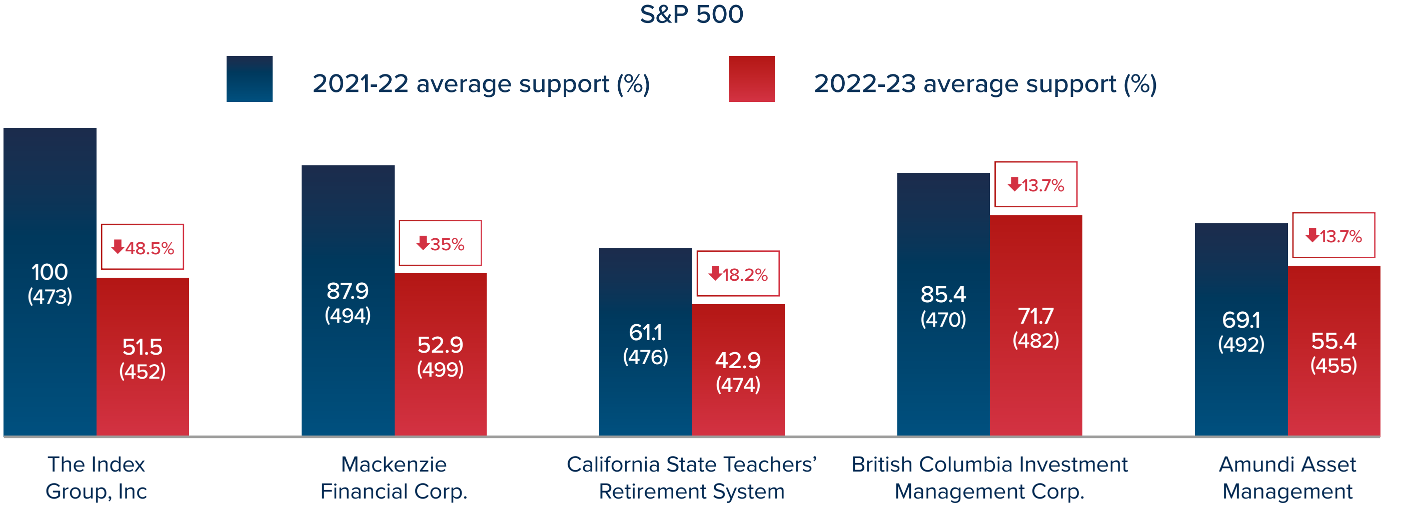
No. and average support for (%) Russell 3000 social shareholder proposals

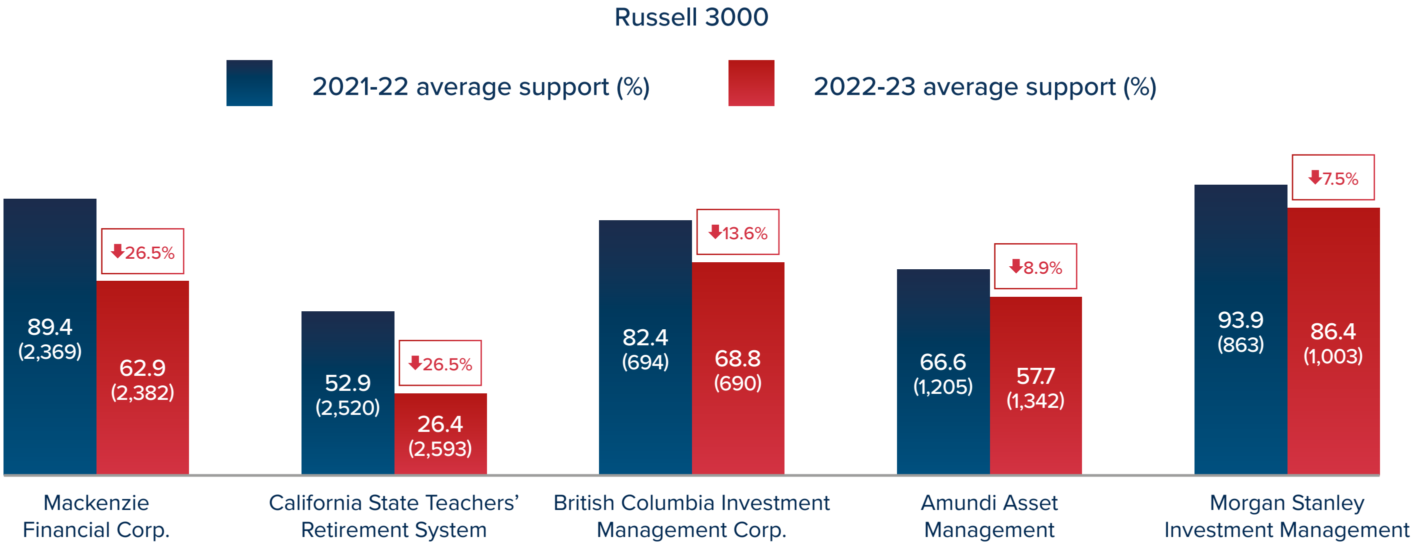
Proxy season	No. proposals
2018-19	118
2019-20	109
2020-21	101
2021-22	190
2022-23	227



Source: Diligent Market Intelligence / Voting

Investors with the biggest decrease in support for (%) director re/election proposals between the 2022 and 2023 proxy seasons





Figures in parentheses represent the number of meetings where proposal types were voted on.

*S&P 500 data limited to investors that voted at a minimum of 50 meetings. Russell 3000 data limited to investors that voted at a minimum of 100 meetings.

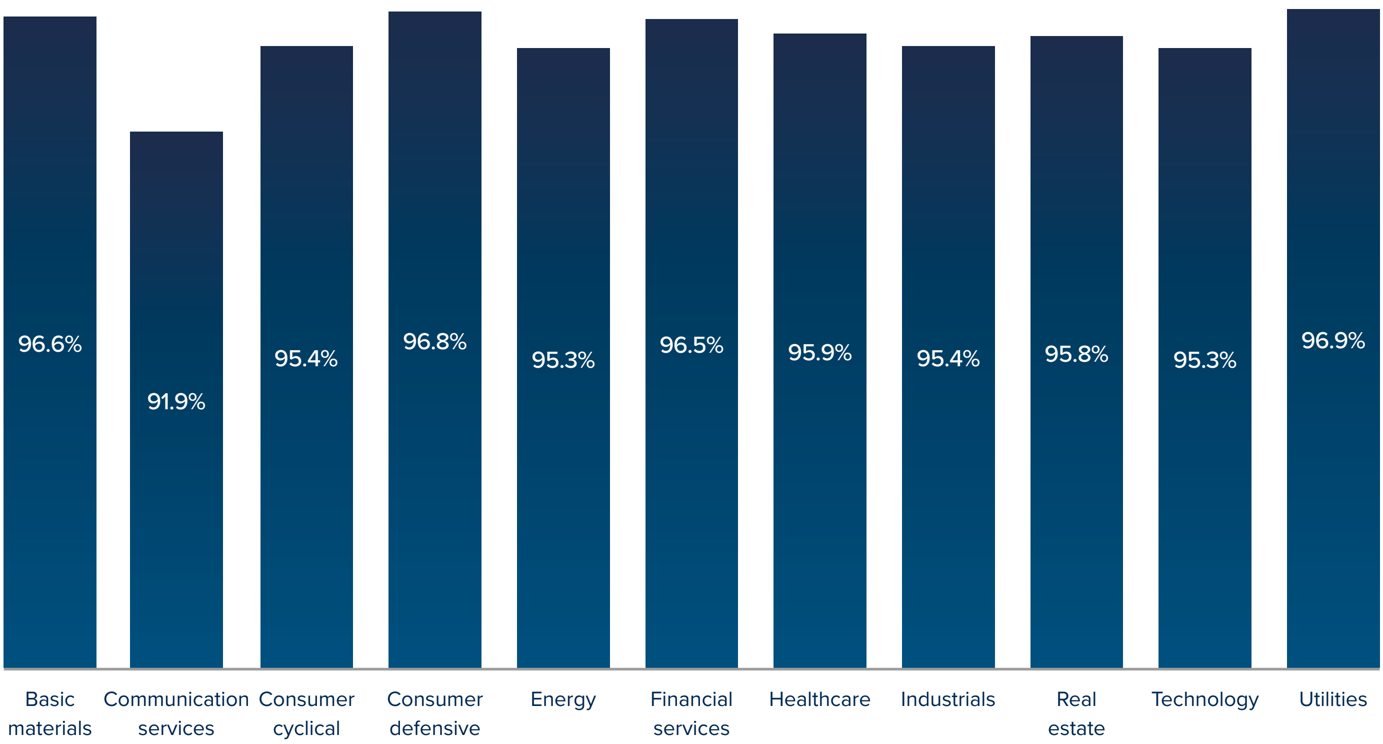
Source: Diligent Market Intelligence / Voting

No. and proportion of failed director re/election proposals (<50% support) by index

	Proxy season							
	2019-20		2020-21		2021-22		2022-23	
Index	No. failed proposals	Proportion (%)	No. failed proposals	Proportion (%)	No. failed proposals	Proportion (%)	No. failed proposals	Proportion (%)
S&P 500	10	0.2	7	0.1	4	0.1	2	0.01
Russell 3000	55	0.3	67	0.4	61	0.3	62	0.3

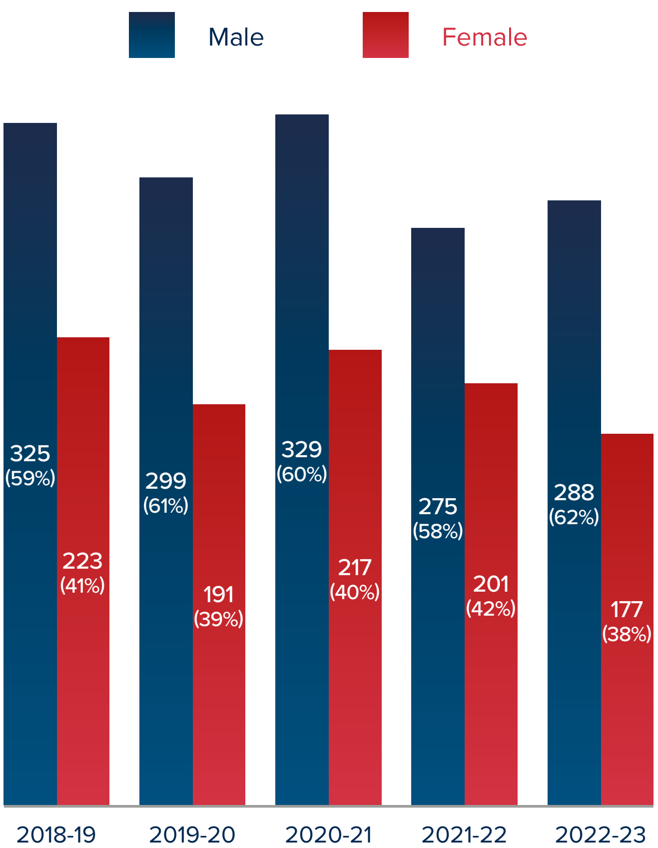
Source: Diligent Market Intelligence / Voting

Average support for (%) S&P 500 director re/elections in the 2022-23 proxy season

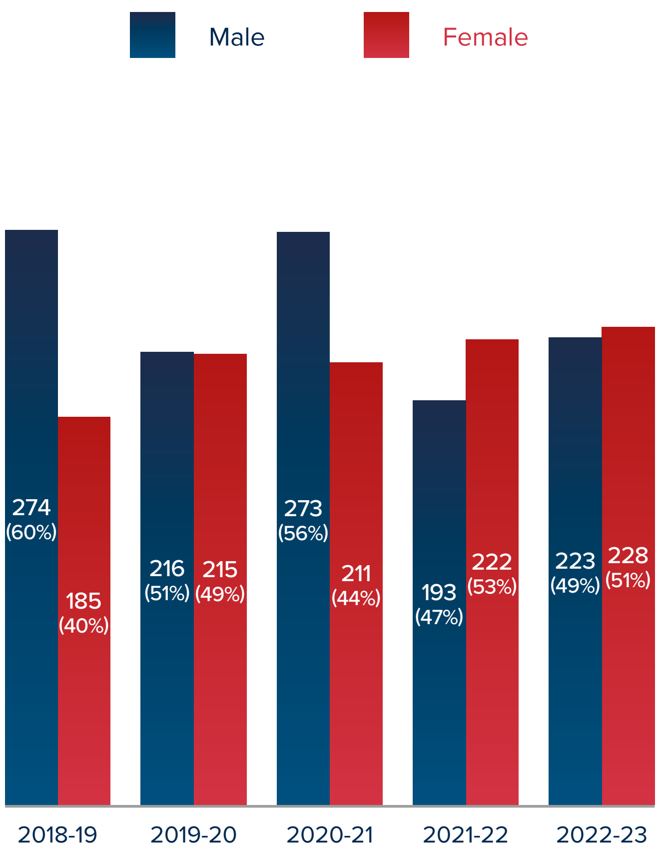


Source: Diligent Market Intelligence / Voting

S&P 500 board appointments by gender



FTSE 350 board appointments by gender



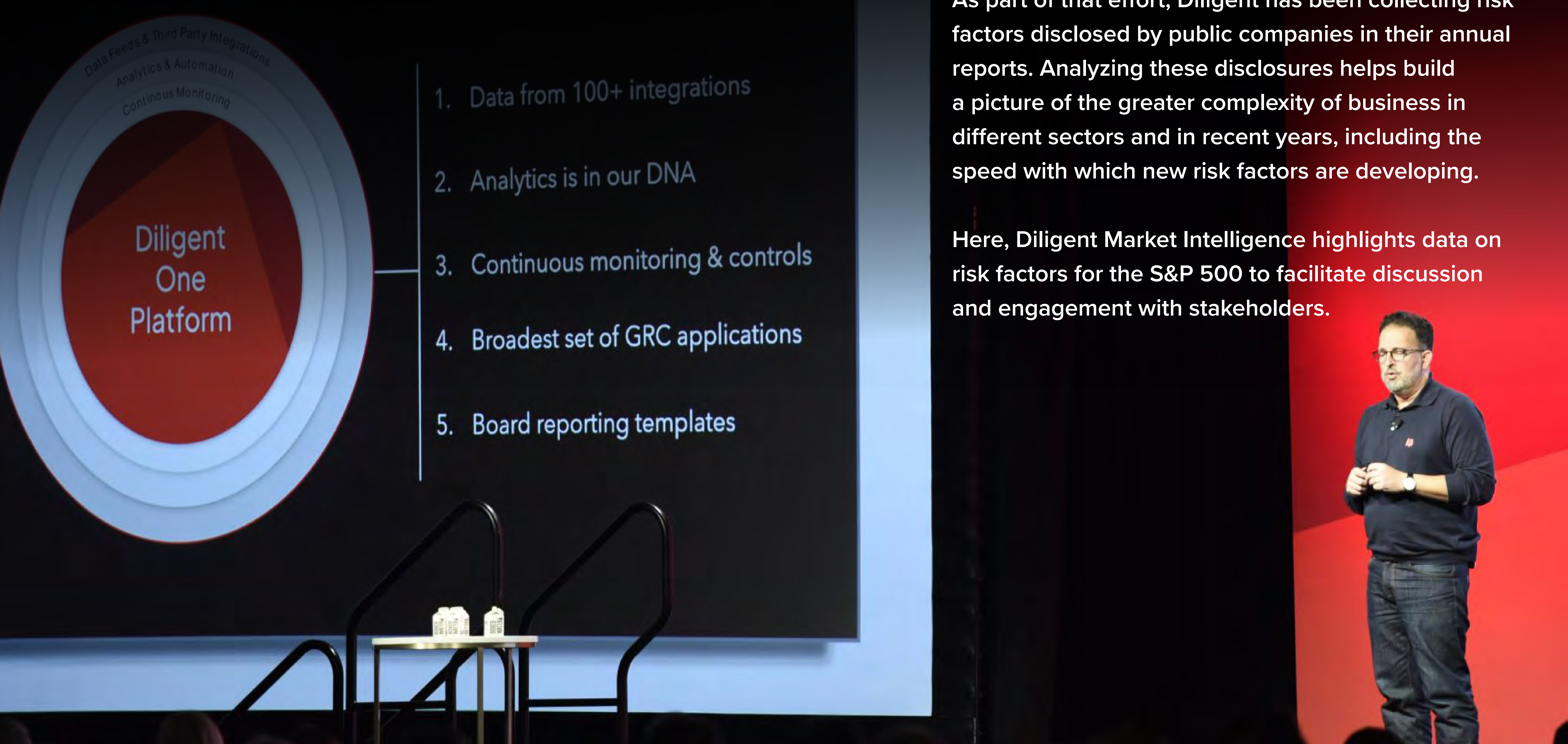
Source: Diligent Market Intelligence / Governance

Understanding public company risks

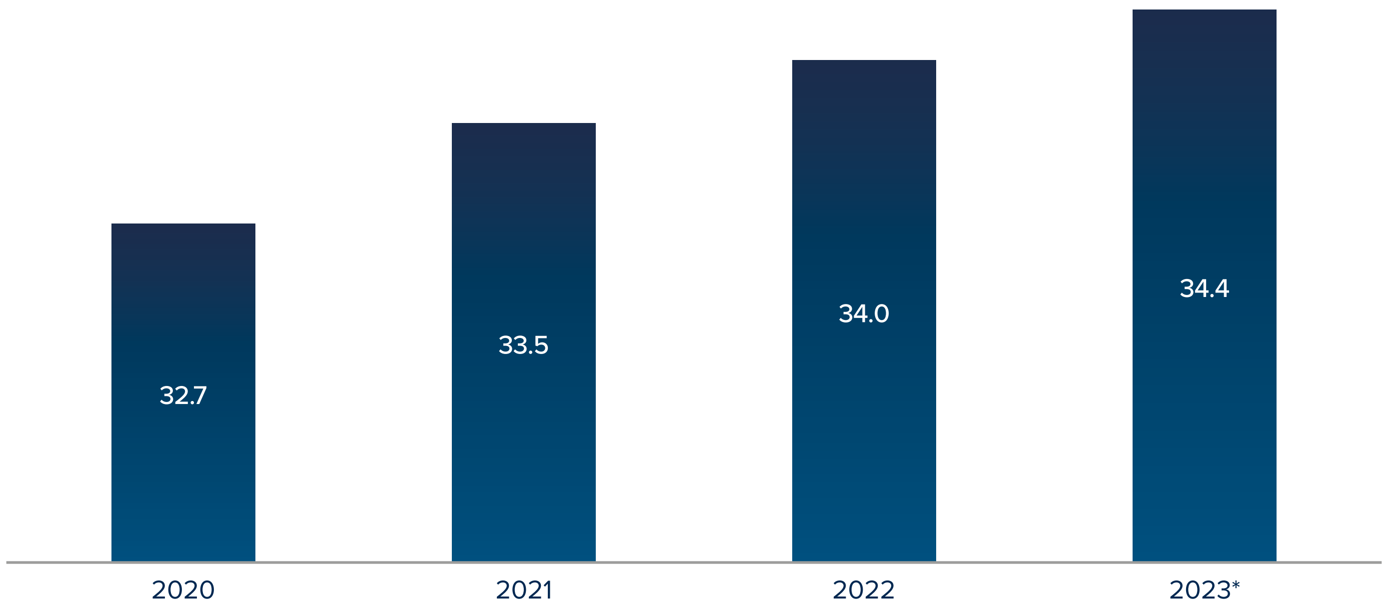
Launched at Modern Governance Summit in September, Diligent One is an exciting new solution designed to seamlessly provide a unified perspective on risks and deliver impactful insights in one consolidated view.

As part of that effort, Diligent has been collecting risk factors disclosed by public companies in their annual reports. Analyzing these disclosures helps build a picture of the greater complexity of business in different sectors and in recent years, including the speed with which new risk factors are developing.

Here, Diligent Market Intelligence highlights data on risk factors for the S&P 500 to facilitate discussion and engagement with stakeholders.



Average number of risk factors disclosed by S&P 500 companies in 10-K reporting



*As of July 30, 2023
Source: Diligent Market Intelligence

Number of S&P 500 companies to disclose at least one risk factor in 10-K reporting

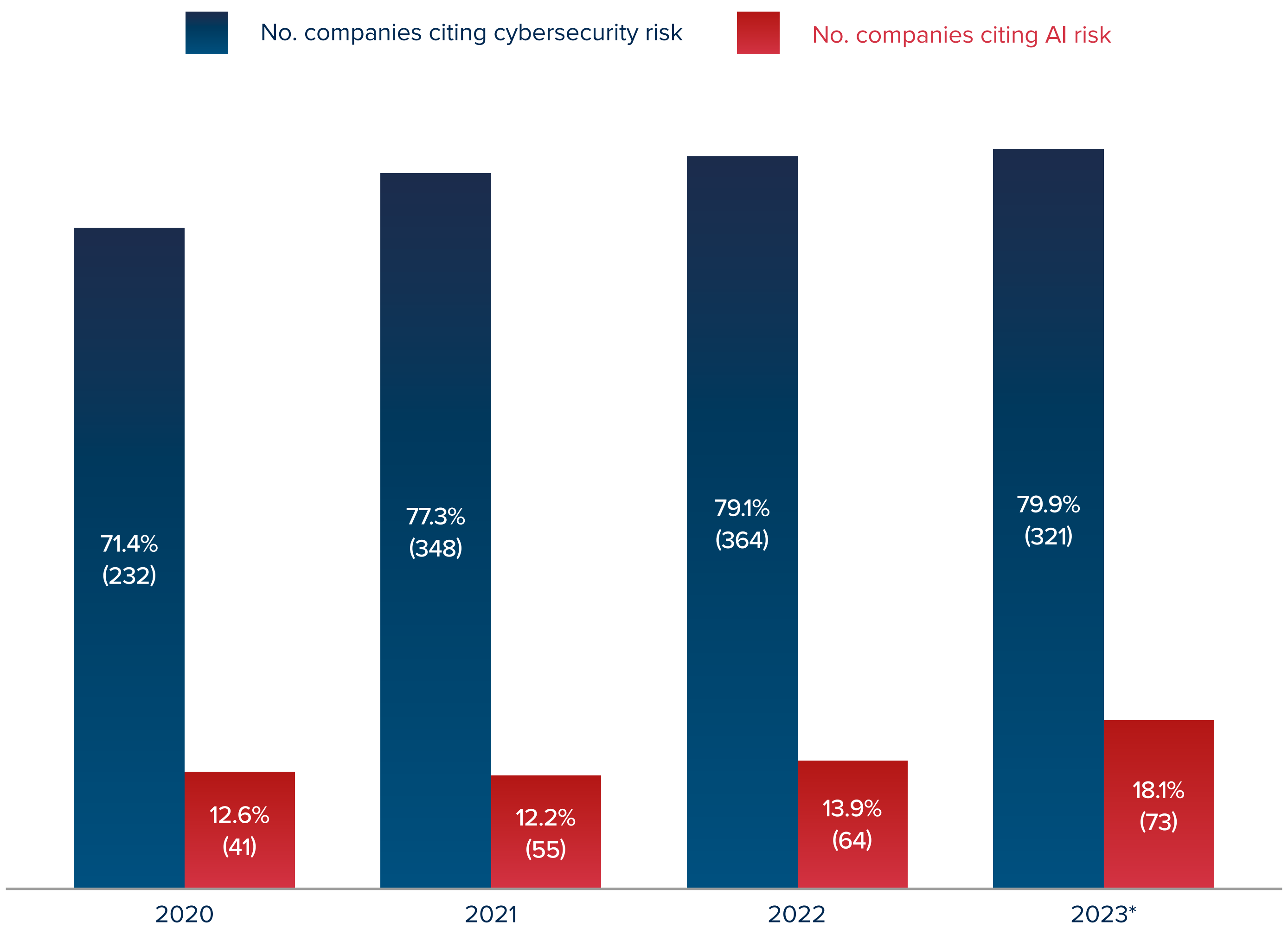
No. companies providing disclosure			
2020	2021	2022	2023*
325	450	460	402

Average distribution of risk factors disclosed by S&P 500 companies by sector in 2023*

	Risk factor category						
Sector	Supply chain	Technological	Strategic	Market	Financial	ESG	Legal and compliance
Communication services	3.9	1.8	9.7	1.4	6.5	0.4	5.8
Consumer discretionary	5.5	1.6	11.5	1.3	5.8	0.8	5.4
Consumer staples	5.6	1.5	8.7	1.5	5.0	0.8	5.1
Energy	4.2	0.9	10.4	0.5	9.4	1.9	6.4
Financials	3.7	1.7	9.9	1.4	13.4	1.1	7.5
Healthcare	7.1	1.3	8.7	1.1	6.6	1.3	10.8
Industrials	2.5	1.1	9.6	1.3	5.5	0.5	5.7
Information technology	6.0	2.0	10.4	1.6	7.0	0.8	7.1
Materials	3.2	1.0	10.6	1.3	5.7	1.3	5.1
Utilities	4.0	1.6	9.0	0.5	7.9	2.6	7.5

*As of July 30, 2023
Source: Diligent Market Intelligence

Proportion of S&P 500 companies disclosing at least one cybersecurity risk factor



*As of July 30, 2023
Source: Diligent Market Intelligence

Strengthening pay practices

U.S. pay plans saw increased support from investors in 2023, as companies took steps to align CEO pay with shareholder experiences and market trends, writes Will Arnot.

2023 marked the first time in four years S&P 500-listed issuers awarded compensation packages based on a down market. In 2022, the S&P 500 index's total return was -19.4% and companies generally responded as investors would expect, with average granted compensation for companies in the index decreasing to $15.7 million in 2022, down from $17.5 million in 2021.

Despite these tough market conditions, investors responded positively to more modest CEO payouts. 2023 marked the first proxy season in five years where support for advisory "say on pay" proposals at S&P 500 companies increased in comparison to the previous year. Proposals of this kind received 92.1% support on average in 2017, bottoming out at 87.7% average support in 2022. 2023, however, bucked the trend, with "say on pay" resolutions winning 88.9% average support, according to Diligent Market Intelligence's (DMI) *Voting* module.

"You're seeing the fruits of the labor of company engagements," Brian Valerio, senior vice president at Alliance Advisors, told DMI in an interview. "Companies have been engaging with shareholders to understand their compensation philosophies and craft plans that align with company needs, but also drive value for investors."

Constructive criticism

In 2023, issuers seemed to take stock of shareholder claims that executive pay needs to be more closely aligned with performance and shareholder experiences.

Average total shareholder return (TSR) for S&P 500 companies fell to 18.8% in 2022, compared to 90.1% a year prior, while Russell 3000 TSR declined by 80.7% to 17.2% in 2022. This decline brought CEO compensation closer to the levels seen in 2020, where S&P 500 CEOs earned $15.1 million on average, according to DMI's *Compensation* module.

A shift away from one-time awards contributed to the increase in investor backing for pay plans. In BlackRock's 2023 season review, the world's largest fund manager noted that companies used out of plan awards "less frequently than in previous years, with the number decreasing to 323 from a high of 427 in 2022."

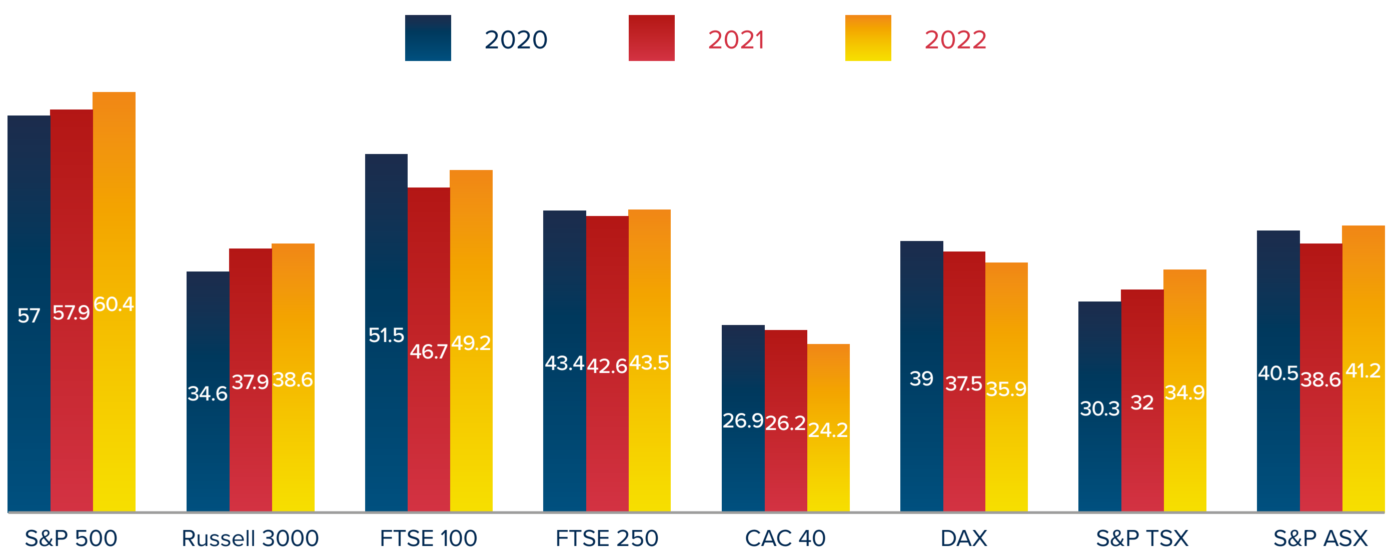
One of the biggest increases in support for "say on pay" plans this season was seen at technology giant Intel, where the company previously faced pushback due to significant one-time equity awards.

Intel's 2023 pay plan was opposed by just 8.1% of votes cast, compared to 65.9% a year prior. BlackRock was among the many investors to oppose the 2021 pay plan, noting in a voting bulletin that CEO Patrick Gelsinger's 2021 one-time equity award and base pay were "misaligned with shareholders' long-term interests."

Similar situations presented themselves at both CenterPoint Energy and JP Morgan Chase's 2023 annual meetings, where "say on pay" plans won higher support than seen in previous years, after CEOs took 63% and 59% cuts in granted pay, respectively.

Bruce Kistler, managing director at Okapi Partners, told DMI in an interview that, following a year of "very low" support for pay plans in 2022, the resurgence in 2023 was a natural bounce back attributable to more companies returning to "normal" compensation practices.

Average percentage (%) of pay that is long-term incentive by index and year



Source: Diligent Market Intelligence / Compensation

In 2022, the realized compensation of S&P 500 CEOs also declined, reflecting market volatility and broader stakeholder experiences. CEOs saw realized pay drop by 68% to $25.6 million, compared to $79.9 million in 2021. Russell 3000 pay also declined, with total average CEO realized pay declining by 52.4% to $10.2 million in 2022, compared to $21.4 million a year prior.

Easy as SEC

While both investors and issuers alike have been keen to understand how the Securities and Exchange Commission's (SEC) new Pay versus Performance disclosure rules will impact "say on pay" support in the U.S., some industry members think that the rule has made minimal impact on the 2023 season and will play a larger part come 2024.

The rule, which was adopted in August 2022, requires U.S.-listed companies to disclose specified executive pay for the past five fiscal years. Issuers are also required to report TSR, net income and between three and seven financial or nonfinancial measures considered when aligning executive pay to company performance.

When asked about the impact of the rule on pay plans, Valerio of Alliance Advisors told DMI it was "a little too early to tell. Companies recognize that they need to comply with this, but it hasn't really been a frequent discussion topic during engagements with investors, as it is not something that shareholders seem to be interested in discussing."

The rule has, however, encouraged companies to be more thoughtful about how to disclose and report on pay, especially in regard to metrics used to evaluate pay plans and corporate performance.

"CEOs saw realized pay drop by 68% to $25.6 million, compared to $79.9 million in 2021."

"These disclosures likely would have had significantly more value 10+ years ago when they were originally contemplated under Dodd-Frank. However, many investors and advisors have developed and refined their own models since then," Kistler of Okapi noted. "I think where [the rule] may have helped is pushing some companies that have traditionally spent less time speaking to metric selection rationale to rethink that and spend more time on this."

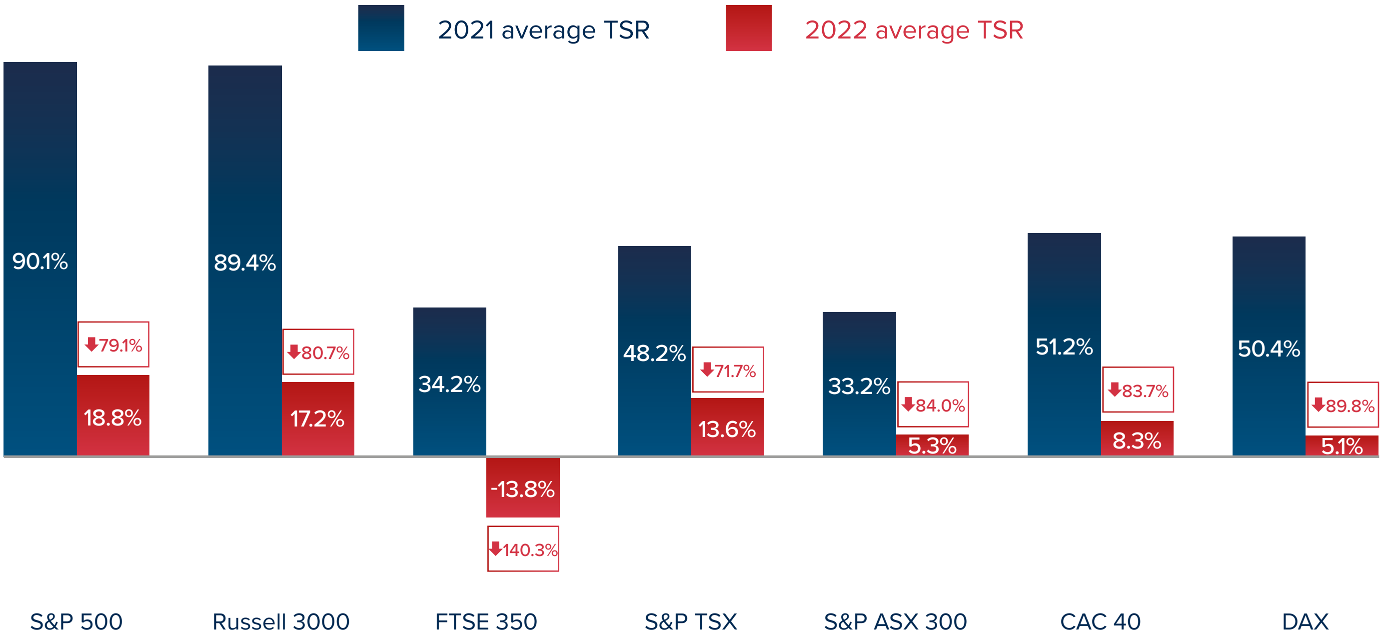
In Vanguard's U.S. 2023 season review, the fund manager revealed it supported 95% of U.S. management pay proposals, thanks to companies being more open about "how they planned to modify their disclosures" to aid investor decision-making, which it attributed to the new legislation.

Support for (%) S&P 500 "say on pay" proposals by sector

	Proxy season			
	2021-2022		2022-2023	
Industry	No. proposals	Avg support (%)	No. proposals	Avg support (%)
Basic materials	29	92.0	29	90.5
Communication services	5	79.8	7	81.0
Consumer cyclical	62	84.0	65	86.2
Consumer defensive	35	89.1	36	90.4
Energy	27	87.0	23	94.0
Financial services	61	90.0	62	88.7
Healthcare	61	86.0	63	88.5
Industrials	77	89.5	82	90.2
Real estate	27	90.0	27	84.8
Technology	77	85.2	74	84.7
Utilities	29	91.4	30	93.5

Source: Diligent Market Intelligence / Voting

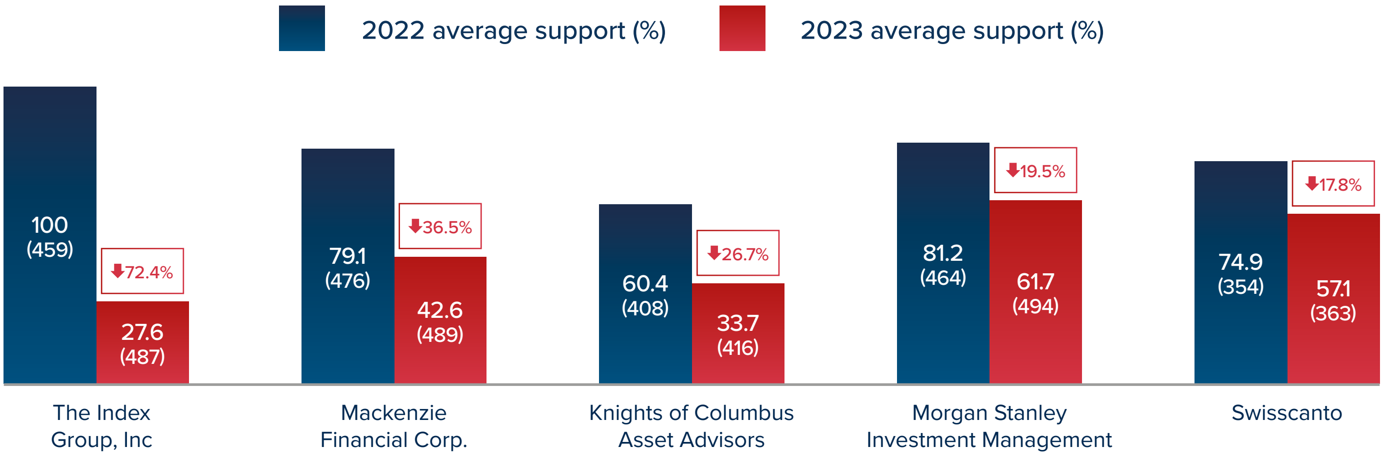
Average total shareholder return (TSR) by index



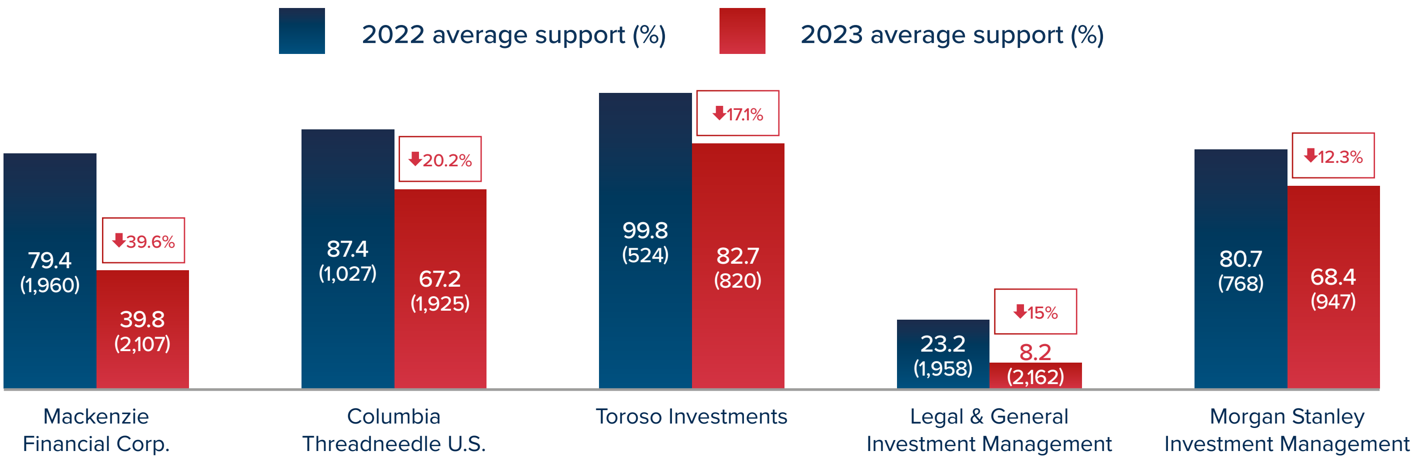
Source: Diligent Market Intelligence / Compensation

Investors with the biggest decrease in support for (%) advisory “say on pay” proposals between the 2022 and 2023 proxy seasons

S&P 500



Russell 3000



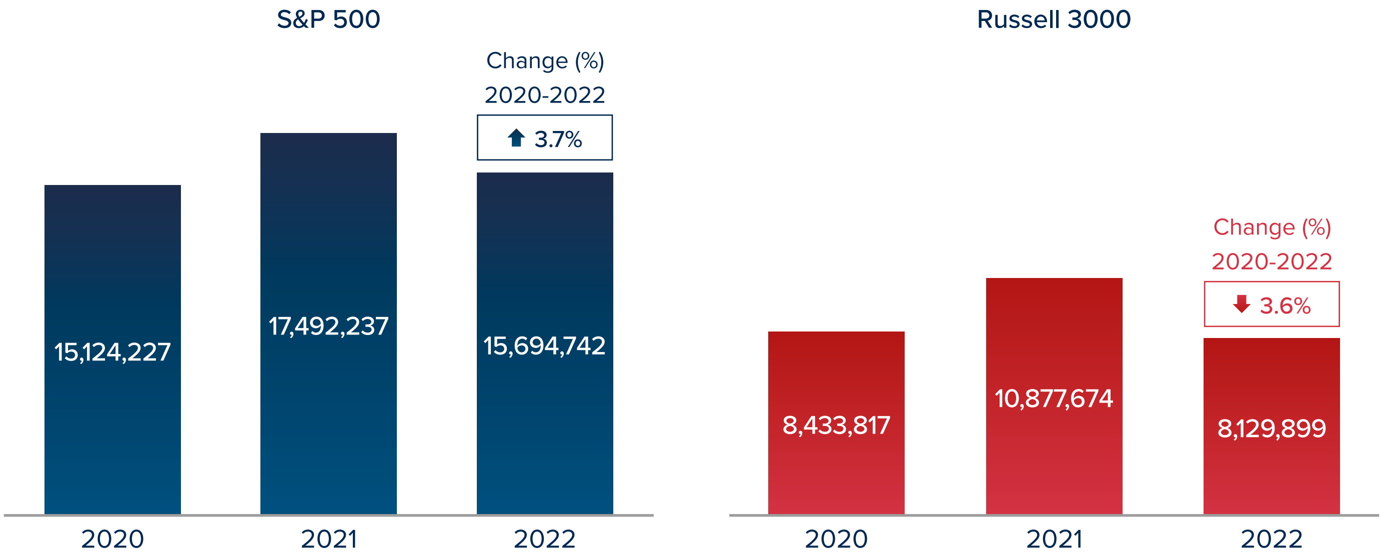
Figures in parentheses represent the number of meetings where proposal types were voted on.

*S&P 500 data limited to investors that voted at a minimum of 300 meetings. Russell 3000 data limited to investors that voted at a minimum of 500 meetings.

Source: Diligent Market Intelligence / Voting

CEO granted compensation by index and year ($)

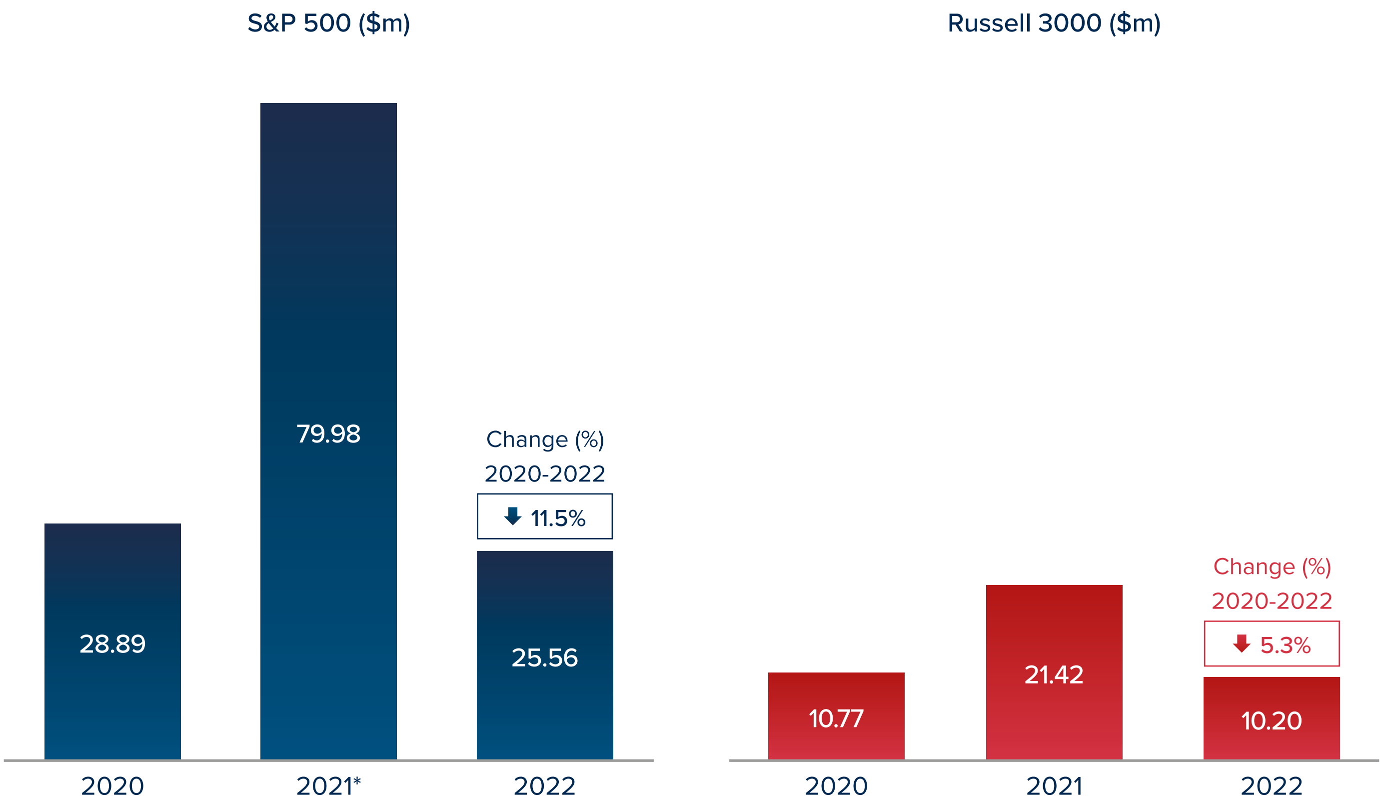
Compensation is disclosed retrospectively for fiscal years, so 2022 data was disclosed during the 2022-23 proxy season.



Compensation is by the company's fiscal year.

Source: Diligent Market Intelligence / Compensation

Average CEO total realized pay by index and year



*S&P 500 CEO pay was atypically high in 2021, largely in response to significant stock awards.

Source: Diligent Market Intelligence / Compensation

Ensuring effective engagement

As issuers prepare for a new proxy season, establishing a robust investor engagement strategy can help pave the way to success, writes Michael Vogele, managing director, global advisory group, Alliance Advisors.

"While bringing about change may take months or even years, the communication of this strategy must be sound."

Michael Vogele
mvogele@allianceadvisors.com

Now that the dust has settled on the 2023 proxy season, companies are asking themselves what the 2024 season may hold in store for them.

Some companies look at N-PX filing data, a Securities and Exchange Commission (SEC) form that details the proxy voting records of registered funds, to give them insights into investor voting decisions, while investor voting policies are another avenue to aid issuer understanding of voting decisions. While investor policies are publicly available and updated on an annual/bi-annual basis, understanding voting triggers requires a nuanced review.

Starting in September, companies also begin the practice of proactively engaging with their largest shareholders, rather than waiting for investors to contact them with concerns or disclosure requests. The companies taking this initiative are hoping to understand what compensation, governance, environmental and social (E&S) or sustainability risks an investor may perceive and ways to avoid a non-supportive voting decision.

Regrettably, not all companies effectively engage with their shareholders. They believe that having calls with the investor portfolio managers is sufficient. Yet, by doing this, they are excluding the ESG, stewardship or responsible investor teams, as they are known in different jurisdictions. It is these entities that end up making the proxy voting decisions and they are the ones that need to be engaged with.

Depending on the level of vote support at the annual shareholder meeting, investors and proxy advisors may be expecting a company to make appropriate structural changes. Specifically, any resolution receiving below 80% support from shareholders, be that elections or discharge of the boards, "say on pay" resolutions, auditor ratification, all require a robust corporate response, including clear disclosure on engagement efforts. In addition, should a shareholder resolution receive upwards of 20% support, it would also behoove a company to determine why shareholders supported this resolution by such a wide margin.

That being said, many companies unfortunately do not understand what responsiveness looks like for an investor. As a pertinent example, let us discuss board elections where typical objections are based on shareholder unfriendly governance practices, lack of diversity on the board, or compensation concerns, to name a few reasons. What are companies expected to do with this initial insight?

What we would recommend initially is to speak to as many shareholders as are willing to have a conversation, including holders that voted for as well as against the proposal. Should the pattern emerge from this dialogue that a majority of respondents share these concerns then a company should begin making changes. While bringing about change may take months or even years, the communication of this strategy must be sound. This would entail the publication of robust targets and appropriate timelines for implementation in the appropriate public filing. It is the latter process that one would deem to be responsive.

Similarly, should the company employ a governance practice that investors deem to be shareholder unfriendly, such as maintaining a classified board, then the company should consider sunsetting this practice. As stated above, most investors realize that it may take a company multiple years to resolve this structure, so communicating this effectively is paramount.

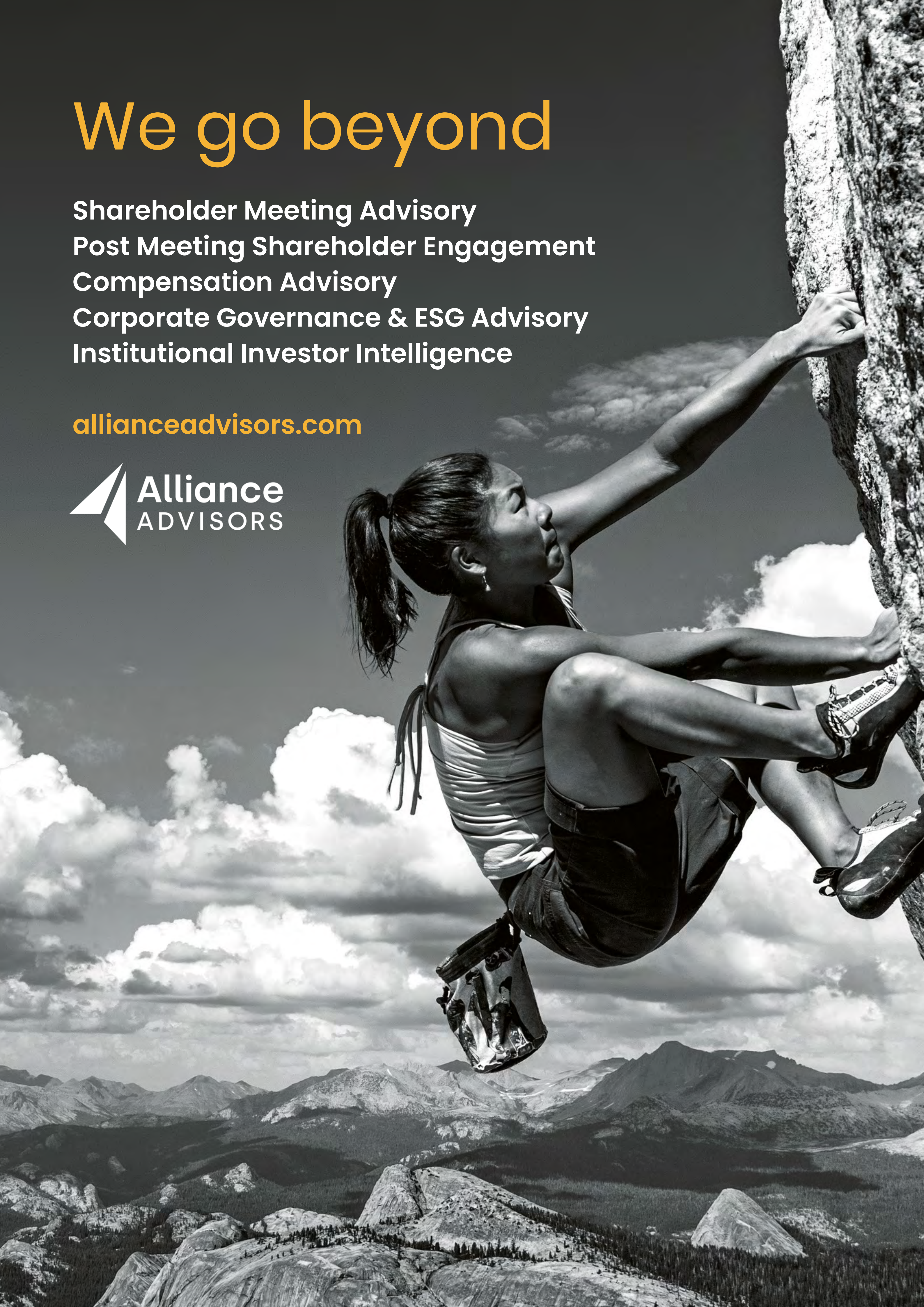
Addressing compensation concerns

Switching to the contentious topic of compensation, every investor has their preferred constructs, and some companies may feel like these principles do not allow for industry-specific considerations. This dilemma highlights the necessity to begin a dialogue with shareholders to determine what they prefer and what non-best practice market norms can be overcome by transparency.

An example of this is the publication of financial or non-financial goal data for short-term incentive schemes, specifically the disclosure of threshold, target and max goals. Companies may claim competitive disadvantage by publishing this data, however, should an incentive program exceed target payouts, then an investor may question if the targets were even robust in nature. This is where concise disclosure is fundamental, listing shareholder feedback and describing consequent changes to compensation structures.

Equally, responding to compensation structure concerns requires a comprehensive review and follow-up statement in the necessary fillings. Should there be a historic concern with over-payment for under-performance, then shareholders will expect an appropriate response by implementing risk mitigators, reducing short and/or long-term incentive grant multiples and/or more robust goal setting for long-term incentives.

Finally, some companies are still uncertain how to react to shareholder proposals that received support of above 20%. Again, engaging with investors is essential and then responding in an appropriate manner. Never miss the opportunity to state that the company is compiling the necessary information and it will be available at a certain future date.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Shareholder Meeting Advisory
Post Meeting Shareholder Engagement
Compensation Advisory
Corporate Governance & ESG Advisory
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Which ESG proposals won the favor of investors?

Employee welfare, diversity and CEO pay were subject to enhanced scrutiny as depressed markets redirected investor attentions away from traditionally popular ESG concerns, writes Miles Rogerson.

A select group of ESG proposals have led the way in terms of shareholder support during the 2023 proxy season. Freedom of association, alongside broader human rights reporting proposals, won occasional majority support from investors in the 2023 proxy season, as shareholders identified employee retention and recruitment as a potential risk resulting from current market volatility.

In a market plagued by rising inflation and cost-of-living concerns, a number of shareholder proposals on pay equity and severance package approval were also forthcoming.

Human capital becomes a priority

Freedom of association proposals, which seek to guarantee employees' right to form trade unions, rank among the best performing ESG proposals of the 2023 season. Nine proposals of this kind won 35.5% average support, up from one proposal winning 38.9% support a season prior, while none made the ballot in the 2021 season.

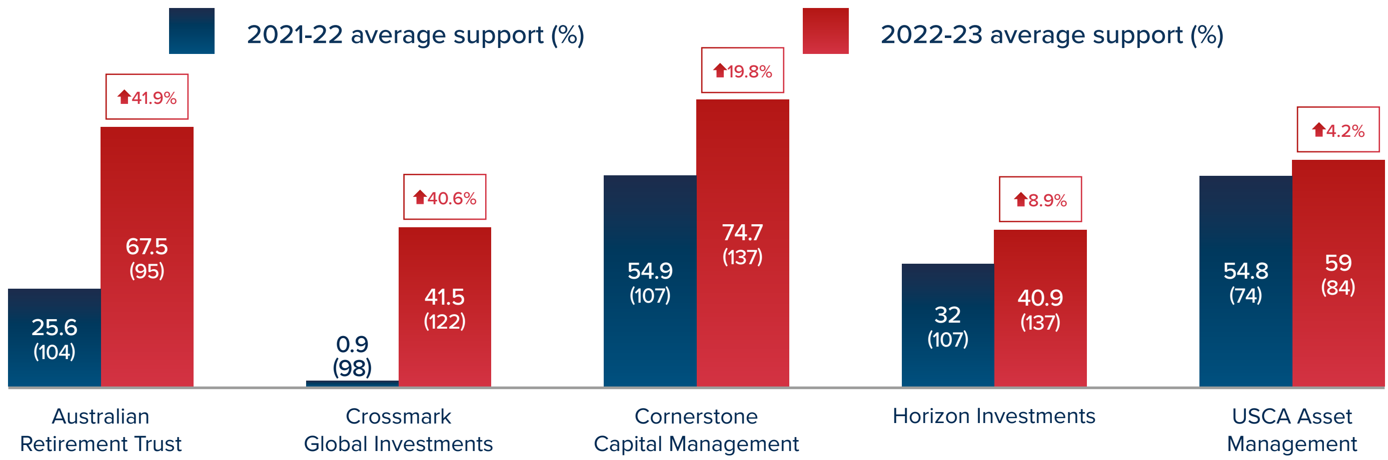
"Proposals on freedom of association and diversity, equity and inclusion (DEI) reporting that went to a vote continued to gain traction with investors, despite the broader decline in support for environmental and social proposals, an indicator that investors felt the social risks they addressed were tied to financial value," PJT Camberview Director Sheena VanLeuven told Diligent Market Intelligence (DMI).

One proposal filed by the New York City Comptroller, asking Starbucks to commission an assessment of its workers' rights and freedom of association policy, won 52% support at the U.S. coffee company's March 23 annual meeting.

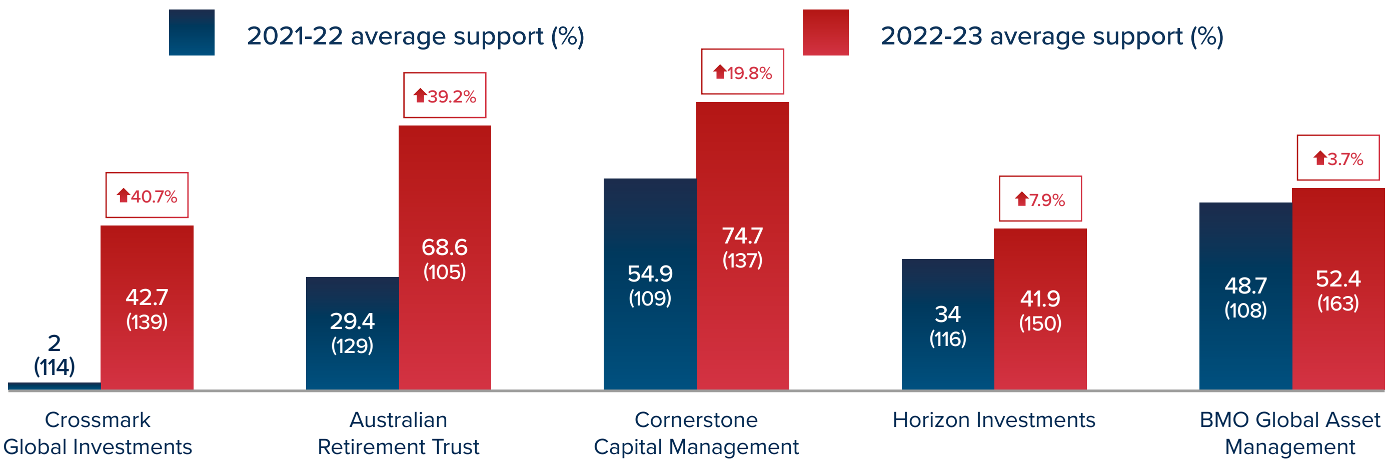
Vanguard elected not to support the proposal, explaining that while matters relating to workers' rights are a "material risk"

Investors with the biggest increase in support for (%) environmental and social shareholder proposals between the 2022 and 2023 proxy seasons

S&P 500



Russell 3000



Figures in parentheses represent the number of meetings where proposal types were voted on.

*S&P 500 data limited to investors that voted at a minimum of 50 meetings. Russell 3000 data limited to investors that voted at a minimum of 100 meetings.

Source: Diligent Market Intelligence / Voting

at Starbucks, the coffee giant's board "appeared to be taking appropriate steps to remediate and address the risks." Seven other proposals of this kind won above 30% support in 2023 at companies such as Netflix and Activision Blizzard.

Beyond unionization, other human rights concerns received elevated levels of support, albeit rarely winning majority support. Two proposals asking Smith & Wesson Brands and Axon Enterprises to adopt/amend their human rights policies won 41.8% and 13.7% support, respectively.

In comparison, during the 2022 season, proposals asking Smith & Wesson and Microsoft to adopt/amend their human rights policies received 43.9% and 4.1%, respectively. In 2021, support for human rights proposals was markedly lower, with reporting requests at Twitter and Alphabet receiving 14.3% and 10.3% support, respectively.

"A lot of companies have ramped up their governance of human rights issues, DEI and freedom of association over the last few years," Marc Lindsay, managing partner, director of research at Sustainable Governance Partners, told DMI. "Investors are giving companies credit for enhancing their disclosure or governance practices."

Many U.S. companies with operations in Europe will also be required to enhance their human rights reporting in the near future, thanks to the EU's Corporate Sustainability Reporting Directive (CSRD).

Under the new rules, made effective January 5, 2023, U.S. companies with European subsidiaries will be required to report on due diligence processes related to their corporate value and supply chains, which must also be subject to a third-party audit.

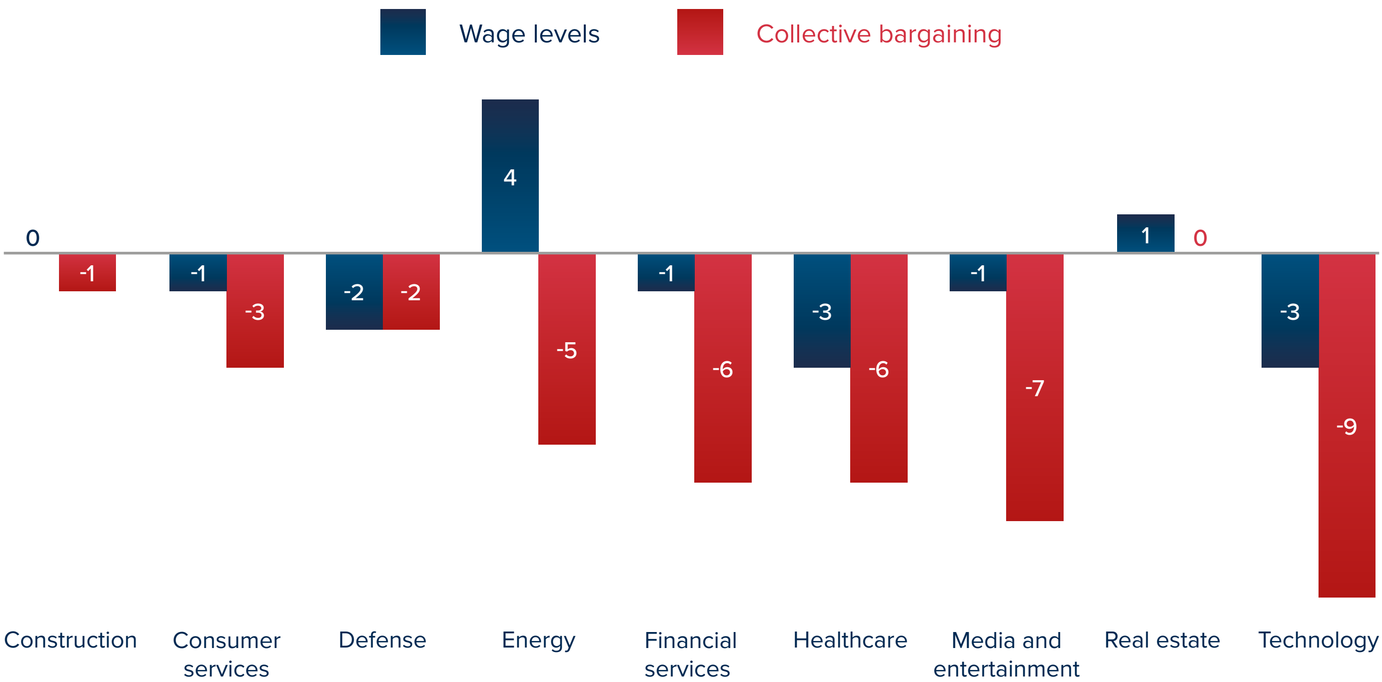
Diversity disclosure

Broader focus on employee welfare also meant that support for proposals seeking the approval of, or amendments to U.S. diversity and equal employment opportunity (EEO) policies remained relatively consistent in the 2023 season, with eight proposals winning 28.4% average support, compared to 11 winning 32.7% support in the 2022 season.

Global employee equity health scores by industry

Manzama health scores track corporate ESG commitments from -10 to +10, with the higher the score reflecting fewer risks.

The technology sector is subject to the most risks related to employee equity, with below average wage equality and weaker collective bargaining rights. The energy sector provides the highest average employee wages, while real estate has the strongest collective bargaining policies.



*As of August 31, 2023.

Source: Diligent Market Intelligence / Manzama

As with freedom of association proposals, only one of the 2023 EEO-1 proposals received majority support in the season. That was at Expeditors International of Washington's May 2 annual meeting, where the proposal won 57.3% support. Legal & General Investment Management (LGIM) was one of many investors to support the proposal, noting in its rationale that "disclosing the level of information contained in the EEO report may lead to reduced inequality," and thus reducing business risk.

"Freedom of association proposals, which seek to guarantee employees' right to form trade unions, rank among the best performing ESG proposals of the 2023 season."

"The proposals that got higher support this year were carefully crafted by the proponent to be focused solely on disclosure and not on being prescriptive around company strategy," Lindsay told DMI. "Proponents know that the passives are going to be hesitant to support proposals that are more prescriptive.

"While divergent voices have started to take aim at companies for advancing social initiatives, all indications point to these topics continuing to be priorities for investors and companies alike in the year ahead," said VanLeuven.

"I think the anti-ESG sentiment has had a chilling effect at some of the larger asset managers, in terms of whether they support these diversity resolutions," said Edgar Hernández, assistant director, department of strategic initiatives at the Service Employees International Union (SEIU). "My hunch is that the biggest asset owners probably did not, and that's a big obstacle to overcome when pushing issues like gender, racial and ethnic diversity on boards."

Pay disparity

Investor concerns also extended beyond employee welfare and human rights, with many proposals seeking to enhance scrutiny of executive pay. Proposals pushing U.S. companies to create pay disparity reports have seen support hold steady at 33.8% compared to 35.5% in 2022, while the number of proposals being filed has increased to 11 this season, up from eight in 2022.

While no director remuneration proposals managed to win majority support this season, James McRitchie's proposal urging Boeing to establish an annual report on unadjusted median and adjusted pay gaps across race and gender globally came the closest, winning 47.4% support at the airline's April 18 annual meeting.

20 proposals pushing U.S. companies to submit executive severance packages to a shareholder vote were put before investors at annual meetings this season, winning 31.4% average support. Three of these proposals, targeting Delta Air Lines, Becton, Dickinson and Co. and Expeditors International of Washington, were backed by a majority of votes cast. Proposals seeking clawback policy amendments at Marathon Petroleum and Verizon Communications won 45.2% and 37.9% support, respectively.

"While divergent voices have started to take aim at companies for advancing social initiatives, all indications point to these topics continuing to be priorities for investors and companies alike in the year ahead."

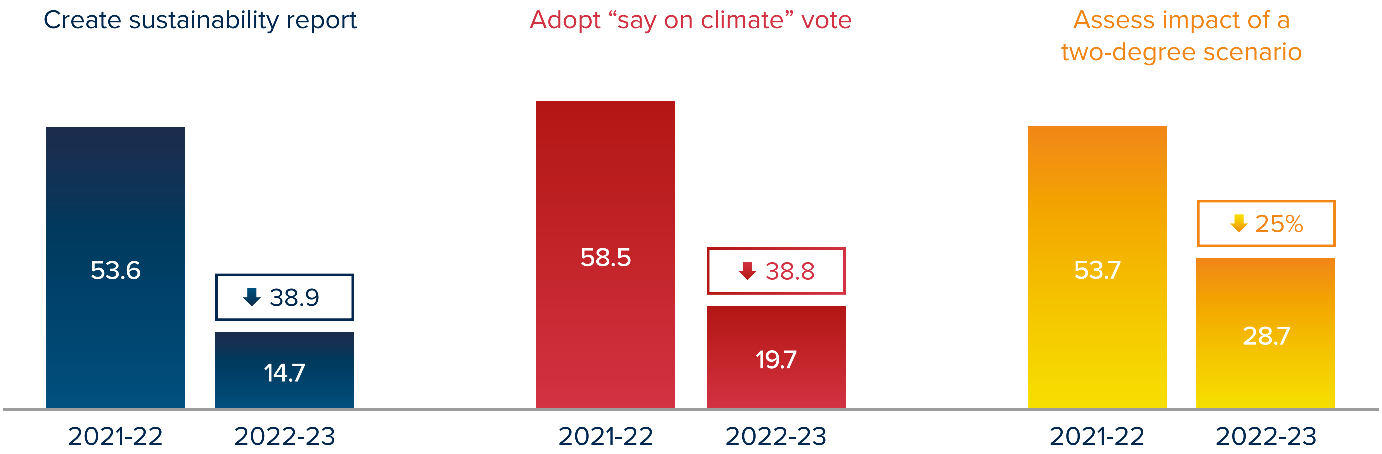
Average support for proposals asking U.S.-listed companies to approve clawback provisions also increased to 41.5%, compared to 27.5% a season prior.

"In some cases, the U.S. is somewhat of a laggard on these issues, and I think we really need to push more to ensure that there is gender and racial pay equity. There's definitely been a lot of great progress made so far, but there's still some ways to go," Hernández said.

ESG shareholder proposals with the most significant decline in support (%) between the 2022 and 2023 proxy seasons globally

Proposal type	No. proposals with results	
	2021-22	2022-23
Create sustainability report	2	3
Adopt "say on climate" vote	2	8
Assess impact of a two-degree scenario	7	32

Average support for (%)

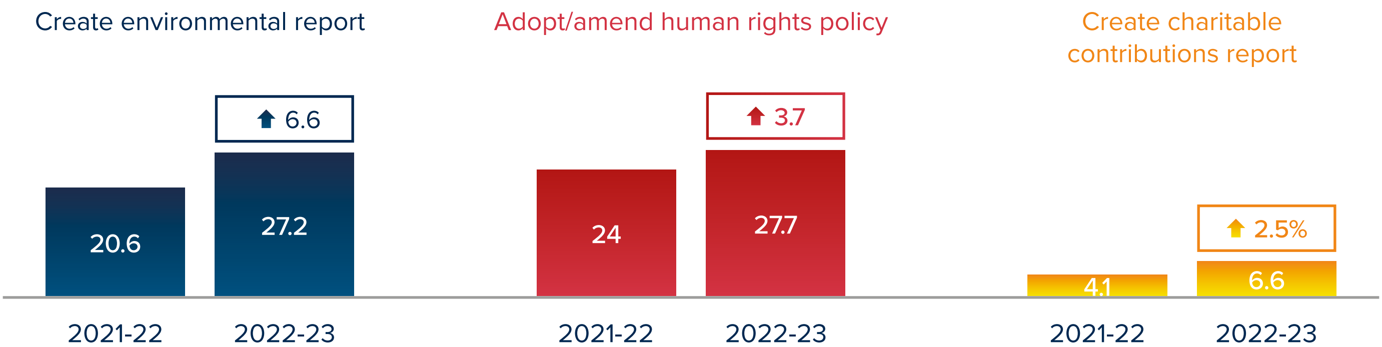


Source: Diligent Market Intelligence / Voting

ESG shareholder proposals with the most significant increase in support (%) between the 2022 and 2023 proxy seasons globally

Proposal type	No. proposals with results	
	2021-22	2022-23
Create environmental report	12	9
Adopt/amend human rights policy	2	2
Create charitable contributions report	13	3

Average support for (%)



Source: Diligent Market Intelligence / Voting

Holding ESG funds to account

Developments in global policymaking mean asset managers are facing enhanced scrutiny on greenwashing and ESG fund labelling, writes Rebecca Sherratt.

With the National Bureau of Economic Research revealing that the share of global index funds with an ESG mandate has nearly doubled from 3% to 5% between 2019 and 2022, fund labelling and greenwashing are priority concerns for regulators. In September, both U.S. and European policymakers took steps to prevent asset managers from making misleading claims about the climate credentials of their funds.

On September 20, the U.S. Securities and Exchange Commission (SEC) voted 4-1 in favor of enhancing its Investment Company Act Names Rule, which addresses fund names that are likely to mislead investors about related assets and risks. Five days later, the regulator finalized a $25 million settlement with Deutsche Bank, citing greenwashing and other concerns.

The amended ruling requires registered investment companies whose fund names suggest a focus in investments with particular characteristics, such as thematic ESG factors, to adopt a policy to invest at least 80% of the value of their assets in those investments. Funds will also be required to review portfolio assets at least quarterly and include a specific time frame for getting back into compliance if a fund departs from its 80% policy.

That same month, the European Parliament and Council reached agreement on new rules banning funds from using sustainability labels not based on approved certification schemes. The rule also bans companies across all industries from making "generic environmental claims," such as a fund being "environmentally friendly," without proof of environmental performance related to the claim.

Responses to the policies have been mixed. Some industry members have praised the rules for enhancing the reliability of fund sustainability claims and holding asset managers to account. "Today, we see funds with ESG in their names holding dozens of fossil fuel extraction companies and coal-fired utilities. The plain English meaning of 'fossil free' should rule out these holdings," Andrew Behar, CEO of As You Sow, said in a press release. "We call on asset managers to embrace the spirit of these rules and ensure that their ESG funds have holdings that align with the fund name and prospectus language."

Critics cited the cost of compliance and whether such rules could deter new fund formation and hamper stock picking. "Smaller funds may not have the resources to sift through a mountain of correspondence to decipher the staff's views, and all funds – including larger funds – will incur significant costs in complying with the expanded rule," Republican SEC Commissioner Mark Uyeda said in a press statement. "Alternatively, funds might simply select generic or exceedingly complex names that do little to help investors."

The asset management industry will now be watching closely to see whether these policies restore investor confidence in ESG funds or lead to a decline in the number of ESG products offered to investors.

"Some industry members have praised the rules for enhancing the reliability of fund sustainability claims and holding asset managers to account."

ESG fund policy breakdown

Investment Company Act Names Rule	Empowering Customers for the Green Transition Rule
Applies to funds whose name suggests a focus in investments with a characteristic or thematic focus, through names such as "sustainable" or "socially responsible."	The regulation will apply to EU funds and also applies to issuers marketing products and services as "sustainable" or "green."
Requires funds to invest at least 80% of the value of its assets consistent with its name.	Funds are prohibited from making generic environmental claims such as being "environmentally friendly" without proof of recognized excellent environmental performance relevant to the claim.
Should a fund depart from the 80% requirement, it is expected to return to compliance in a timely manner, (in most cases, within 90 days).	Funds can only use sustainability labels based on approved certification schemes or established by public authorities.
Funds must also disclose how they define the terms in their name and select appropriate investments.	A final vote is expected to take place in November, after which member states will have 24 months to incorporate the rule into law.
Fund groups with less than $1 billion in net assets and upwards of $1 billion in assets under management will have 24 and 30 months to comply, respectively.	

Diligent

Takeaways from Diligent MGS 2023

Diligent's Modern Governance Summit (MGS) showcased that corporate risk oversight is a growing priority for both activist and institutional investors.

On September 13 – 15 in Orlando, Florida, Diligent brought together 750 governance, risk and compliance professionals to discuss the latest trends in corporate governance at MGS 2023. Alongside a packed three days of live seminars and thought leadership sessions, attendees also made the most of on-demand presentations, networking opportunities and product sessions. Here is a selection of key takeaways, as selected by the Diligent Market Intelligence (DMI) team.

Trends in shareholder engagement

Investor outreach should be a priority for boards in 2024 as they navigate the new universal proxy card (UPC) landscape, according to a panel hosted by DMI Editor-in-Chief Josh Black, featuring insights from Shaun Mathew, partner at Kirkland and Ellis, Bob Marese, president of MacKenzie Partners, Dimitri Zagoroff, senior editor, global content, at Glass Lewis and Strategic Governance Partners' Partner, Steven Balet.

Activist investors gained strong momentum in the 2023 season, with 403 U.S.-listed companies subjected to activist demands in 2023, compared to 362 in the same period in 2021. Directors are under enhanced scrutiny, with the newfound flexibility of UPC increasing the likelihood of dissident minority slates being elected.

The summit also played host to a DMI proxy season bootcamp, consisting of three sessions exploring the latest trends in shareholder activism, investor voting and board governance.

Bootcamp 1: Executive compensation and succession planning

Pay plans that place significant emphasis on "at risk" compensation, while also being long-term in nature, are likely to win the favor of investors, according to a session moderated by Rachel Simon, senior director, product marketing at Diligent, who was joined by Etelvina Martinez, managing director of Alliance Advisors, Nick Lamplough, founding partner of Collected Strategies, and DMI's Josh Black.

Issuers also shouldn't underestimate the importance of proxy statements as a tool to win over shareholders, panelists noted. Institutional investors find both the narrative and data extremely valuable in understanding the robustness of pay and succession plans.

Bootcamp 2: Shareholder engagement and activism preparedness

DMI's Black also moderated a session on preparing for activism engagement, featuring insights from Greg Taxin, managing member of Spotlight Advisors, Mark Harnett, senior managing director of Okapi Partners and Lamplough of Collected Strategies.

Now more than ever, every shareholder is a potential activist, whether they be an investment firm or a current director. As such, the biggest mistake companies can make is being dismissive of its shareholders. Proactively addressing investor concerns is vital to ensure investor confidence; a history of effective execution can help a company gain credit for actions during a proxy fight that might otherwise look reactive.

Bootcamp 3: ESG at a crossroads

The third DMI bootcamp, hosted by Black, explored the rise in anti-ESG sentiment. According to panellists Sheena VanLeuven, director of PJT Camberview, Ariel Giumarelli, partner at Kirkland and Ellis and Martinez of Alliance Advisors, more investors are seeing shareholder proposals as a blunt tool for guiding issuers on their ESG journey and are exploring other methods to hold issuers to account, such as votes against directors.

Companies are also finding it challenging to navigate the growing ESG divide but should prioritize being authentic to their goals and understand that there is no one-size-fits-all approach to ESG oversight.

Navigating risk

Risk is evolving rapidly and unabating. In this session, Diligent Distinguished Evangelist Renee Murphy, together with David Metcalfe, CEO of Verdantix, Anthony Pugliese, president and CEO of IIA, Dominique Shelton Leipzig, partner at Mayer Brown, and Renee Wynn, deputy chief information officer at the Environmental Protection Agency (EPA), explored emerging risks in the realm of artificial intelligence (AI), ESG and cybersecurity.

Given the significant speed with which AI is evolving, human oversight of AI is critical. Both board members and management need to be well versed in navigating and understanding related risks, particularly in regard to test monitoring and auditing AI for inaccuracy and bias.

The session also delved into how compliance professionals need to take the initiative in addressing climate-related risks. Digital technologies, such as ESG risk management software, are a vital resource to help support corporate ESG programs. The risk of legal liability for greenwashing is ever present and companies should make sure their sustainability reporting and their 10-Ks are aligned.

"By understanding that you are vulnerable, you can take actions to protect yourself as well as your business," Wynn of EPA said.

Evolving ESG reporting requirements

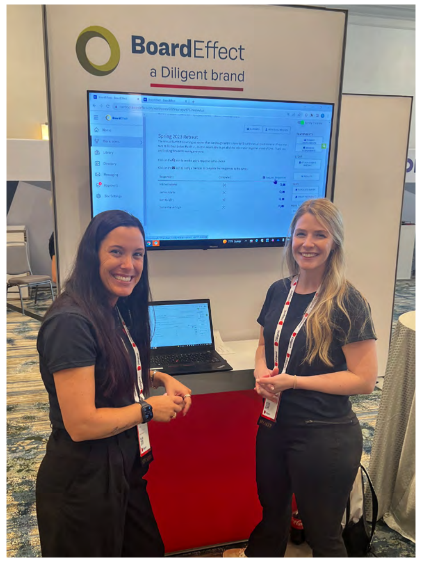
Non-financial reporting has been subject to significant changes this season, thanks in part to the International Sustainability Standards Board's (ISSB) new reporting standards. One session, moderated by Diligent's Murphy and featuring insights from Kate Wiese, senior manager, ESG & sustainability at Deloitte and Joyce Cacho, CEO and president at Adinura Advisory Services, discussed the importance of boards tying ESG data both to financials and organizational strategy.

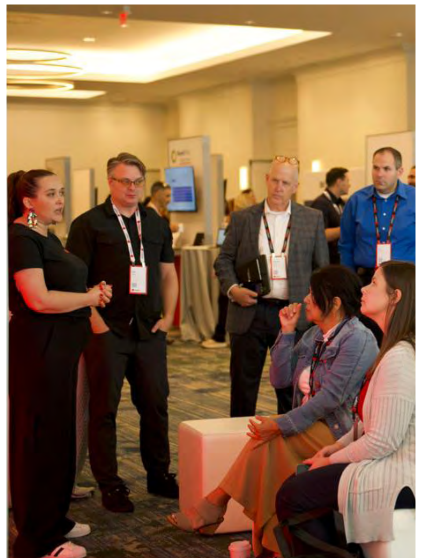
While more companies are becoming well-versed with ESG, many continue to approach ESG purely from a compliance perspective, without accounting for it in related risk reporting. Materiality reports should be conducted every two to three years to help boards keep abreast of developing risks.

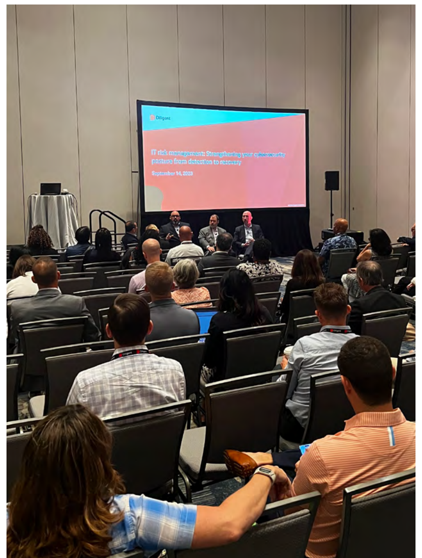
"Where the transformation happens is when ESG becomes a way of business," Joyce Cacho, CEO of Adinura, said. "We have to recognize that the boardroom is the last safe space for the intersection of those three letters and to have the discussions with management on how they plan to operationalize ESG."

Diligent One

At MGS, we also introduced our new platform, Diligent One. This one-stop solution is designed to easily centralize entire governance, risk and compliance (GRC) practices, seamlessly providing users with a unified perspective on risks and deliver impactful insights in one consolidated view.







Enhancing climate accountability

Corporate climate transition plans are facing voting revolts as investors and policymakers increase expectations on sustainability reporting, writes Rebecca Sherratt.

"Say on climate" shareholder proposals, which request issuers provide an annual advisory vote on their climate transition plans, failed to gain prominence among U.S. issuers since their introduction three years ago, but continue to be used as a tool to ensure climate accountability throughout Europe and Canada.

The eight shareholder proposals of this kind subject to a vote globally won 19.7% average support in the 2023 proxy season, compared to nine winning 44.7% support two seasons prior, according to Diligent Market Intelligence's (DMI) *Voting* module.

In contrast, management "say on climate" proposals, which provide investors with the opportunity to voice their thoughts on corporate decarbonization plans, are facing more revolts year-on-year, as shareholders enhance their expectations regarding what constitutes a robust climate transition plan.

Of the 33 management "say on climate" proposals that went to a vote in the 2023 season globally, four (12.2%) received under 80% support, up from zero in 2021 and four (10.3%) in 2022.

Turning commitments into action

In the three years since the "say on climate" initiative's inception, many global issuers have committed to providing annual votes on their climate strategy.

Initially, investors were largely supportive of this ballot item making the agenda. In recent years, however, investors have more readily opposed plans where corporate climate commitments are deemed lacking.

"Investors want companies to move from words to actions," Kirsten Snow Spalding, vice-president of the Ceres Investor Network, told DMI in a recent interview. "Investors are looking for companies to publish comprehensive climate transition action plans that provide more information about the company's climate lobbying practices, capital expenditure alignment, climate accounting and their efforts that support a just transition as we move towards a more sustainable economy."

In Australia, the six management "say on climate" plans subject to a vote in the 2023 season won 85.4% average support, with two (33.3%) proposals winning under 80% support.

AGL Energy's climate plan garnered 69.3% support at its November 2022 special meeting which also saw all four of Mike Cannon-Brookes' dissident nominees appointed to the board, amid claims that the energy giant's continued reliance on coal was "globally irresponsible."

In Europe, the 23 management "say on climate" proposals subject to a vote in the 2023 season received 93.2% average support, compared to 14 winning 96.5% support two season prior. Glencore's plan, which won 69.7% support compared to 76.3% a year prior, was opposed by BlackRock amid concerns that "aspects of the report and recent developments pointed to inconsistencies in the company's stated strategy."

> *"Management 'say on climate' proposals are facing more revolts year-on-year, as shareholders enhance their expectations regarding what constitutes a robust climate transition plan."*

Strengthening reporting

This rise in "say on climate" revolts can be partly attributed to investors enhancing their expectations regarding advisory climate plan disclosure.

2022 marked the first year in which State Street Corp. began voting against directors in major indices for failing to provide reporting in line with Task Force for Climate-related Financial Disclosure (TCFD), which calls for annual climate plan reporting.

Climate Action 100+ (CA100+), the largest global climate-related investor initiative, also revealed its transition to its second phase in June, which will see signatories scale up engagement with companies on how to strengthen their climate plans and expand their disclosure.

"This next phase will shift focus from climate-related disclosure to implementation of corporate climate transition plans," Snow Spalding told DMI. "This is designed to create long-term shareholder value as investors work with companies to move to net-zero in the next seven years."

Policymakers join the discussion

While the number of issuers providing annual climate plan disclosure remains few in number, 2023 has seen a number of policymakers take steps to expand this disclosure across a broader range of issuers.

The International Financial Reporting Standards Foundation's S1 and S2 climate reporting standards bring together the Value Reporting Foundation's integrated reporting framework and the Sustainability Accounting Standards Board's (SASB) standards, asking companies to disclose a climate transition plan.

"Investors want companies to move from words to actions."

Starting in January 2024, climate plans will be expected to disclose physical and transition risks arising from a company's decarbonization strategy, including Scope 1, 2 and 3 emissions reduction targets. This framework will form the basis of a number of global standards, with the U.K. having already confirmed it will draw from the IFRS for future climate legislation.

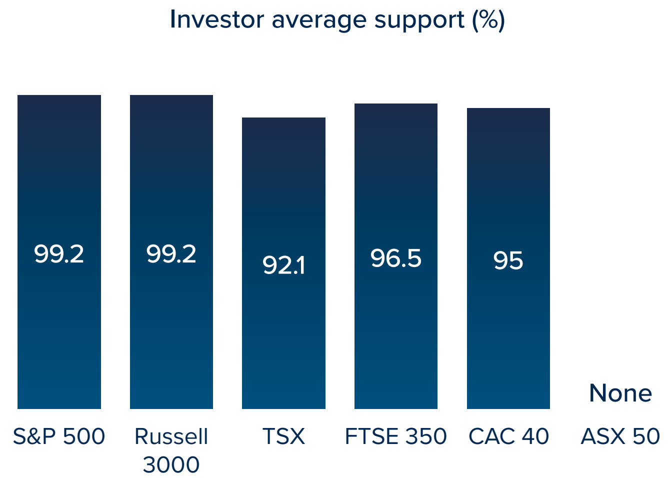
In July, a law which would require French issuers to disclose their climate plans for shareholder approval every three years as an advisory vote was adopted by France's national assembly, after being supported by a majority of over 270 representatives. In October, the amendment was withdrawn from France's Green Industry bill.

"In Europe I think there is still significant political, social and investor support for environmental proposals," Neil Robson, financial services partner at law firm Katten Muchin Rosenman U.K., said. "Particularly in light of the EU and U.K. disclosure requirements on sustainability initiatives, followed by asset managers with the EU's Sustainable Finance Disclosure Regulation (SFDR)."

No. and average support for (%) management "say on climate" proposals

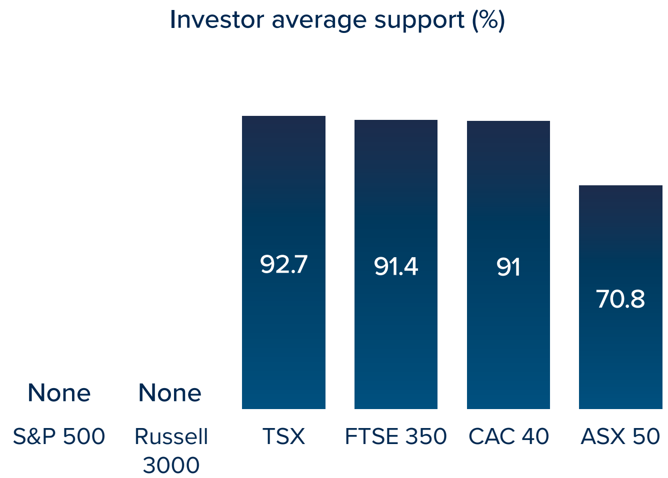
2020-21 proxy season

Index	No. proposals with results
S&P 500	2
Russell 3000	2
TSX	1
FTSE 350	5
CAC 40	2
ASX 50	N/A



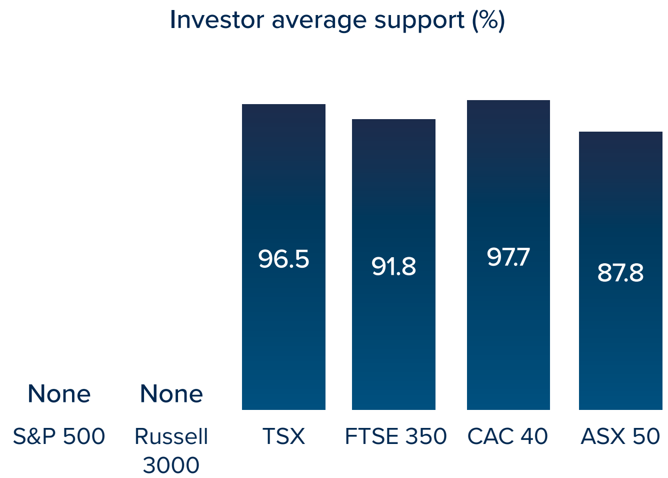
2021-22 proxy season

Index	No. proposals with results
S&P 500	N/A
Russell 3000	N/A
TSX	2
FTSE 350	13
CAC 40	3
ASX 50	4



2022-23 proxy season

Index	No. proposals with results
S&P 500	N/A
Russell 3000	N/A
TSX	1
FTSE 350	8
CAC 40	1
ASX 50	3



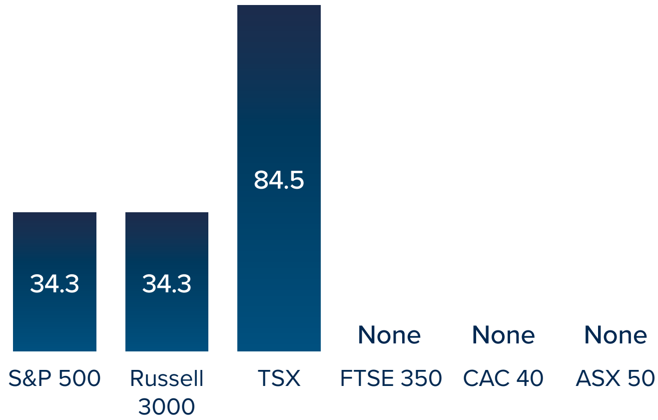
Source: Diligent Market Intelligence / Voting

No. and average support for (%) shareholder "say on climate" proposals

2020-21 proxy season

Index	No. proposals with results
S&P 500	5
Russell 3000	5
TSX	1
FTSE 350	0
CAC 40	0
ASX 50	1

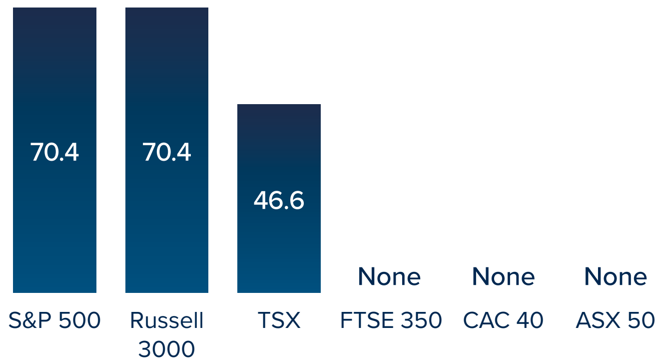
Investor average support (%)



2021-22 proxy season

Index	No. proposals with results
S&P 500	1
Russell 3000	1
TSX	1
FTSE 350	0
CAC 40	0
ASX 50	0

Investor average support (%)



2022-23 proxy season

Index	No. proposals with results
S&P 500	0
Russell 3000	0
TSX	7
FTSE 350	0
CAC 40	1
ASX 50	0

Investor average support (%)

Source: Diligent Market Intelligence / Voting

Anti-ESG key players

After U.S. environmental and social shareholder proposals received record levels of support in 2021, 2022 and 2023 bore witness to an increase in anti-ESG proposals.

The investors and conservative groups that have been labeled anti-ESG argue that the rise in responsible investing has resulted in diminished financial returns for investors, driven by political choices and corporate ESG commitments pushed by stakeholders. The movement advocates for companies and investors alike to refocus on the financials and steer clear of making political or social statements that could potentially alienate large portions of their stakeholder base.

Here, Diligent Market Intelligence (DMI) highlights five key players in the anti-ESG movement, outlining their key engagements and thoughts on the current state of responsible investment.

1. The National Center for Public Policy Research (NCPPR)

Conservative think tank NCPPR is perhaps the most prominent player in the anti-ESG movement. In an interview with Diligent Market Intelligence (DMI), NCPPR's Fellow and Free Enterprise Project (FEP) Director Scott Shepard said that the think tank is dedicated to keeping "shareholder money and the corporate voice out of taking any side on public policies and social debates not related to their core business purposes."

In the 2023 season, NCPPR filed 57 proposals with U.S. issuers on the risks of ESG investing, more than 30 of which made the ballot. Proposals this year concerned the risks of corporate statements on abortion, business activities in China and audits of corporate net-zero goals.

Shepard noted that the rise in corporate diversity and inclusion policies is a particularly significant risk for companies, citing a June lawsuit in which a New Jersey court ruled Starbucks must pay a white former employee $25.6 million in damages for racial bias. Shepard suspects many more cases of reverse discrimination will come to pass, amid pressure on issuers to enhance employee diversity.

2022-23		
Proposal type	No. filed	Average support (%)
Environmental and social		
Abortion risk reporting	1	1.9
Diversity, equity & inclusion	15	1.6
Environmental	4	1.9
Human rights	1	6.5
Governance		
China risk audit	3	4.7
Content censorship	1	0.3
Director overboarding	3	0.7
Partnership reporting	3	1

Source: Diligent Market Intelligence / Voting

2. The National Legal and Policy Center (NLPC)

Conservative non-profit group NLPC was the second most-active filer of anti-ESG resolutions in 2023, with 14 proposals subject to a vote at U.S. issuers, seeking content censorship risk audits and government take-down requests and content censorship reporting, among other topics.

NLPC's proposals seeking reporting on operations in China were among its best received, winning 7.5% and 7.4% support, respectively, at Boeing's and Walt Disney's annual meetings.

Despite so-called anti-ESG proposals receiving little backing from investors, NLPC said the importance of these filings cannot be underestimated.

"Liberal activist shareholders have dominated this [shareholder proposal] process for many years and now 'own the battlefield,' which should not be a 'battlefield' — it should be a process in which shareholder proponents engage to try to help improve governance, leading to better company performance and returns," Paul Chesser, Corporate Integrity Project director at NLPC, told DMI in an interview.

2022-23		
Proposal type	No. filed	Average support (%)
Environmental and social		
Political spending	1	10
Governance		
Content censorship	4	1.3
China risk audit	9	4.1
Independent board chair	9	21.3

Source: Diligent Market Intelligence / Voting

3. American Conversative Values ETF

American Conservative Values ETF (AVC) partnered with NCPPR for the first time this season, filing four shareholder proposals at U.S. issuers on the risks of political speech and diversity and inclusion policies.

In an interview with DMI, CEO and founder William Flaig said the fund is not anti-ESG but believes the rise in ESG investing means companies and asset managers often fail to place sufficient focus on investor returns.

"We are at risk of ESG considerations becoming entrenched in corporate culture, where resources would be better spent elsewhere."

"In our mind, stakeholder capitalism and corporate resources should be used to maximize shareholder returns and some ESG policies do not necessarily do that," Flaig said. "One notable example of this is Exxon Mobil, which is facing pressure to go green. Exxon is not a market leader in sustainable energy, so forcing it down this avenue is not in the best interests of shareholders."

2022-23		
Proposal type	No. filed	Average support (%)
Environmental and social		
Diversity, equity & inclusion	2	1.3
Political spending	2	0.5

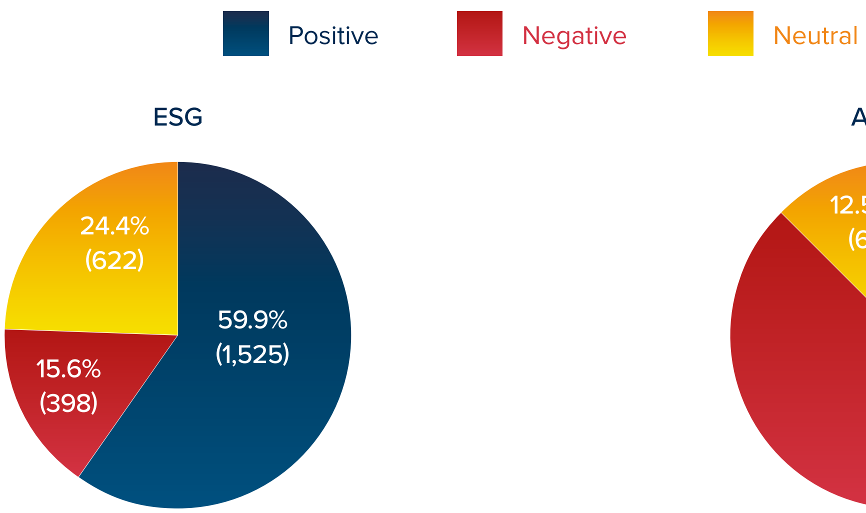
Source: Diligent Market Intelligence / Voting

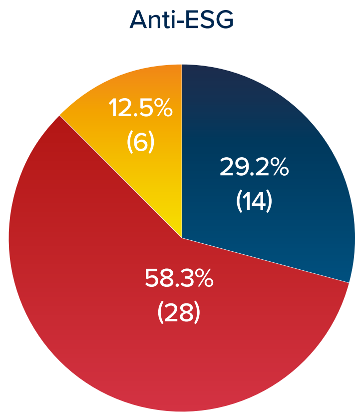
ACV's proposals asking the senior management of both Home Depot and Berkshire Hathaway to avoid making political statements received 1.7% and 0.8% support, respectively, while a request for Mastercard to conduct a cost-benefit analysis of its diversity and equality initiatives garnered 0.5% support.

Flaig went on to tell DMI that the rise in ESG reporting regulations will likely damage shareholder returns even further. "The cost of compliance alone must be significant. We are at risk of ESG considerations becoming entrenched in corporate culture, where resources would be better spent elsewhere," he said.

Global ESG news story sentiment in the past 12 months

The majority of global ESG stories continue to be positive in sentiment, despite growing anti-ESG backlash.





*As of August 31, 2023.

Source: Diligent Market Intelligence / Manzama

4. Strive Asset Management

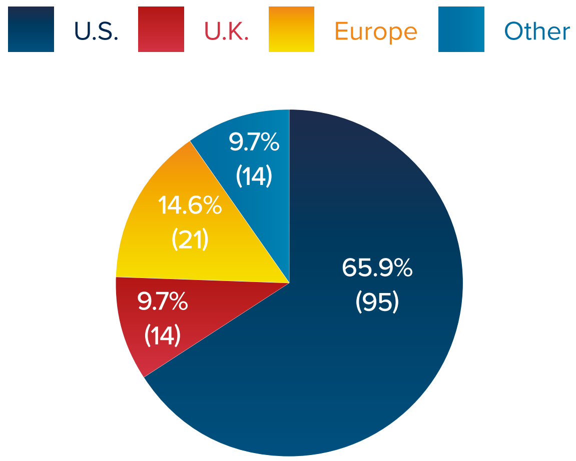
Strive Asset Management, founded last year by Republican presidential candidate Vivek Ramaswamy, is unique in that it adopts a more activist-oriented approach when engaging with issuers on the risks of responsible investing.

Strive first made headlines in September 2022, when it sent letters to the leadership of Chevron, Apple and Walt Disney Co., criticizing their decisions "to adopt value-destroying human resources policies" and to get involved with state policymaking.

More recently, the fund manager also wrote to McDonald's, expressing concern that its decision to set diversity, equity and inclusion (DEI) targets could put the company at risk of litigation.

It seems that Strive may be changing its approach, however. In a letter to investors, recently made public, the ETF acknowledged that the fund is being viewed as "political- over investment-oriented," a perception it seeks to shed as it looks to expand its growth opportunities. The majority of the fund manager's assets are invested in energy companies but returns have remained flat, following an initial bump at launch.

Prevalence of anti-ESG news terms by geography in the past 12 months



*As of August 31, 2023.

Source: Diligent Market Intelligence / Manzama

5. Steven Milloy

Former Fox News commentator and lawyer Steven Milloy is one of the few individual investors to partner with NCPPR and submit proposals concerning the risks of ESG investing. His resolution asking Chevron to rescind its "misguided" Scope 3 emissions reduction targets received 1.3% support at the oil major's May 31 annual meeting.

In his climate-related proposals, Milloy argues that corporations should not be pressed on reducing Scope 3 emissions derived from their value chain, as such requests "seek to force [companies] to sell less of the products [they] produce and from which [they] profit."

Milloy's highest-performing proposal this season had an ESG slant, asking Ford to report on child labor risks related to the increased mining of cobalt for the production of electric vehicles. The proposal won 6.5% support at the U.S. vehicle manufacturer's May 11 annual meeting.

2022-23		
Proposal type	No. filed	Average support (%)
Environmental and social		
Environmental	1	1.3
Human rights	1	6.5

Source: Diligent Market Intelligence / Voting

"Stakeholder capitalism and corporate resources should be used to maximize shareholder returns and some ESG policies do not necessarily do that."