Takeaways from the 2023 proxy season

KPMG Board Insights podcast transcript

Announcer: Hello, everyone, and thanks for joining us. This is the KPMG Board Insights podcast, and this episode is about takeaways from the 2023 proxy season. This series is brought to you by the KPMG Board Leadership Center. The KPMG Board Insights podcast features conversations with directors, luminaries, and business leaders exploring the emerging issues and pressing challenges facing boards today. In this episode, BLC Senior Advisor Stephen Brown talks with Pamela Marcogliese, a partner with Freshfields, about takeaways from the recent proxy season and what boards and shareholders might expect for 2024.

Stephen Brown: Welcome to the podcast. I'm Stephen Brown, a senior advisor at the KPMG Board Leadership Center. And I'm here today with a good friend, Pamela Marcogliese, partner at Freshfields. We always get together to talk shop on proxy season, and this is no different. We want to talk about the 2023 proxy season, which for the most part is over here in the US. And I'd like to, if you don't mind, Pam, to talk about it in five big things about the 2023 proxy season. First, let me just say hello. Thank you, Pam, for doing this.

Pamela Marcogliese: Stephen, it's always nice to be here with you.

Stephen: The thing about proxy season is that when you talk to folks who have been around it for some time, who are seasoned veterans, the one thing that we know is that one year doesn't make a trend. But we do look from year to year. What we're learning about the trends in a 5- to 10-year period that are continuing, or maybe show signs of waning.

That said, let me first start with point number one, which is understanding the regulatory space that we're in. If we could, talk a little bit about the SEC. An understatement would be to say that this SEC, under Chairman Gensler, has been very, very busy. First, why don't we talk about how the SEC approached pre-proxy season, with no-action requests.

Pam: That is an understatement. You are correct. And I think your point about historical context is very important, especially on this issue. So, the SEC, I think last year, changed its guidance on how it was going to approach no-action relief. And for the listeners out there, no-action relief means that when the company gets a shareholder proposal, if they want to exclude it from the proxy statement, they need the SEC to agree, and the SEC does that by granting no-action relief.

What the SEC did was change its guidance recently to say we are going to make it harder to allow companies to exclude proposals from the proxy. And essentially, what that meant is, they largely stopped being the arbiter of the proposals, and decided that instead, what companies should do is put proposals to a shareholder vote, and let the shareholders themselves decide whether or not the issue was a good one, that they were willing to support.

And the reason why this is important is because if you look at the numbers, you see that there's an increase in the number of proposals that go to a vote. But you also see that there's a decrease in support. And that could lead you to conclude, "Wow, people must not care about ESG anymore"—not care about it as much, since they're not in voting in favor of it as often or as much—and nothing could be further from the truth. I think ESG continues to be very important. But the reason that you're seeing the trends behind those numbers is exactly because of what I described.

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There are now just more proposals that are going to vote. So, in many ways, it's not surprising that fewer of them get support, because those may have been the proposals that would likely have been excluded in the first place, under the prior SEC guidance.

Stephen: Thank you for that, because I think that also explains when people are looking at trends—if you read headlines, the big headline is that investors are not backing as many ESG proposals as they backed two years ago, as they backed last year. But the deep inside knowledge about how investors work and how the SEC works is exactly what you said. Because the SEC is not playing the arbiter and gatekeeper for most of those proposals, the actual voters are. So, they're looking at proposals they would not have seen three years ago, and saying, "You know, that's too prescribed, or that goes overboard," and then not voting for it. That said, that leads to—if you don't mind, I'll jump to the second big thing—which is, ESG is here to stay. It's still the king and queen of proposals. We're seeing E, and really, to be precise, environmental and social proposals. But what we must notice is that there's a deep diversity and nuance in the environmental and social proposals. Can you talk about the fact that we're seeing all this diversity—the different types of E, the different types of S in these proposals?

Pam: Each category is very broad and includes many things but when you look at them in the aggregate, it really belies some of the trends that are going on. What I would say is that we continue to see a decent amount of support for E and S proposals. Very few of them this year, no matter what subcategory you consider, got more than 50 percent approval. And I think that one of the reasons, in addition to what I just described earlier, is also the fact that you have to remember, companies have been at this now for quite a long time. And so, they have made a lot of progress. And shareholders have been very vocal over the years and have made their views known, and have indicated to companies what does and does not matter to them.

And so, I think that the gap between where companies are and what shareholders think is appropriate has narrowed in a lot of circumstances. So, I don't think that people are backing away from ESG. I think ESG very much is here to stay. It's just that … when you look at the proposals, I think there are a lot of shareholders who think many of the proposals just aren't appropriate anymore, because companies are already doing what they need to be doing to keep up in this space.

Stephen: Indeed. And also, we'll see proposals which we've seen for the last 25 years crop back up, because, as I'm always fond of saying, "They matter when they matter." So, we have say on pay. We've had say on pay for over a decade now. The overwhelming supermajority of companies pass that vote and do very well with that. But when it pops up, it pops up, and you just don't want to be part of that 2 percent that gets that no vote. So, it means something because it's there. And shareholders appreciate it—that it's there, that we can take action when we need to. And they don't … pull that lever. They don't pull the fire alarm all that often.

The third big thing is this notion that proposals typically are following two things: what investors think or believe that they need to know about certain risks as well as cultural trends. So, if I could sort of lean on you for that last part of cultural trends. What have we seen? And it's been a trend now for a couple of years around proposals following cultural trends that are in the news in the last 12 months, in the last 6 months.

Pam: Yes, we have seen this trend now for a while, so I think it's safe to say it's pretty reliable. It originally cropped up, I think, in a significant way, when the US pulled out of the Paris climate accord. Following that, there had been a number of proposals on getting companies to do reports on how they plan to modify their operations to be in line with the Paris accords, and those got approval for the first time after not having been approved in prior years.

We saw it again during the pandemic, where there was an increase in the focus on employees and employee-related issues. And then, of course, we saw all of the racial issues that happened at the same time that also then created a massive focus on some of these issues. And so, then we saw lots of proposals on racial [equity] audits, on human rights, on treatment of employees, all that kind of stuff. And this year we've seen it again. I'm sure you all will remember last year, we had the abortion decision out of the Supreme Court. And this year, in this proxy season, we saw quite a number of shareholder proposals, frankly, on both sides of the issue, but relating to what companies' positions are with respect to abortion. And so, I think that it is safe to say, especially as we go into an election year, and you know shareholder proposals are due by the end of the year, for the most part. So, the next expense, I think, as shareholders start formulating their proposals, part of what will be looming is, you know, as we get closer to the election.

Stephen: We should add on this topic of following cultural trends, we have seen now, I guess in the first, or this might be the second year of it, the so-called anti-ESG proposals. Can we talk a little bit about that?

Pam: Anti-ESG started a little bit last year, but this year, I think really over the past year, has really ingrained itself in the fabric of the ESG landscape. And those proposals are essentially proposals that take the other side of the ESG issue. So, you have to look carefully at these proposals because it's not always obvious. It could be a proposal that

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says something like, “I think there should be more diversity at the board.” But when you look at the supporting statement and some of the comments made by the proponent, you start realizing that, when they think about diversity, what they really mean is they’re concerned about the lack of white men on the board, or they’re concerned about the policies that seem to favor women and people of color on the board at the expense of white men. And so, you have to be careful, and read them carefully. But the thing about these proposals is not that they’re worrisome for their own sake, because if you look at the support they get, it’s pretty small. It’s generally single-digit percentages of support. So, I don’t think there’s a significant risk that any of these are actually going to pass. But what they really do for companies is they can create a massive reputational issue, because all of a sudden you have this anti-ESG topic on the ballot that the company has to deal with or explain, and it can be really easy to get a runaway headline that puts the company in the spotlight on an issue where it would prefer to possibly not be front and center. So, I think that’s really the concern on the anti-ESG proposals.

Stephen: The fourth big thing I wanted to bring up from the proxy season is the general power of investors and proxy advisors, which we’ve seen for the last decade, and how important and how influential the big three—BlackRock, State Street, and Vanguard—is in voting. But we saw something crop up this year, which is that they got the message, at least the message that was sent that they may be too powerful by certain parts of our capital system, and we’ve seen them embrace pass-through voting. Can we talk about that a little bit?

Pam: Sure. So, when you look at these three large investors and how much of corporate America they own—in many public companies, they can own anywhere from 25 to 35 percent, all three of them together. That’s a pretty big chunk. And so, what they have done is they have now allowed for some version of pass-through voting, and it’s a little bit different for each one. But basically, what that means is, rather than each of them voting the entire block of shares that they own on behalf of their own investors, they have decided to take some portion of that and allow the individual investors to make their own voting decisions. And so, it’s too early to really tell what the actual impact of this will be. But I think as we go forward, this is going to be an important trend to focus on, because the big question out there is, does this really change the outcomes of any votes? And by that, I mean, whereas before, if you needed the support of the big three investors, you could reach out to them, and if they agreed with whatever the company’s position was, the company could be assured that, you know, 25 to 35 percent of the votes would swing the company’s way. Now, if they are not controlling the full block, the support will be some amount below that. And so, in instances where you need their support, you’re not going to have the full extent of it. But at the same time, on the issues where perhaps you may have diverged from the large investors, the amount of the vote that they can swing will be less. So, too early to tell which way this is going to go and whether this is going to be favorable or not favorable, and to whom.

Stephen: Thank you for that. And, by the way, I said I had five big things, and it may be six now. In talking to you, I added a couple. That fifth one was really about the trends that we’ve seen over the last year with directors and how directors conduct themselves internally. So, the internal governance point about how we can have committees, and how directors are thinking about their own refreshment.

Pam: You know, a director’s job is a big job. It’s an important job, and it’s busy. And so, as a result of that, I think a lot of companies have started to look at their committee structures and try to figure out whether or not they need a few more committees to be able to distribute the work among their directors. And so, what we have seen is an increase—not an overwhelming increase, and certainly not the majority—but an increase in the number of ESG or sustainability committees, however companies are describing them—to focus on all of these issues that we’re talking about, again, as a way to spread the work around.

For companies that don’t have ESG committees, this work generally tends to be housed in the governance committee. And the other one that we’ve seen is the risk committee. So, the banks, the regulated financial institutions, have been required to have risk committees for a long time. But we’re seeing these committees crop up among nonfinancial institutions, largely, I think, in response to two things.

One is the cyber risk and a desire to take this issue away from the audit committee and put it in a different committee, either on the theory that the audit committee was too busy, or the skill set of the members of the audit committee didn’t always lend itself perfectly well to address the cyber issues.

The second reason is because we’ve seen some case law come out of Delaware in terms of how they are now understanding the duty of oversight, the Caremark duty of oversight, and putting an additional focus on directors and making sure that they are actually on top of the company’s risks, and are proactively ensuring that the company is following up on any red flags. And I think that this applies particularly in companies that have mission-critical

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risks, and I think for those reasons, companies are seriously considering whether or not a risk committee, in one form or another, is appropriate.

Stephen: Thank you for that, Pam. If I can add sort of a sixth point here, it's really thinking about what you've just said over the last few minutes, and thinking about how this is a very busy SEC. When we compare it in history—so I'm thinking about recent history, '08, '09 after the financial crisis—you saw the SEC very busy in producing proposed rules at this timeframe, maybe about 56 to almost 60 different proposals, which is sort of on pace to what we see right now.

Of course, that was in response to the financial crisis and the aftermath, and being responsive to constituencies. If we look at how busy the SEC is right now with its proposals, what are they responding to? Why so many proposals and this much activity compared to the post-[financial] crisis? What are they responding to, or purportedly responding to?

Pam: [What they're] responding to is what we're seeing play out on a daily basis in our own lives, which is what is the role of a corporation? So, if you just think about it from a purely academic perspective, under Delaware [law], directors are required to manage the corporation in the best interest of the corporation and the shareholders, which had historically really been understood as making decisions that were good for the bottom line. That, of course, continues to be the law, but now the lens through which directors and management view that responsibility has gotten broader.

I think it's as a result of how the world has evolved and how society has evolved more generally. And so, we're certainly seeing that in the shareholder proposals, as we've been talking about. So, in a way, it's not surprising that you're seeing it from an SEC perspective, trying to figure out if these issues are becoming increasingly important, or if this is becoming increasing area of focus, what kind of disclosure do I think—i.e., the SEC—do I think that investors need in order to be able to fully understand the picture here?

I think what this SEC is doing with the climate rule, with the potential HCM—human capital management—rules that are going to come out, and some of the other rules that we've been seeing is really trying to keep up with the trends that we're seeing in society that companies and shareholders, and frankly, society at large, is grappling with more generally. And so, I think that's the big issue here. That's the big turning point that we're seeing that's driving a lot of the SEC's rulemaking focus.

Stephen: I'd be remiss if I let you get away without doing a little prognostication of what we should expect in 2024 in terms of proxy season. Much of the same or are we going to see something different?

Pam: I think we are going to see the same; I think it's going to continue. But I think, in a way, that's sort of good news. And by that, I mean, I think ESG is here to stay. I just think that over time, people are not going to really think about it as ESG, they are just going to think about it as a different category of risk. For example, if you're a company that has a plant in the coastal area, is that an ESG risk, or is that really a question of, "Will I be able to get insurance if my plant gets flooded? What's my business continuity plan look like? Do I have risks that I may have to cease my operations?" Somebody might say that's ESG, but somebody might also say that's just the business risk. And we think that that's the direction in which the conversation will eventually move. People will move away from calling it ESG for ESG's sake and view this as just yet another category of risk. I think that allows companies, together with investors, to have much more thoughtful conversations about the actual issues and how they apply to each company, as opposed to trying to view ESG as some broad-based thing that applies in the same way to every single company—which we, of course, all know is not the way it works.

Stephen: Indeed. So, we'll see a narrowing of that definition. I agree with you. I think that's a positive that we get if we all get in sync and have clarity on that—that shareholder proposals, as they did this year, as they did last year, as they did 10 years ago—always do reflect the context.

Pam, it is always a pleasure to speak with you. So, thank you so much, Pamela Marcogliese, from Freshfields. And of course, thank you to our listening audience. We do appreciate that you choose us as someone to listen to for podcasts. Thank you so much.

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