Westlaw Today
powered by Reuters

Investors press for progress on ESG matters, and SEC prepares to join the fray

By Marc S. Gerber, Esq., and Raquel Fox, Esq., Skadden, Arps, Slate, Meagher & Flom LLP*

FEBRUARY 3, 2022

Takeaways

- The SEC plans to propose an array of new disclosure requirements relating to ESG matters.
- A record number of shareholder proposals involving environmental and social issues won majority support in 2021.
- Institutional investors will vote against directors where companies have not met certain minimum director diversity goals or made certain ESG disclosures.
- Investors are demanding that boards actively oversee climate risk mitigation efforts.

The second year of the Biden administration is likely to see significant and wide-ranging Securities and Exchange Commission (SEC) rulemaking covering various environmental, social and governance (ESG) topics, a process that is likely to be contentious and politicized.

In 2021, a record 39 E&S shareholder proposals received majority support, almost double the record of 21 set in 2020 and more than triple the 12 in 2019.

Meanwhile, investors are not waiting for SEC action. They continue taking matters into their own hands, demanding improved disclosure, greater management attention to these issues and increased board oversight, and they are voting against directors and management when they are unsatisfied.

Boards of directors need to remain diligent in understanding this constantly evolving landscape, determining which ESG topics have the greatest relevance for their companies and engaging with shareholders and other stakeholders to assess their perspectives and convey the board's robust oversight of relevant matters.

SEC ESG agenda

ESG disclosures were a recurring topic in speeches in 2021 by the SEC's chair and commissioners, the focus of a new SEC enforcement task force and the subject of comment letters. ESG disclosures also featured prominently in the agency's semiannual regulatory agendas published in June and December 2021.

Although these regulatory agendas can be viewed as aspirational, the range of ESG matters included makes clear the emphasis this area will receive. Topics include:

- **Board diversity**. Proposed rules could require companies to provide enhanced disclosures about the diversity of board members and nominees;
- **Climate change**. New rules may seek disclosures on governance, strategy and risk management related to climate matters, as well as specific metrics for items such as greenhouse gas emissions;
- **Human capital management**. New mandates may require disclosure of metrics such as workforce turnover, skills and development training, compensation, benefits, demographics (including diversity) and health and safety; and
- **Cybersecurity governance**. Proposed rules could require disclosures about cybersecurity risk management and governance.

A record number of E&S shareholder proposals won majority support

Most shareholder proposals are nonbinding requests that a company or its board of directors take some kind of action. Failure to act on a proposal that was supported by a majority of votes cast at a shareholder meeting can result in a board being labeled as "unresponsive," and, in turn, directors receiving significant negative votes in the next election.

Proposals on traditional governance matters — from board declassification to proxy access to eliminating supermajority voting — have a long track record of drawing majority support.

On the other hand, historically, very few shareholder proposals relating to environmental and social (E&S) topics won that level of backing.

That is no longer the case. In 2021, a record 39 E&S shareholder proposals received majority support, almost double the

Thomson Reuters is a commercial publisher of content that is general and educational in nature, may not reflect all recent legal developments and may not apply to the specific facts and circumstances of individual transactions and cases. Users should consult with qualified legal counsel before acting on any information published by Thomson Reuters online or in print. Thomson Reuters, its affiliates and their editorial staff are not a law firm, do not represent or advise clients in any matter and are not bound by the professional responsibilities and duties of a legal practitioner. Nothing in this publication should be construed as legal advice or creating an attorney-client relationship. The views expressed in this publication by any contributor are not necessarily those of the publisher.

THOMSON REUTERS®

record of 21 set in 2020 and more than triple the 12 in 2019. Topics achieving majority support included:

- Environmental and climate change matters, including setting reduction targets for greenhouse gas emissions and reporting on the alignment of companies' lobbying efforts with the 2-degree Celsius goals (15 proposals);
- Board diversity, workforce diversity and other human capital-related matters (13 proposals); and
- Political contributions and lobbying expenditures reporting, a topic of increased investor focus in the wake of the January 6, 2021, U.S. Capitol riot (10 proposals).[1]

As the 2022 annual meeting season approaches, these results may motivate companies to negotiate with proponents to withdraw proposals rather than have them go to a vote.

Board, management and workforce diversity

Investors have put increasing emphasis on issues of systemic racism and boardroom, C-suite and workforce diversity since the murder of George Floyd in 2020 and the protests that ensued. That has had an impact in boardrooms. According to the 2021 U.S. Spencer Stuart Board Index, at S&P 500 companies last year, 47% of new directors were racially or ethnically diverse and 30% of all S&P 500 directors were women.

Investors and other stakeholders remain keenly interested in building on this progress. Moreover, as reflected in the voting policies of proxy advisory firms and investors, many believe that diversity matters are relevant for all companies, regardless of industry, although many provide some latitude based on company size:

- **Institutional Shareholder Services (ISS)**. For companies in the Russell 3000 or S&P 1500, ISS will generally recommend against nominating committee chairs where the board has no apparent racially or ethnically diverse members or women. Starting in 2023, ISS' policy regarding companies with all-male boards will extend beyond those included in the two indices.
- **Glass Lewis**. The firm will generally recommend against Russell 3000 nominating committee chairs where the board has fewer than two women directors. Beginning in 2023, it will generally recommend against nominating committee chairs at Russell 3000 companies whose directors are not at least 30% gender diverse. Glass Lewis may recommend against nominating committee chairs at S&P 500 companies with "particularly poor" disclosure about director diversity and, in 2023, it will recommend against the nominating committee chair at S&P 500 companies lacking any individual or aggregated director diversity disclosure.
- **State Street Global Advisors**. In 2021, the firm started voting against nominating committee chairs at S&P 500 companies that did not provide board racial/ethnic diversity information. In 2022, it will vote against nominating committee chairs at S&P 500 companies that do not have at least one director from an underrepresented community.
- **BlackRock**. The firm states that boards should aspire to 30% diversity and have at least two directors who identify as women and at least one who identifies as a member of an underrepresented group. It reports that a lack of board diversity was the top reason for its votes against directors in the Americas region in its 2020-21 proxy voting year.

Regarding workforce diversity, in 2021 shareholder proposals calling for disclosure of a company's workforce diversity statistics or reporting on the company's diversity and inclusion efforts routinely were withdrawn following company agreements to make those disclosures. The proposals that proceeded to a vote largely achieved majority support.

Investors have put increasing emphasis on issues of systemic racism and boardroom, C-suite and workforce diversity.

In addition, starting in 2022, State Street will vote against compensation committee chairs at S&P 500 companies not disclosing their federally mandated EEO-1 report data on workforce diversity, likely resulting in disclosure of that data becoming the norm for large cap companies in 2022.

Board oversight of climate change strategies and risks

Investors and other stakeholders remain sharply focused on the risks and opportunities presented by climate change. In addition to being the topic of shareholder proposals, climate risk is more frequently a topic raised by shareholders when engaging with companies, factored into voting decisions and used by activist investors.

As a starting point, investors want assurance that there is board oversight of these matters. For example, Glass Lewis will generally recommend voting against the governance committee chair where a company fails to disclose the board's oversight role of environmental and social issues (although it is agnostic as to whether this oversight is done by the full board, a separate committee, an existing committee or individual directors).

In the case of carbon-intensive industries, investors and others are looking not just at board oversight but at the steps the company is taking to address climate risk. Investors view this issue as impacting the economics of their investment.

For example, BlackRock states that companies that address these risks early "will also be best positioned to capture associated growth opportunities at a time of significant industry transition." BlackRock focuses on over 1,000 carbon-intensive public companies and reported that in the 2020-21 proxy year, it voted against 255 directors based on climate-related concerns it believed could affect long-term shareholder value.

Similarly, for 2022, ISS has adopted a new voting policy relating to the 167 companies currently identified as the Climate Action

100+ Focus Group. ISS will recommend against the incumbent chair of the responsible board committee if it determines the company is not taking the "minimum steps" needed to understand, assess and mitigate climate risks, both for the company and larger economy.

Noting that "minimum steps" may increase over time, for 2022, the firm is looking for detailed disclosure about climate risks, including board governance, corporate strategy, risk management analyses and metrics/targets, and reduction targets for greenhouse gas emissions that cover at least a significant portion of the company's direct emissions.

Advice for boards going forward

The key takeaway for boards of directors is this: Investors and other stakeholders expect them to fully understand and be engaged in overseeing their company's approach to relevant ESG matters, including the risks and opportunities, impact on strategy and investment decisions, and disclosure and reporting.

They also expect boards to have the necessary competence or expertise to ask the right questions about these matters and to be able to articulate the company's approach when engaging with shareholders.

Finally, it is worth stressing that many of these items are not "one and done." This is a dynamic landscape in a world challenged by, among other things, new phases of a global pandemic, supply chain issues and extreme weather events. The relevance of various ESG topics may evolve with changes in a company's business and strategy, and oversight mechanisms that were appropriate at one point in time may not work at another.

Looking to 2022, ESG matters likely will demand increasing attention from management and boards of directors and will continue to grow as a measure by which investors assess their performance. Boards that fail to regularly refresh their understanding of ESG matters in light of their particular company's circumstances risk losing the confidence and support of investors.

Notes

[1] https://bit.ly/3ADg3e8

About the authors

Marc S. Gerber (L) is an M&A partner at **Skadden, Arps, Slate, Meagher & Flom**. He concentrates his practice on mergers and acquisitions, corporate governance, general corporate and securities regulation, and environmental, social and governance matters. Gerber has represented purchasers and sellers in a wide variety of transactions, including private acquisitions and divestitures, public acquisitions, and proxy fights. **Raquel Fox** (R) is a corporate partner at the firm, concentrating her practice on capital markets, mergers and acquisitions, corporate governance, and general corporate and securities matters. She advises clients on the full range of SEC reporting and compliance requirements. Both authors are based in the firm's Washington office. This article was originally published Jan. 19, 2022, on the firm's website. Republished with permission.

This article was published on Westlaw Today on February 3, 2022.

*** © 2022 Marc S. Gerber, Esq., and Raquel Fox, Esq., Skadden, Arps, Slate, Meagher & Flom LLP**

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional. For subscription information, please visit legalsolutions.thomsonreuters.com.