April 2018

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2018 Proxy Season Preview: Investors Demand Accountability

With the vast majority of annual meetings set to be held in the coming weeks, the contours of the 2018 proxy season are coming into focus. While previous years are remembered for defining initiatives — "say on pay" in 2011, proxy access in 2015 and 2016 and majority support for climate change resolutions last year — 2018 is likely to be shaped by investors' focus on board accountability.

From board diversity and employee gender pay equity to corporate culture and the environment, investors are signaling through public communication, engagement and votes that their priorities for generating long-term value creation are expanding beyond traditional compensation and governance topics. Plus, they are more willing than ever to hold companies — and directors — accountable for failing to be responsive to their concerns.

Proxy season in 2018 will be a marker of how quickly investor expectations of companies and boards have changed over the past few years. A decade ago, topics such as climate risk oversight and board composition were infrequently raised and largely considered the purview of management by the vast majority of investors. In recent years, these issues have emerged as primary topics of engagement — and today, they are litmus test issues for the largest investors in the world. Look for 2018 to bring to the fore continued investor focus on holding management and directors accountable for implementing an agenda that comports with the new and growing expectations of their investors on environmental, social and governance issues.

Expanding Investor Priorities

Over the past several years, major institutional investors have steadily expanded their engagement efforts and grown their investment stewardship teams. Today, with nearly three-quarters of S&P 500 companies reporting engagement with investors, dialogue between companies and their biggest shareholders is more robust.

While many of these discussions center around executive compensation, this year, top of mind for investors will be board oversight of topics such as sustainability and cybersecurity, as well as company culture - including the board's role in ensuring the workplace is free from sexual harassment and discrimination. Several boards have taken steps to increase transparency about their oversight of these topics, but issuers should expect increased scrutiny on their practices as societal expectations of corporate responsibility shift and workplace dynamics continue to evolve.

Diversity and Gender Pay Equity

Board diversity and gender pay equity will also be long-term value creation priorities for investors in 2018. Board diversity has become perhaps the most resonant topic across the investor community, with major institutional investors touting their votes against directors and reporting success in forcing change at many companies. According to Bloomberg, there are now just 47 Russell 1000 boards with no women, down from 176 in 2009. In 2018, BlackRock, State Street and Vanguard have all signaled that they will build on their stated policies from prior years with plans to vote against boards without gender diversity.

New voting policies put in place by ISS and Glass Lewis that will, respectively, flag or recommend voting against boards without female members in coming years will only increase the pressure on companies to add diverse directors. A growing number of company targets of gender pay gap campaigns have released data following a wave of shareholder proposals in 2017 and 2018. New requirements in the United Kingdom have spurred additional disclosure on the topic. Expect more companies to make commitments to disclose and close their gender pay gap in the coming months.

Sustainability

Investors will also be pushing for companies to link sustainability and performance to business strategy and corporate citizenship. The momentum gained in 2017 from majority-supported climate risk shareholder proposals is likely to accelerate in 2018. Proxy Preview reports that 80 resolutions asking companies to address and provide additional disclosure on climate change risks were filed in 2018.

Evidence that a range of sustainability issues will be an ongoing priority for investors can be found in BlackRock Chairman and CEO Larry Fink's annual letter to CEOs, which called for companies to deliver both financial and social value. One recent example of how this new focus on corporate citizenship may translate to engagement and voting decisions can be found in the investor response to the recent school shooting in Parkland, Florida. BlackRock's public statement on the topic outlined its intent to address the issue of firearms companies in index portfolios (BlackRock subsequently announced new ETF products that exclude civilian firearms manufacturers and certain retailers). It also included a series of questions BlackRock is proactively raising in engagement, in addition to the possibility of votes against specific directors or management proposals if a company's response is deemed insufficient.

Growing Expectations for Board Disclosure

The push for companies to be responsive to investors is increasingly falling on the shoulders of directors. Proxy disclosure around board composition and evaluation practices, in particular, will be closely scrutinized by investors seeking to understand how the qualifications and attributes of directors are tied to overseeing long-term company strategy. Initiatives such as the New York City Comptroller's Boardroom Accountability Project 2.0 have spurred enhanced disclosure about director attributes and skills from several companies.

In 2018, investors' expectation that boards will address public policy priorities alongside strategic business goals will drive home the value of directors who can help set the tone at the top.

A version of this CamberView Insight appeared in Corporate Board Member magazine.

April 2018

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