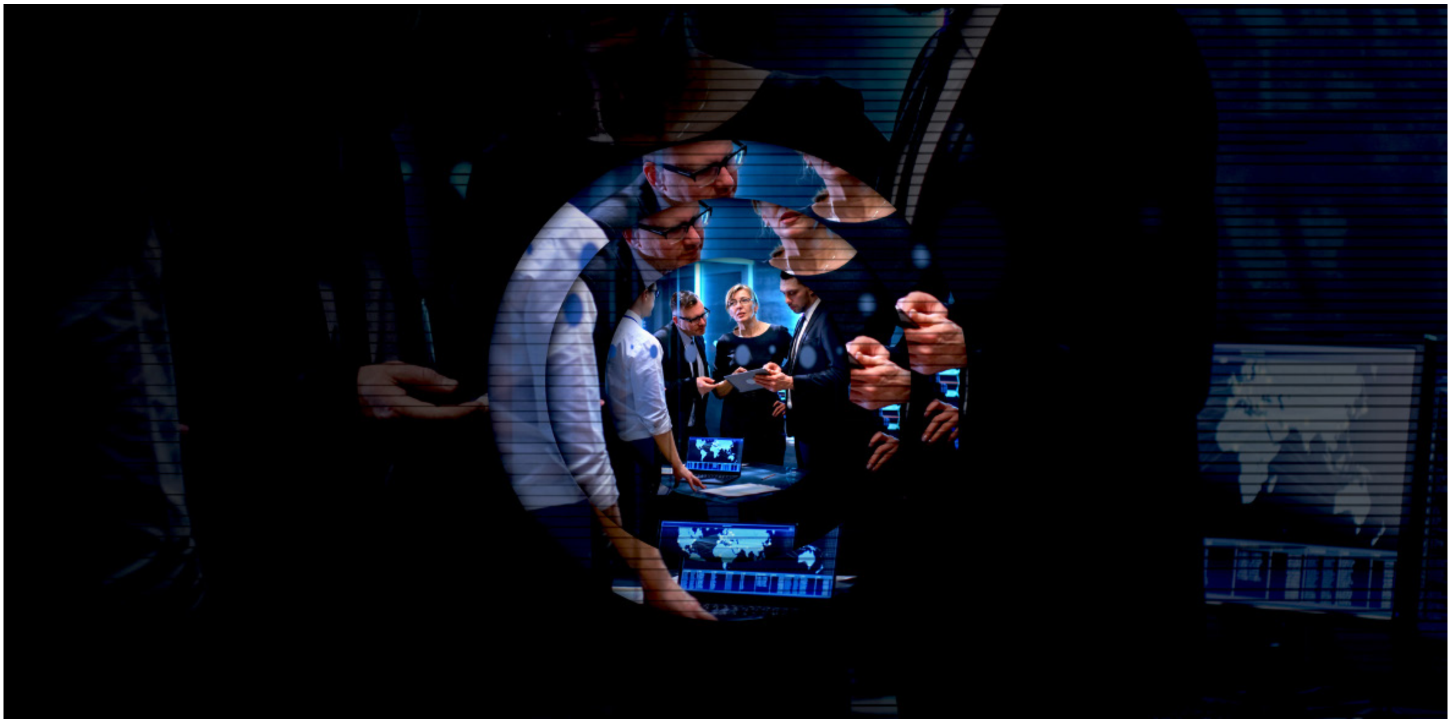

Post covid-19: Voting patterns point to sustainability

In this unprecedented era caused by the Coronavirus outbreak, many familiar features of the corporate governance landscape have changed significantly, in particular because shareholder meetings are now held virtually or behind closed doors.[1] A good deal of this shift from physical meetings to online-only or to a hybrid model is expected to remain in place in the post-Covid-19 world.[2] Moreover, the areas about which shareholders engage with portfolio companies are evolving, given the increasing number of challenges companies are facing now. Taking a broader view, the 2020 season of shareholder meetings has even revived the long-standing scholarly debate on the opposition between shareholder capitalism and stakeholder capitalism.[3]

Some institutional investor research, supported by leading scholars, has found that *"investors increasingly want to align with companies that truly understand the importance of proper ESG management when it comes to business resiliency and operations"*.[4] Indeed, across the globe and in the results of voting outcomes across multiple companies, we have witnessed a growing convergence of the concepts of sustainability (such as climate change, race and gender diversity) together with long-term shareholder value. Therefore, boards of directors and institutional investors should consider placing an increased focus on these ESG-related trends and voting patterns in the coming months and beyond.

First look at the 2020 proxy season

In recent years, many large institutional investors have inserted ambitious ESG and sustainability-related objectives into their voting policies and shareholder engagement policies.[5] A similar movement has occurred on the management side, as illustrated by the release of the now well-known Statement on the Purpose of a Corporation issued by the Business Roundtable, and signed by more than 180 CEOs of America's largest companies.[5] A first look at voting statistics for the 2020 proxy season points to a significant new trend: the COVID-19 situation has enabled all governance actors to "walk their talks" by supporting further stakeholder-oriented decisions.[7] One can see this stronger institutional investor support most clearly in shareholders'

August 2020

annual general meetings (AGMs)—and in particular in votes on the following typical agenda items:

- **Capital allocation:** While dividends and buybacks are always at the top of shareholders' agendas, issues surrounding capital allocation become even more critical in a period of crisis, where business resilience is at stake. An ICGN Viewpoint dated April 2020 states that ***"it will be generally difficult for share buybacks to be a legitimate use of funds for companies or their shareholders"***[8] (ICGN, or the International Corporate Governance Network, is one of the largest investor-led organizations in the world). Moreover, multiple governments across the world have provided companies with COVID-19 related loans and credits, conditional upon certain conditions and restrictions including, in some cases, dividend prohibitions.[9] In this context of uncertainty, many investors have also expressed that they have reduced expectations for dividend distribution[10] and have voted accordingly in the 2020 proxy season.
- **Executive compensation:** An early look at the 2020 proxy season shows that the level of opposition to executive compensation-related management proposals remains stable and relatively low.[11] Of course, the impact of Coronavirus on executive compensation remains low—shareholders are voting this proxy season generally on 2019 pay levels—before the crisis fully hit—and shareholder opposition may not become visible until 2021. Still, investors have expressed their intent to scrutinize how companies will address executive pay, and appear concerned about potential adjustments to short- or long-term incentive plans, for example.[12]
- **Climate change resolutions:** Another clearly visible trend is increased investor support to environmental and social proposals. This season, certain shareholder resolutions requesting material disclosure that is compliant with the Sustainability Accounting Standards Board (SASB) environmental and social corporate reporting standards received overwhelming rates of shareholder approval.[13]
- **Board diversity:** Board diversity remains an area of strong investor focus, with some voting data showing more votes against incumbent directors where the respective board of directors do not reach (investor-specified) diversity requirements.[14]

Overall, these early findings arising from the 2020 shareholder meeting season are mostly aligned with public statements issued by major institutional investors as a reaction to the pandemic.[15]

New voting behaviors

Future post COVID-19 corporate governance trends are hard to predict from these first voting outcomes of the 2020 proxy season. For example, investors' strong focus on sustainability may continue or, on the contrary, it might fade as investors address more immediate issues such as liquidity and workforce health. However, there is a large consensus, as illustrated by the recent United Nations Principles for Responsible Investment statement, that the required short-term reaction to the Coronavirus should not prevent companies from maintaining a long-term focus.[16] To support corporate sustainability strategies, investors can request further disclosures, using for example the United Nations Sustainable Development Goals (SDGs) as a framework to assess companies' roles in society, or to engender debate on the evolving purpose of the corporation in a wider context. A recent survey reported on the Harvard Law School Forum for Corporate Governance shows that a majority of large investors is engaging with companies on their corporate purpose specifically: indeed, following the perceived success of investor say-on-pay votes, shareholders' demand for a say-on-sustainability and say-on-purpose may also be increasing.[17] However, it remains to be seen how this stronger focus on sustainability will be reflected in investors' votes in the upcoming proxy season. Support for ESG proposals appears to be relatively low among the largest investors, which is generally explained by voting policies which usually require a case-by-case individual analysis.[18] A leading European asset manager recently published a memorandum concluding that there is a real need to ***"separate high-quality from low-quality [ESG] proposals in order to protect and enhance shareholder value by supporting resolutions that are in the company's best long-term interests and voting against those that are not"***.[19]

It is worth noting that the global COVID-19 pandemic has turned the 2020 governance agenda upside down, and forced all corporate actors to focus on topics requiring immediate attention. More than ever, a detailed and forward-looking plan for the next proxy season will be required. We expect to see stronger shareholder/company dialogue and updated investment stewardship strategies, which should empower boards of directors and institutional investors to properly address crisis recovery and sustainability issues in the upcoming year.

5 areas for boards to consider in their dialogue with investors:

- **Capital allocation:** Ensure that decisions around share buybacks and dividends adequately balance investor expectations, local regulations and requirements (e.g. dividend limitations due to COVID-19 government loans) and stakeholder needs (particularly those relating to workforce)
- **Board diversity:** Assess if board diversity is aligned with investor expectations
- **Executive compensation:** Define proper alignment between shareholders and executives and consider any adjustments to existing executive compensations plans
- **Climate change and ESG objectives:** Identify efficient ESG disclosure schemes (SDG framework, SASB reporting standards) and include ESG objectives in sustainability and growth strategies
- **Corporate purpose:** Encourage an internal debate on company purpose, define a corporate purpose and establish relevant KPIs to track and assess implementation

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2 A Proxy Insight survey of 87 governance professionals shows that a large majority would support, going forward, the continuation of electronic format for shareholder meetings: Proxy Insight, COVID-19, a new era for corporate governance, 2020.

3 Watch the Harvard-Oxford Debate on Stakeholder Capitalism held at the University of Oxford on 25 June 2020: https://www.sbs.ox.ac.uk/oxford-answers/stakeholder-versus-shareholder-capitalism-great-debate

4 Quote from Prof. George Serafeim, in a State Street Investor Insights publication entitled "Crisis as Catalyst: Corporate Resiliency and the Future or ESG": https://www.statestreet.com/content/dam/statestreet/documents/Articles/Crisis-as-Catalyst-Corporate-Responsiblity-and-ESG-George-Serafeim.pdf

5 For an example of global asset managers' statement focusing on sustainability and ESG: https://corpgov.law.harvard.edu/2020/03/05/joint-statement-on-the-importance-of-long-term-sustainable-growth/

6 https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans

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9 As illustrated in the US by the Coronavirus Aid, Relief, and Economic Security (CARES) Act and its requirements regarding businesses receiving loans and loan guarantees.

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17 https://corpgov.law.harvard.edu/2020/06/19/making-corporate-purpose-tangible-a-survey-of-investors/

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