The Global CEO Advisory Firm

They Want Their ESG!

Top 10 Questions to Expect from Investors This Proxy Season

January 2022

Overview

Those of a certain age may remember the 1980s “I Want My MTV” campaign demanding that the popular music television station be included in all cable lineups.

Over 30 years later, major institutional investors have launched a similar campaign demanding that a different three-letter acronym – ESG – be included in every company’s business strategy. But while most companies understand that environmental, social and governance (ESG) issues are now a primary focus for investors, many companies are still unclear on what those investors expect in regard to ESG. Gaining greater clarity is critical because the consequences of getting ESG “wrong” can be quite substantial. This fact was proven last year at both Exxon and Danone when ESG activist campaigns resulted in board and executive leadership change.

To help companies gain greater clarity about investor ESG expectations, we have listed the top 10 questions that we believe institutional investors will pose during the 2022 proxy season. Given the quickly evolving nature of many ESG issues, few institutional investors expect company responses to be perfect and complete. In fact, there may be no perfect answer to many investor ESG questions. However, investors do expect that any response from a company or board be strongly influenced by its business strategy and continuously informed by a robust stakeholder engagement program.

#1: How does the board oversee the company's material ESG risks and opportunities?

Most institutional investors expect boards to oversee a company's material ESG risks and opportunities just as they would oversee traditional business risks and opportunities. In fact, BlackRock and other investors are increasingly voting against directors that they believe have failed to adequately oversee ESG risks. In addition, proxy advisor Glass Lewis will now recommend voting against the governance chair of a company that "fails to provide explicit disclosure concerning the board's role in overseeing material ESG issues". While investors are not prescriptive as to how boards should oversee ESG, they expect robust disclosure describing the role of the board and its committees in overseeing a company's material ESG issues.

#2: Does the board include any directors that are ESG competent?

Proper oversight of a company's ESG risks and opportunities requires board members with specific ESG experience and/or knowledge. While investors may not expect every board to include a climate scientist, investors do expect that the board includes individual directors that are ESG competent. Investors recognize that this area is still evolving, but they are likely to support companies that add ESG criteria to any new director searches, revisit experiences of current directors with an ESG lens and provide ESG education to all directors. These are all reasonable steps to help the board become more ESG competent.

#3: How does the Board think about its gender and ethnic diversity?

Investors have been advocating for greater board diversity for many years. Recently, investors have enhanced their focus on ethnic diversity and have increased their expectations for overall board diversity. For example, BlackRock recently announced it now expects all boards to be at least 30% diverse, with at least two or more female members and at least one member from an under-represented group. While many boards do state that diversity is a consideration for board candidates, boards that lack specific diversity targets or adequate diversity representation should be prepared to explain how they are considering diversity as part of their composition strategy.

#4: Are any ESG metrics tied to the company's executive compensation plan?

As discussed in our recent thought leadership piece, one of the fastest evolving topics is whether ESG metrics should be included in executive compensation programs. Investors are generally aligned that the board's compensation committee should at least review this issue, even if most do not hold prescriptive policies on the use of ESG metrics. There is also a general consensus that if ESG metrics are included in executive compensation plans, the specific metrics and criteria should be clearly disclosed so that investors can properly assess their rigor and alignment with the company's long-term strategy.

#5. Are the company's political activities aligned with the company's statements on ESG issues?

Given the urgency around ESG issues, investors have increased their focus on whether a company's political activities are aligned with its public statements. This scrutiny includes a company's membership in trade associations that advocate against legislation that potentially advances a public issue. Companies that announced a pause in political contributions after January 6, 2021, should also be prepared to discuss how the company decided to resume political contributions – especially if contributions were made to members of Congress that opposed President Biden's certification.

#6. How is the company managing its human capital management risk?

The "Great Resignation" has increased investor scrutiny of how companies are managing their human capital risk. In 2021, investors demanded the disclosure of company demographics via a company's EEO-1 Report to help their assessment. This year, investors are asking for more company data relating to human capital management, including retention, promotion and turnover diversity data, as well as the unadjusted pay gap. As with the EEO-1 Report, companies will need to continue to assess the risks of providing such disclosure and consider whether its diversity strategy is sufficient to address any lagging diversity statistics.

#7. Has the company performed a racial equity audit?

Shareholder proposals requesting racial equity audits received strong support in 2021 despite being a relatively new concept. These audits explore how a company contributes to or combats systemic racism and are generally conducted by independent third parties. In addition to assessing the company's policies and practices as they relate to employee diversity, the audits look at the company's external impact through its supplier and partner relationships – and the impact of its operations, products and services. Although most investor inquiries were directed at financial institutions, they are targeting other public companies as well. As we see more audits this year, expect investors to be more sophisticated in their understanding and expectations of the third-party auditor selected and their methodology.

#8. How is the company contributing to the Paris Agreement's climate goals?

While climate change poses different degrees of risk to different industries, investors expect all companies to do their part to achieve the Paris Agreement's climate goals. This includes setting a science-based net zero target by at least 2050 (including Scope 3), setting and disclosing shorter term GHG reduction targets, and having GHG reduction targets verified by an external party such as the Science Based Targets initiative.

#9. How is the company evolving its ESG disclosures?

Our recent white papers on the state of sustainability reporting and the IFRS sustainability reporting framework initiative highlight the ongoing evolution of company sustainability disclosure. The pending regulatory initiatives from the U.S. Securities & Exchange Commission and European Union will only accelerate this evolution. Companies will need to be transparent about their progress towards ESG goals and commitments made in 2020 and enhance the external assurance of any ESG data.

#10. How does the company provide shareholders with meaningful participation at the AGM?

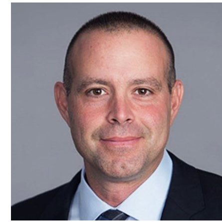
With the global pandemic continuing, companies will likely hold virtual annual shareholder meetings again in 2022. While the virtual shareholder meetings have been generally well received by most institutional shareholders, companies should provide shareholders with clear, advanced disclosure on how to participate in the annual shareholder meeting and provide meaningful opportunities to ask questions of management. Shareholders will be on high alert for anything that could be perceived as disenfranchising.

Conclusion

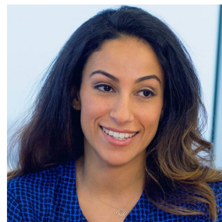
The risk of a company getting ESG “wrong” will likely increase in 2022, given the many recent ESG developments. For example, BlackRock announced recently that it will now give its asset owner clients such as pension funds – who typically vote against management at a relatively high rate – more discretion as to how to vote their proxies. Other large asset managers may eventually follow suit. In addition, other market initiatives seeking to harness the power of retail investors have emerged given the recent momentum from campaigns such as GameStop. The SEC has also signaled greater leniency on allowing ESG shareholder proposals on the ballot and plans to release new ESG disclosure rules in early 2022. New SEC rules on a universal ballot may have an impact on activist situations later this year. Companies with ESG strategies influenced by its long-term business strategy and informed by a robust stakeholder engagement program will be best positioned to manage their future ESG risks.

Authors

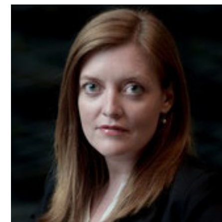
Dr. Martha L. Carter
Vice Chair & Head of Governance



Matt Filosa
Senior Managing Director, Governance



Faten Alqaseer
Managing Director & Co-Head of Diversity, Equity & Inclusion



Sydney Carlock
Managing Director, Governance

Sean Quinn
Managing Director, Governance

Morgan McGovern
Vice President, Teneo

For Questions or Comments, Please Contact:

Lisa Chou
Director of Global Marketing
lisa.chou@teneo.com

Teneo is the global CEO advisory firm

Working exclusively with the CEOs and senior executives of the world's leading companies, Teneo provides strategic counsel across their full range of key objectives and issues. Our clients include a significant number of the Fortune 100 and FTSE 100, as well as other corporations, financial institutions and organizations.