

**POLICY BRIEFING**

# THE SHAREHOLDER VOTING PROCESS, ESG INTEGRATION AND PROXY ADVICE IN THE US



# THE SIX PRINCIPLES

## PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

- 1 We will incorporate ESG issues into investment analysis and decision-making processes.
- 2 We will be active owners and incorporate ESG issues into our ownership policies and practices.
- 3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- 4 We will promote acceptance and implementation of the Principles within the investment industry.
- 5 We will work together to enhance our effectiveness in implementing the Principles.
- 6 We will each report on our activities and progress towards implementing the Principles.



## PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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This briefing provides an update for signatories on legislative and regulatory proposals under discussion in the US regarding the shareholder voting process, ESG integration and the role of proxy advisory firms.

On November 15, 2018, the Securities and Exchange Commission (SEC) will host a roundtable discussion on possible regulatory changes to the shareholder voting process. The official agenda for the roundtable is forthcoming. However, in a July speech announcing the roundtable, SEC Chair Jay Clayton asked SEC staff to consider topics including the regulatory framework applicable to proxy advisory firms and whether the SEC should increase the required level of support that a shareholder proposal must receive for the proponent to resubmit it the following year.

This briefing is intended to support signatories in submitting comment letters to the SEC in advance of the roundtable. For further questions or comments, contact [policy@unpri.org](mailto:policy@unpri.org).

## SHAREHOLDER VOTING PROCESS THREATENED

Discussions are underway in Washington, D.C. to change the shareholder voting process. Concerned about the growing influence of investors in the shareholder voting process, targeted proposals are advancing at the SEC and in Congress.

Currently, the SEC is considering a number of possible regulatory changes to the proxy voting process. The SEC is holding a formal conversation on “whether proxy rules should be refined” at a November roundtable on the proxy process. Topics for discussion and eventual regulation include giving individual retail investors more authority to dictate their votes, increasing the thresholds for minimum ownership to submit a shareholder proposal, and limiting the ability to resubmit a shareholder proposal, among others.

Although the outcomes of the discussion are uncertain, regulatory changes are likely. SEC Chair Jay Clayton has publicly stated his support of changes to the proxy voting process. Notably, the SEC recently broke from protocol by rescinding two guidance letters on proxy voting. These letters, issued in 2004, provided assurances on the ability of institutional investors to use proxy advisory firms for voting recommendations. In the past, the SEC would be expected to wait to act until after the roundtable, allowing an opportunity for interested parties to provide input.

## DETAILS ON RECENT SEC ACTION

On September 13, 2018, the SEC [rescinded](#) two of its previously-issued guidance letters on proxy voting. While the law allowing the use of proxy advisory firms for recommendations is still in effect, SEC Chair Jay Clayton states that the withdrawal of the letters is meant to “facilitate a discussion” in advance of the November roundtable. An SEC roundtable is best viewed as a step in the regulatory process aimed at building a public record on a given topic. While roundtables are not necessary for regulatory reform, they often result in some action, whether as simple as further study or more significant action such as enhanced enforcement of existing rules, new proposed rules, or even prompting of Congressional action to change SEC authorities. For this reason, the roundtables should be followed closely by those interested in the proxy process.

## WHAT REGULATORY CHANGES IS THE SEC CONSIDERING?

The publicly-stated purpose of the November roundtable is to hear from stakeholders on “whether the SEC’s proxy rules should be refined.” The SEC released a list of general topics for discussion at the roundtable, which have been summarized below. A more detailed version of this list can be found [here](#).

### Voting process

- the likelihood that broker-dealers are voting more shares or less shares than authorized (“over voting” and “under voting”) and ways to remedy the issue;
- challenges ensuring that an investor’s shares are voted as directed; and
- challenges providing investor communications to securities owners who hold their shares through a brokerage account (in “street name”).

### Retail shareholder participation

- ways to encourage retail shareholders to participate in the proxy process.

### Shareholder proposals

- whether changes are appropriate with regard to the current eligibility requirements for investors to submit shareholder proposals including minimum length of time and amount of shares held; and
- whether the SEC should [revise](#) the rules that allow companies to omit shareholder proposals that received less than 3 percent, 6 percent, or 10 percent of the vote, based on the number of times a proposal on that topic has come up for a vote at the company in recent years.

### Proxy advisory firms

- the extent to which investors are excessively reliant on proxy advisory firms for voting recommendations;
- whether public corporations are being given a sufficient opportunity to raise concerns if they disagree with a proxy advisory firm's recommendation;
- whether proxy advisory firms should be required to provide more public information about their voting policies and procedures;
- whether proxy advisory firms appropriately manage, mitigate and disclose potential conflicts of interest, such as those that arise from consulting services provided by proxy advisory firms; and
- the appropriate regulatory regime for proxy advisory firms.

### Technology and innovation

- whether technology can be used to make improve the proxy process.

## MORE ON EFFORTS TO CHANGE SHAREHOLDER PROPOSAL RULES

While the SEC has listed the above general topics for discussion at the November roundtable, it is possible that its efforts to change shareholder proposal rules will be similar to efforts in Congress on this topic. In 2017, Congress tried but failed to pass language into law that was originally in their comprehensive financial reform bill, the Financial CHOICE Act. The final legislative package excluded the shareholder provisions due to insufficient support in the Senate.

The Financial CHOICE Act attempted to adjust the eligibility requirements to submit a shareholder proposal. Current SEC regulations permit shareholders to submit a proposal if they hold shares for one year and own \$2,000 in stock. The Act lengthened the time required to own shares to three years and required at least 1 percent ownership of the company's stock.

Additionally, the legislation raised the thresholds for a corporation to exclude a resubmitted proposal from its proxy if it fails to receive the support of: 6 percent of shareholders the last time it was voted on (currently 3 percent); 15 percent if it had been voted on twice in the last five years (currently 6 percent); and 30 percent if it was voted on three or more times in the last five years (currently 10 percent).

The SEC states it will consider whether minimum ownership thresholds need to change and whether resubmission thresholds are fair. Additionally, while the shareholder proposal provisions did not become law, [new legislation](#) in the House of Representatives revives the same resubmission threshold provisions of the Financial CHOICE Act.

### WHAT ARE THE IMPLICATIONS?

Shareholder proposals are an important tool to help companies manage new and emerging risks, especially regarding ESG factors. They have increasingly driven ESG engagement, with a growing number of proposals being withdrawn due to corporate management developing workable solutions with investors.

Requiring at least 1 percent ownership of the entire company's stock and limiting resubmission rules will greatly limit shareholder proposals submitted, particularly those that include ESG factors.

## CORPORATE GOVERNANCE REFORM AND TRANSPARENCY ACT

H.R. 4015, the [Corporate Governance Reform and Transparency Act](#), passed the House of Representatives on December 20, 2017, by a vote of 238 – 182. (Many of the provisions included in this bill were originally in the Financial CHOICE Act but excluded in the final version signed into law.) This bill places regulations on proxy advisory firms that provide research, advice and voting recommendations based on corporate disclosures.

The bill would create substantial additional registration and reporting requirements for proxy advisory firms. Notably, it would allow corporations to lobby the proxy firms prior to shareholder recommendations. This raises questions about the ability of shareholders to receive impartial analysis.

*For more on this, read:*

[Congress Shouldn't Silence American Works at the Behest of Corporate Interests](#)  
[Consumer Federation of America Urges Opposition to H.R. 4015](#)

### MAJOR PROVISIONS OF H.R. 4015

Corporate lobbying on draft proxy recommendations:

- requires proxy advisory firms to share draft recommendations to the corporation it is analyzing. The legislation requires that the corporation has at least three days to subsequently lobby the proxy firm on the recommendations before the shareholder vote.
- requires proxy advisory firms to employ an ombudsman to receive complaints about proxy recommendations.

### Registration of proxy advisory firms

- [requires](#) firms to register with the SEC and disclose information such as:
  - the procedures and methodologies used to develop voting recommendations and whether the size of a company is considered;
  - the applicant's code of ethics; and

- any potential or actual conflicts of interest relating to the ownership structure and whether the proxy advisory firm provides additional services for corporate issuers, and the revenues generated by ancillary services.

### Conflicts of interest

- each proxy advisory firm must establish and enforce written policies and procedures to address and manage any conflicts of interest that can arise from its business. The bill gives the SEC discretion to provide further regulations on conflict of interest issues.

### Prohibited acts

- prohibits the conditioning of a proxy recommendation on the purchase by a corporation of other proxy advisory firm services or products.

### Statements of financial condition

- each proxy advisory firm must file confidential financial statements to the SEC.

### Censure, denial, or suspension of registration

- the [SEC](#) can censure, limit, suspend or revoke the registration of any registered proxy advisory firm if the Commission finds it is necessary for the protection of investors and in the public interest.

## WHY IS THERE AN EFFORT TO WEAKEN ESG INVESTING?

In May, the [Main Street Investors Coalition](#) was created to lead advocacy efforts to weaken the influence of institutional investors. Although advertised as representing the average retail investor, it is primarily funded by the National Association of Manufacturers.

The coalition's chief aim is to change the proxy voting process that occurs at annual shareholder meetings. With growing recognition of the importance of ESG factors in long-term value creation, more institutional investors have sought to incorporate these factors in their investment decision making in the proxy process. A May 2018 [GAO report](#) examined the integration of ESG issues in US investment.

While there is significant data to support the long-term economic value of ESG factors to retail investors and corporations, the coalition contends the principles harm corporations' bottom line and are inconsistent with retail investors' wishes. The group is circulating [white papers](#)

and a [survey](#) funded by the National Association of Manufacturers to advance its positions at the SEC and in Congress. A 2016 Government Accountability Office report to the Senate Banking Committee has also been cited as raising concerns about proxy advisory firms.

For more on this, read: [What's Behind a Pitch for the Little-Guy Investor? Big Money Interests](#) - New York Times  
[The Main Street Investor's Coalition is an Industry Funded Effort to Cut Off Shareholder Oversight](#) - Harvard Law School Forum on Corporate Governance and Financial Regulation

## POLICY RECOMMENDATIONS

Opponents to such legislative and regulatory efforts include the Council of Institutional Investors, the Consumer Federation of America, and public sector pension fund managers.

### Roundtable discussion on proxy voting process

While the official roundtable discussion is being finalized, stakeholders and members of the public can submit comments to the SEC [here](#). The PRI will write to the SEC and encourages US and non-US signatories to do so as well.

### The Corporate Governance Reform and Transparency Act

Legislation is currently pending in the Senate. PRI signatories can contact Senators to share their concerns.

### Information to share with the SEC and lawmakers

- shareholder proposals are a vital tool in helping companies manage new and emerging risks. By increasing the minimum threshold for ownership and limiting the resubmission of proposals, the important voices of many shareholders are omitted.
- the motivation behind the SEC action and legislation is misguided; institutional investors pursue ESG factors to reduce risk and build long-term shareholder value.
- US federal government reports prove the value of integrating ESG factors in investments:
  - in May 2018, the GAO published a report that detailed its own meta-analysis of peer-reviewed academic journals between 2012 and 2017 on ESG investing. It found the vast majority (88 percent) of scenarios reported finding a neutral or positive relationship between the use of ESG information in investment management and financial returns.
  - the [GAO report](#) also cited a 2015 meta-analysis, which reported aggregate evidence from more than 2,000 empirical studies, which similarly found that 90 percent of the studies reported finding a neutral or positive relationship between incorporating ESG factors and financial performance.

- further, the GAO report cited a 2017 study commissioned by the Department of Labor that reported that, while some investors may believe that ESG investing will lead to lower returns, the GAO found in its literature review, that ESG investing typically leads to similar or improved performance compared to tradition strategies.
- proxy advisory firms play a vital role in providing an impartial analysis of and recommendations on corporate issues that are important to institutional investors. Proxy advisory firms follow institutional investors' stated priorities, which increasingly include recognition of ESG factors.
- the Corporate Governance Reform and Transparency Act threatens the ability of shareholders to receive impartial information on corporate governance issues by allowing corporations to lobby proxy advisory firms before a shareholder vote.
- the idea that retail investors are uninterested in ESG factors is false. In a [2017 study](#), the Morgan Stanley Institute for Sustainable Investing found that 75 percent of its individual investors are either somewhat or very interested in sustainable investing. Additionally, over 70 percent agreed that having sustainable practices can lead a company to higher profitability and make it a more lucrative long-term investment.
- an international [meta-analysis](#) by Deutsche Asset & Wealth Management of over 2,000 empirical studies found that most studies show a positive correlation between ESG standards and corporate financial performance.
- [Fiduciary Duty in the 21<sup>st</sup> Century](#) contributes to extensive evidence showing that fiduciary duty is not a legitimate barrier to the integration of ESG issues in investment practice and decision making. On the contrary, the study concludes that failing to consider long-term investment value drivers, which include ESG factors, in investment practice is a failure of fiduciary duty.
- proxy advisory firms conduct the important and necessary work of providing an impartial analysis of corporations, including ESG issues, based on institutional investors' stated priorities. The efforts at the SEC and in Congress would make it harder to implement the vital work of proxy advisory firms in analyzing corporate ESG issues. Additionally, SEC efforts would weaken the strength of institutional investors' voice by placing significant barriers to the implementation of ESG principles.

## IMPLICATIONS OF THE MIDTERM ELECTIONS

The midterm elections on November 6 have the potential to drive significant change in public discourse in Washington. Given this, the PRI will publish a short supplemental bulletin following the election to provide insights on how the results might impact the policy issues discussed in this document.

For more on the PRI's work on active ownership, please see our guide [here](#).

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## **CREDITS:**

Support for this bulletin was provided by North South Government Strategies (NSGS), a Washington, D.C. based government affairs consulting and advocacy firm founded by two licensed attorneys, John McMickle and Eric Silva.



## The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: [www.unpri.org](http://www.unpri.org)



## The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

### United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: [www.unepfi.org](http://www.unepfi.org)



### United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: [www.unglobalcompact.org](http://www.unglobalcompact.org)

