2021 European Proxy Season Review

After an unprecedented proxy season in 2020, 2021 reshaped many aspects of corporate life. For clients in Europe and beyond this proxy season saw many challenges around Environmental, Social, and Governance (ESG) issues.

Global dynamics shifted, inspired by social justice protests that took place all over the world. Meanwhile, the COVID-19 pandemic profoundly altered the way we work. Alongside these changes, 2021 saw an important rise in the social pillar of ESG, with a strong focus on human capital, employee health, safety, equality, inclusion, and diversity. These changes have encouraged shareholders and companies to modify their approaches to these material issues as part of their long-term business investments and strategies. Significant developments around board diversity have been observed, reflecting social evolution. Boardroom diversity is no longer limited to solely gender. Ethnicity, age, nationality, skill, and expertise either have been or recently became key elements.

Environmental concerns, particularly related to climate change, have once again been dominant themes among resolutions in 2021, generating outstanding support levels. Climate urgency in investor demands has sharpened the need for businesses to act and has accelerated the pace toward physical-impact assessment and transition planning. The recent development of say-on-climate resolutions set a trend that will continue over the years. Unsurprisingly, the number of environment-related shareholder/management resolutions is rapidly increasing, as well as average approval rates. As proxy-advisor and investor guidelines grow more demanding, the climate-reporting pressure on companies keeps increasing in certain sectors (such as industrials, energy) and is likely to expand. The potential involvement of auditing firms in climate reporting is currently part of investor initiatives in several countries. In such cases, auditor roles will evolve from 2022 to include consideration of new regulations and client demands on climate.

This year also saw the effects of the COVID-19 pandemic on executive compensation. Some dissent on say-on-pay proposals was linked to measures and board discretion seeking to mitigate the effects of the crisis on executive compensations. This comes after executives decided to take a cut in remuneration without fundamentally restructuring schemes. A disconnect was seen between pay and performance, undermining the alignment between executives and shareholders' experience.

The 2021 proxy season saw a continuance of past trends and ushered in new hurdles. In this review, we will have a look at four key topics of the proxy season in Europe that reflect the old and the new in this challenging year: board diversity, say-on-climate resolutions, the quality of audit, and remuneration.

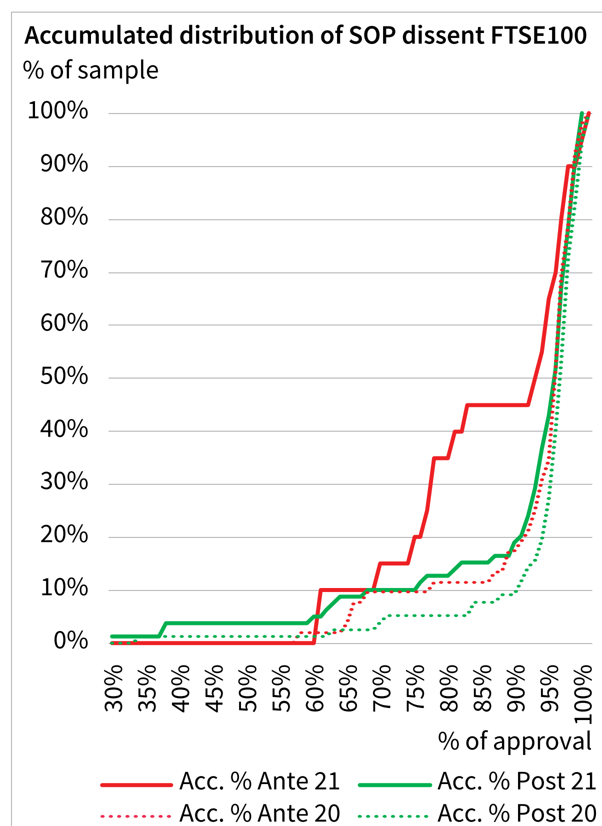
Say-on-pay ("SOP") in key regions: The 2021 landscape and a look ahead

Our 2020 season review was subtitled "unprecedented" and, to a certain extent, this adjective was applicable to the 2021 season landscape as well.

The effects of the COVID-19 pandemic were visible through the voting results on executive compensation, especially in France and the United Kingdom. Part of the dissent on ex-post Say-on-pay ("SOP") proposals was linked to measures and board discretion seeking to mitigate the effects of the crisis on executive compensation. This follows several executives deciding to cut part of their fixed and annual variable remuneration (in general around 20%) over the most affected months of 2020.

United Kingdom

Our focus was on annual general meetings (AGMs) held at FTSE100 companies between 1 January and 15 August. In 2021, we counted 20 ex ante (remuneration policy) resolutions versus 52 in 2020 and 79 votes on ex post (remuneration report) resolutions versus 77 in 2020. The vote on the remuneration policy is submitted to vote on a triennial basis, whilst the remuneration report is submitted annually.



The chart shows, for each resolution in 2020 and 2021, how approval rates (horizontal axis) were disseminated over our samples (vertical axis).

Our research highlights three significant trends:

- More resolutions received significant (>10 percent) or high dissent (>20 percent) in 2021 than in 2020, for both ex ante and ex post votes.
- For each year in our scope, we saw that the dissent was mostly cast on ex ante resolutions.
- Notwithstanding the previous point, only ex post proposals were defeated on our samples, both in 2020 and 2021.

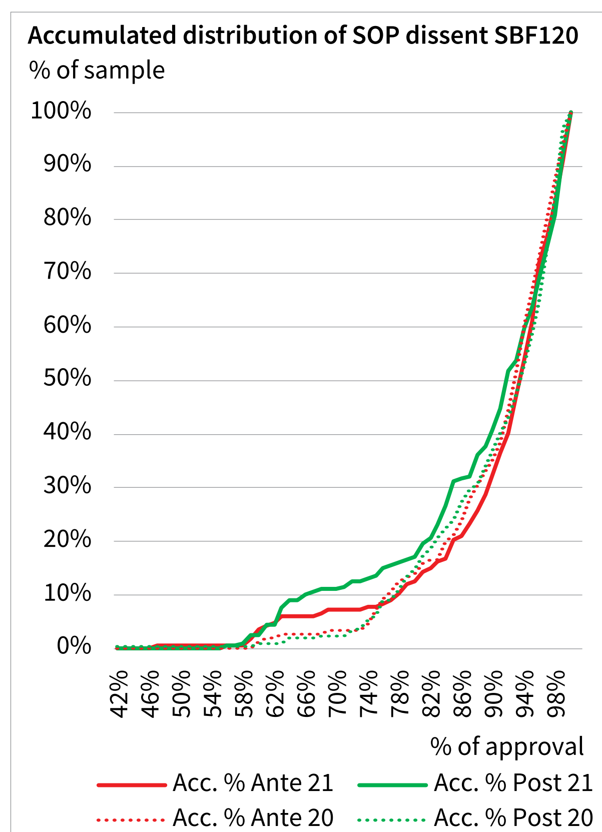
We will see below that part of the dissent was linked to COVID-19, which explains some of the differences between 2020 and 2021.

In the United Kingdom, the ex ante vote is binding, in contrast with the ex post vote. Therefore, the dissent on the remuneration policy allows for both anticipating the issue and forcing the remuneration committee to bring significant change.

It is through the implementation of policies that the actual issues materialise. This may explain our third point and why only ex post reports were rejected.

France

Our focus was on AGMs held at SBF120 companies between 1 January and 15 August. In 2021 we counted 167 ex ante (remuneration policy) resolutions versus 151 in 2020 and 199 votes on ex post (remuneration report) resolutions versus 209 in 2020. All votes are annual and binding and separate resolutions can be submitted per mandate or beneficiaries, in contrast with the United Kingdom approach.



Here as well, each point on the four lines indicates the maximum approval rate reached by a given share of the studied samples.

- We see that more dissent was cast against ex post and ex ante votes in 2021.
- The focus on the ex post vote was much clearer in 2021 than in 2020. Indeed, in 2020, the repartition of dissent was relatively even between ex ante and ex post votes. 2020 was also the first year of implementation of say-on-pay proposals, according to the loi PACTE.
- Going further, there was generally less dissent on remuneration policies in 2021 than in 2020, with the exception of approximately 9% of the sample that faced up to 23% of dissent.

With an annual and binding vote on remuneration reports, investors at French issuers have the possibility of blocking the payment of variable and exceptional remuneration elements. This may explain the focus on ex post say-on pay in France.

It is on the ex post vote that COVID-19-related board discretion was expressed and underlined, thus explaining why the green line on the right is significantly above others.

Germany

The German market saw the generalised implementation of the transposed SRDII through the ARUG II at 2021 AGMs. Unlike the United Kingdom and France sections, there will, therefore, be no comparison between 2020 and 2021 results or between ex ante and ex post votes, as only the former took place for the first time this year.

This being said, among DAX and MDAX, it is mostly the latter that was targeted by significant dissent. We also noted that, for a first exercise, shareholders and proxy advisors did not shy away from recommending and casting votes against management on remuneration policies. Among the DAX and MDAX, 12 companies faced more than 20% of dissent with three rejected resolutions. When recalculating the level of dissent, isolating majority/controlling stakes and strategic shareholders that support management resolutions, we highlighted that 22 companies faced more that 20% dissent from minority shareholders. This may mean that either German issuers were subject to higher scrutiny than their British and French peers or that the expectations from shareholders and voting exercises were not well understood.

The reasons for dissent

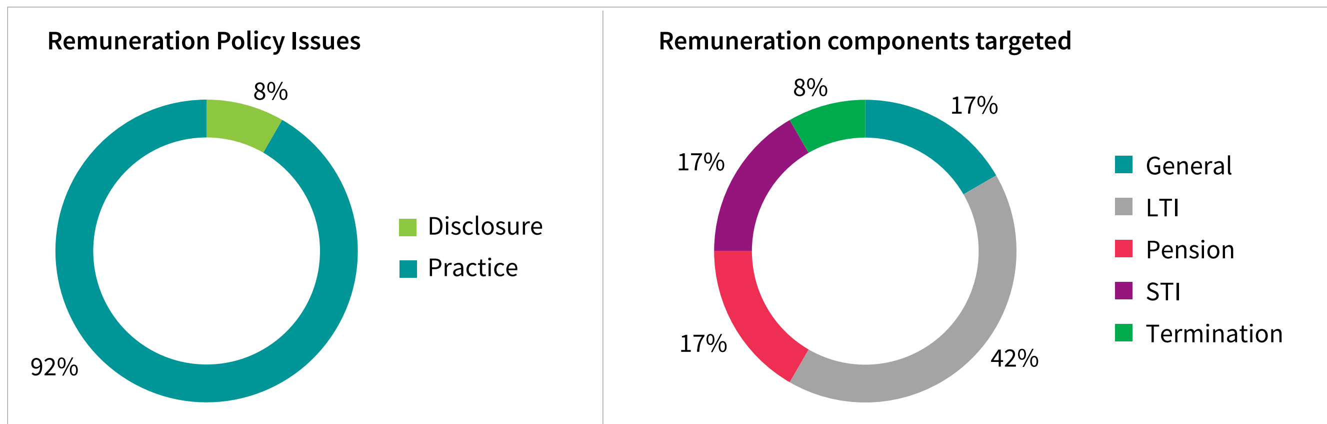
We short listed companies from the samples, focusing on those with higher dissent (above 20% from minority interest). Due to the number of resolutions in France, we focused on CAC40 companies. This section aims to explain what the key drivers were for dissent and consequently highlight areas of attention for boards when setting up and amending remuneration policies and putting together remuneration.

Diving deeper into the voting results on say-on-pay proposals, we looked at the voting rationales from leading proxy advisor Institutional Shareholder Services (ISS) to understand the breakdown of their points of criticism. Here are our main findings:

United Kingdom

We focused on a sample of 19 companies, which faced significant dissent from shareholders at the 2021 AGM.

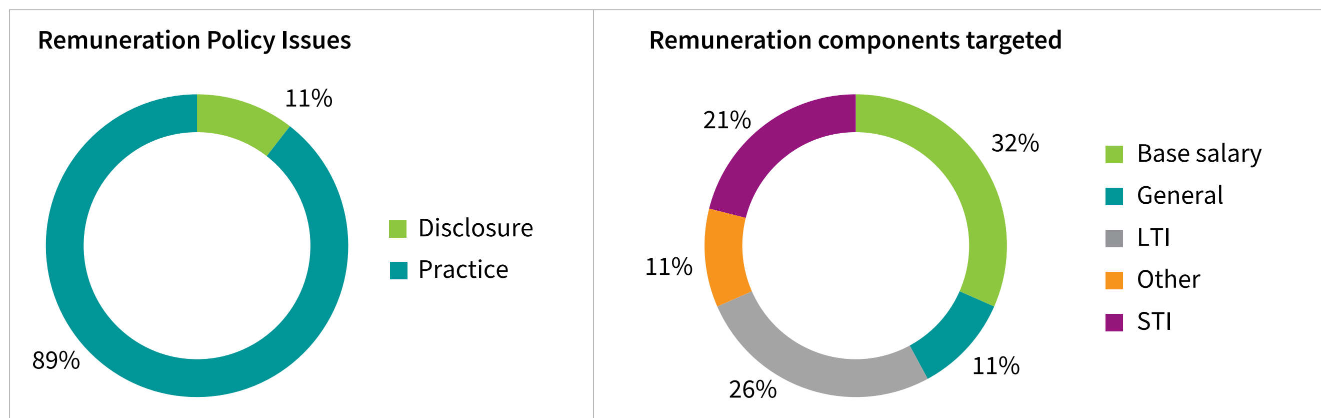
- Ex ante say-on-pay



Two major elements stand out in the above charts. On the one hand, the level of transparency of remuneration policies seems satisfactory. This is understandable as UK issuers have built a good understanding of the level of information expected. Remuneration practices, on the other hand, remain the main area of concern. Remuneration policies are designed to attract and retain key executives. Doing this while complying with voting guidelines is not only a matter of goodwill, an understanding of guidelines, or expertise in the field of compensation. Sometimes, compliance may not be an option. And yet, the approach retained by the board can be the right choice.

Among the 19 companies we studied, we saw that the main remuneration component targeted was the Long-Term Incentive (LTI). The increase of the potential award was the main point of concern, closely followed by concerns on performance-features stringency, or the lack thereof. The same type of concerns applied to Short-Term Incentive (STI).

- Ex post say-on-pay



For the remuneration report as well, the key area of concern was the remuneration practice implemented rather than the lack of information describing remuneration packages.

Base salary increases and their quantum were the prominent source of concern raised in 2020 paid packages. Although not explicitly mentioned, it can be difficult to find the right rationale and tone to support a salary increase while the global economy goes through a crisis.

Regarding both STI and LTI, recurring concerns covered the usage of board discretion. Deviations from initially-approved scheme rules were decided, taking into consideration the impact of COVID-19 when calculating variable-pay output. This was seen as a disconnect between pay and performance, thus reducing the alignment between executive and shareholder experience.

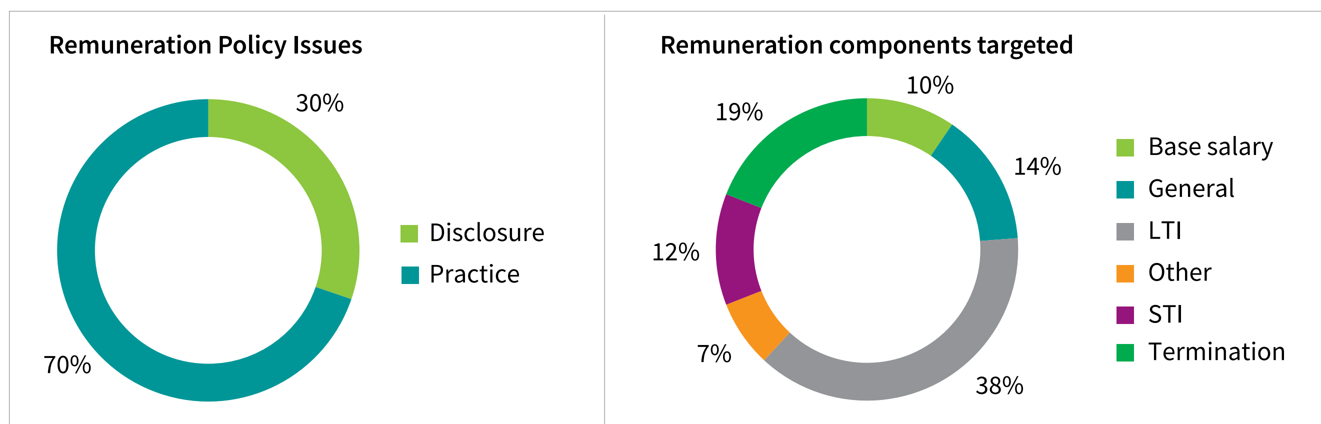
Finally, one specific case retained our attention. At Rio Tinto, a major environmental disaster was referred to as a reason that should have led to using malus and clawback provisions.

The last two points underline the growing diversity of vote drivers retained by proxy advisors and their clients.

France

For the French market, we shortlisted 19 companies that faced more than 20% minority shareholder dissent.

- Ex ante say-on-pay



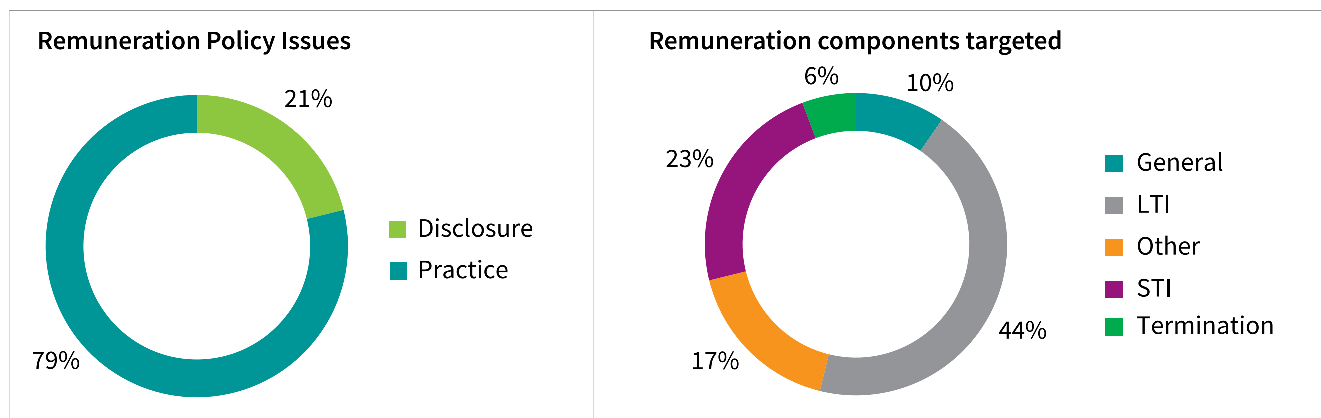
As was the case for the United Kingdom, French issuers proposed a level of disclosure that seemed to comply more with market expectations, even though significant shareholder criticism was observed. This being said, more companies lagged to provide expected transparency, even within the main index. A small majority of those companies had a significant share of strategic/controlling shareholder(s).

LTI was the largest remuneration component in terms of quantum, garnering a lot of attention. This was mostly related to pay-for-performance alignment. Disclosure issues related to LTI targeted the lack of information on reasons for package increases or the lack of information on performance features.

Termination packages also triggered dissent. Their main problematic feature was missing or insufficient performance alignment. The acquisition of unvested shares after the end of the executive mandate or their accelerated vesting were also pointed punctually.

Under the LTI and the STI, ISS often highlighted that the overachievement of several performance conditions compensated for the underachievement of others. This was deemed to facilitate the achievement of packages at cap-level. Such mechanisms face growing scrutiny.

- Ex post say-on-pay



In France, LTI remained the most regarded pay component, even on the ex post vote. In terms of disclosure, a few companies still seemed to struggle with disclosing the targets and level of achievement of performance conditions retrospectively.

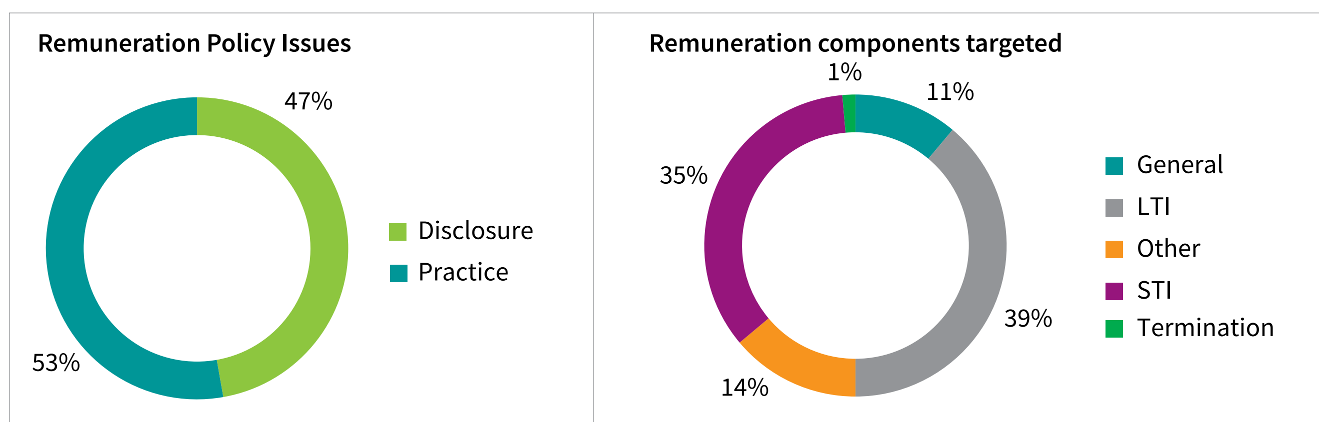
Regarding pay practices and performance stringency, compensatory effects, again, were still underlined at grant when the size of the award increased. However (and this was underlined for LTI and STI), the major trend was the use of board discretion to reduce the effect of the COVID-19 crisis on variable pay outcomes. This was observed at 43% of companies composing this core sample. As explained under the UK section above, it seems like issuers failed to be convincing that this was the appropriate approach in times of global economic downturn.

In particular, Thales faced particularly high dissent due to COVID-19-related discretion, although ISS and Glass Lewis highlighted that sufficient disclosure was provided. In addition, Thales specified that, although one performance condition would be relaxed, the maximum package opportunity would be reduced. Despite the proxy advisors support, more than 40% of shareholders (67% of minority shareholders) opposed the related resolutions. This shows that institutional investors could theoretically defeat a resolution, whatever proxy advisors say, depending on the sensitivity of the topic.

Germany

As explained earlier, the approach retained for Germany is slightly different as no ex post vote in application of the SRDII has taken place yet. We will therefore focus on the 22 companies that faced significant dissent from minority shareholders.

- Ex ante say-on-pay



In contrast with France and the United Kingdom, disclosure and anticipated pay practices foreseen in policies were much more balanced at dissent companies. We would most likely connect this to the say-on-pay exercise being new to German issuers under the SRDII approach. A standard for disclosure remains to be found.

A majority of the dissent targeted variable remuneration components in line with other markets. Performance features were critical and providing the right level of information was the main challenge. Performance targets are considered sensitive information that most issuers do not want to reveal ex ante. Yet there needs to be understanding of how challenging performance conditions can be.

One main deal breaker for remuneration systems was discretion in the form of exceptional awards, deviation policies, performance conditions multipliers, or potential metrics in which boards pick future KPIs. We noticed that exceptional awards were a particularly sensitive component and could alone lead to high dissent. This also had to do with the articulation between a remuneration policy voted for over four years – problematic features remained in place – and the absence of a binding ex post vote that would help block the payment of a problematic feature (as was the case in France).

The stringency of performance conditions was also punctually triggered, notably when relative metrics (more often TSR) would fully vest for performance just at the level of the median (or average) of the comparator group.

Remuneration committee accountability

For this last section we looked at the same companies, but at different items. When the gap between expected pay practices was too wide, or when repeated dissent was cast on say-on-pay, we believe that the reelection of remuneration committee members, notably the chair, could be targeted.

At AGMs held in 2021 in France, the reelection of remuneration committee members within our sample (companies with high dissent) was approved by 90.3% of votes on average. In comparison, the election of directors in France at SBF120 companies in 2021 was approved on average by 92.9% of votes. There are numerous reasons that can explain a vote against the reelection of board members. Therefore, we cannot conclude that there is a direct cause-and-effect relationship. Yet we had the same observation in the United Kingdom, on a higher number of items. This is mostly due to common yearly reelection of the whole board. In 2021, 48 remuneration committee members were reelected at companies with high dissent on say-on-pay, by an average of 91.9% of votes in favor. This approval rate increased to 98.3% of votes in favor of the election of any board members at FTSE100 companies within the same timeframe.

At Carrefour, the remuneration committee chair was up for reelection. The item was rejected by more than 14% percent of votes. Here are some of the rationales supporting votes against:

- **BMO Global Asset Management:** "Companies that received high levels of dissent on remuneration-related proposals should engage with their key shareholders to understand the rationale for opposition and explain in the next annual report how the company intends to address shareholder concerns."
- **BlackRock:** "Vote against compensation committee member because pay is not properly aligned with performance and/or peers. (…) Remuneration committee discretion has been used poorly. (…) Remuneration arrangements are poorly structured."
- **NN Investment Partners:** "The nominee serves on the Remuneration Committee and Glass Lewis has recommended against the remuneration report three years in a row."
- **Sarasin & Partners LLP:** "We will vote AGAINST the Remuneration Committee Chair, where we have voted against the company's proposed remuneration (either policy or report) for 2 or more years, and our concerns have not been adequately addressed. If he/she is not up for election, we will vote AGAINST the long-serving committee members. If none of the members are up for election, we will consider voting AGAINST the Chair of the Board."
- **UBS Asset Management:** "Company has received a significant vote against its executive compensation on each of the last 2 occasions that the remuneration has been put to a shareholder vote."
- Without opposing, **Norges** warned issuers with the following wording: "We will not support the re-election of members of the remuneration committee, or other board members, if the board received low shareholder support for its most recent pay-related proposal and we consider the board has failed adequately to address the issue." **Allianz Global Investors** used a similar approach.
- In the United Kingdom, at Pearson or Informa, numerous shareholders followed a similar approach to companies such as **Legal & General Investment Management, Aviva Investors, Axa Investment Managers, Kempen Capital Management, NN Investment Partners, Calvert Research and Management, Pictet Asset Management, Schroders, and Eden Tree Investment Management.**

Board members were also under growing scrutiny regarding diversity policies, climate action, and remuneration practices. These are new vote drivers. More and more, committee independence is scrutinized, along with board independence. If not addressed, the allocation of the various board and committee responsibilities could bring additional pressure on the reelection of candidates, notably independent directors.

There is not a megatrend for the moment, as indicated by the figures above. Yet, we believe that board accountability will be a converging point in coming years. As per the difficult reelection of the Informa remuneration committee chair (53.4% of votes cast), this may punctually lead to AGM accidents.

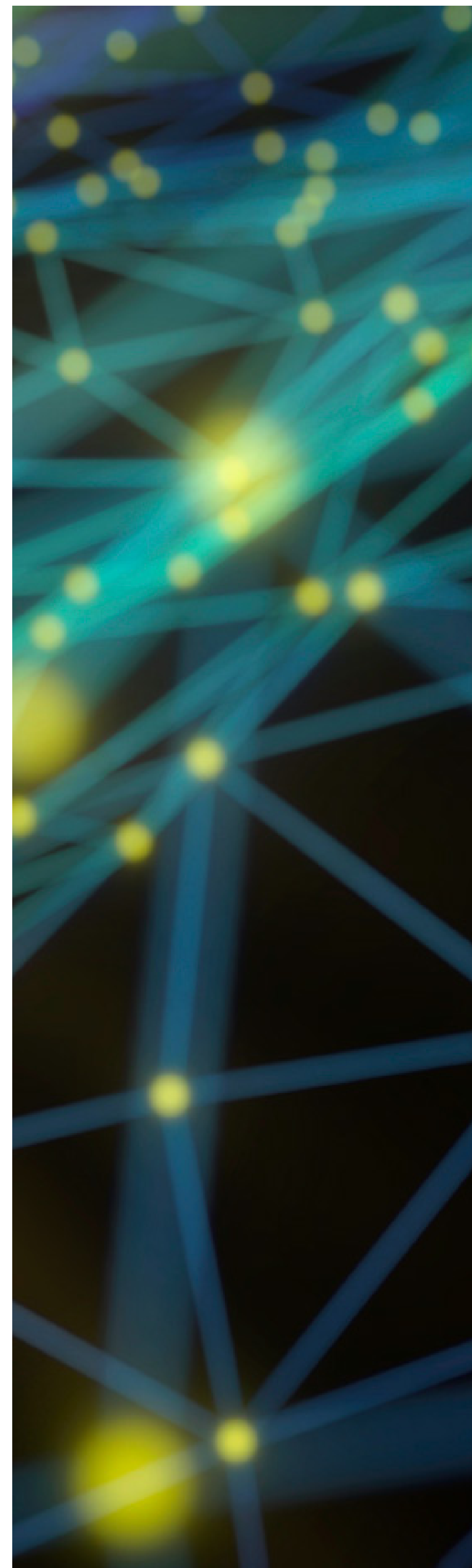
Outlook

In Germany in 2022, shareholders will vote for the first time on remuneration reports. Transparency and didactic approaches to pay mechanisms, as well as company specificities, will be key. As highlighted by voting results on remuneration policies, there will be no wait-and-see from shareholders, who will already vote with high expectations.

If discretion is to be applied by boards due to COVID-19 in 2022, it should remain on a limited portion of packages, i.e. with limited favorable impact. This should remain in-line with a company's approach to remuneration in-general—not just for top managers. Notably, the pay ratio introduced by the SRDII should not be impacted with increasing pay gaps. This could remain a very sensitive point for companies that have not have fully recovered or in the case of new, negative developments.

On all markets, the comply-or-explain principle remains a key factor of success. If compliance with voting guidelines is an easy way out of troubles, it may not always be an option. Being transparent on rationale in reports and through direct engagement is becoming a standard. Involving board members in this exercise is well regarded by shareholders and recommend in a growing number of local governance codes in Europe.

This should help anticipate and iron-out situations in the context of increasingly sophisticated voting guidelines, not necessarily reflected by publicly available institutional literature.



Audit the Auditor

EU audit reform rules came into effect in 2016 and have been implemented in various solutions at the national level across member states. The big four—KPMG, PricewaterhouseCoopers, Ernst & Young, and Deloitte—have been presented various solutions to the same issue: How do you guarantee the quality of an audit?

Continuously and not isolated to one national audit reform system, auditor roles are being questioned. Any inaccuracies set their reputations back, destabilize shareholder trust, and result in calls for more regulation.

Any solution presented needs to be stress tested in a robust way. The role of auditors and the quality of their work will be under the utmost scrutiny in the 2022 shareholder meeting season.

Recent Events

Being credited with the collapse of former DAX member Wirecard AG, amid the largest fraud scandal uncovered in Germany in 2020 ,was certainly not how Ernst & Young intended to attract clientele. In the investigative report, lawmakers also named the auditing firm for repeatedly approving the company's annual accounts, which were later proven to be cooked.

Shareholders started to ask questions on quality standards associated with yearly votes on the ratification of auditing forms at the company. Watchdogs were urged to take action to win back capital market trust. EY stated that it was adding 700 new staff members to help improve its auditing unit and clear divisions between its traditional auditing business and any other corporate consulting businesses, which were usually more lucrative.

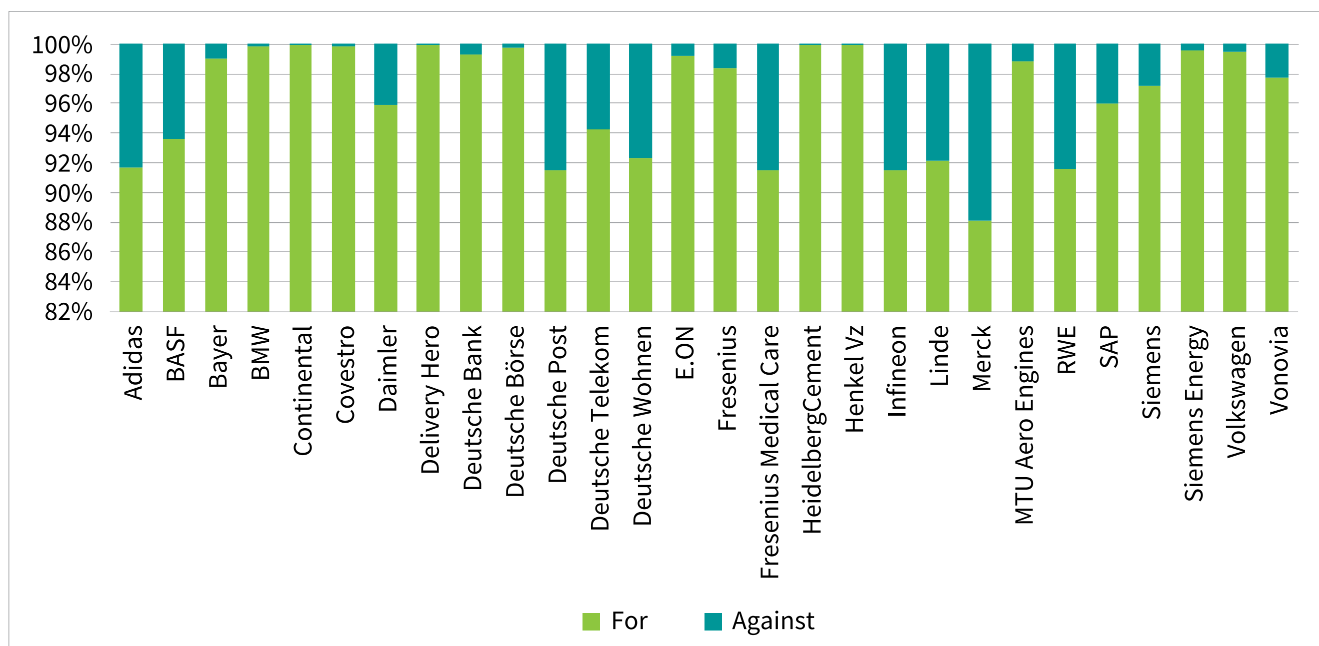
German regulators and legal experts quickly started to work to implement the Finanzmarktintegritätsstärkungsgesetz (FISG). We will look at the repercussions of the sudden shift of focus to auditing firm ratification votes, their potential new definition of scope, and the strengthening of controlling mechanisms.

In addition to the Wirecard scandal, we witnessed similar situations in the United Kingdom at failed travel firm Thomas Cook as well as the collapse of outsourcing giant Carillion.

The Financial Reporting Council (FRC) is in the consultation period of revisions to the UK audit firm governance code, which seeks to strengthen the operational separation of audit practices by introducing key areas of accountability and firm resilience. This is after repeated attempts by the government introduce more competitiveness to the big four without compromising the quality of an audit.

In France, the admission of Paris-listed group Atos that their auditors had discovered accounting inaccuracies at two of their US units saw shares of the company tumble by 15%. In a separate situation at Luxembourg-headquartered Solutions 30, 52% share price losses came after hedge fund Muddy Waters criticism resulted in their auditor (EY) refusing to sign off their annual report.

Meanwhile, all appeared well when we looked at the voting results of auditor elections in Germany in 2021:



Reasons for the dissent during the 2021 shareholder meeting season

When several German issuers put forward the usually low-risk proposal of electing auditors, we saw a large spike in companies facing questions and criticism from shareholders in 2021. Approval rates ensured that none of the proposals failed to be adopted, but caution increased from ISS, Glass Lewis, and shareholder associations such as Deutsche Schutzgemeinschaft fuer Wertpapieranleger (DSW) and SdK. Due to the nature of the private shareholders and with small shareholder associations representing a very active part of meetings in Germany, the dissent and criticism was notable.

SdK, in particular, stated in its assessments that it did not believe that Ernst & Young met the quality requirements of an auditing firm suitable to conduct future audits, citing the failures brought to light during the Wirecard scandal. This judgement was applied to every company proposing E&Y in 2021. DSW followed a similar pattern and cited as part of its concerns that several companies refrained from further utilizing E&Y's services until further notice. Hence, DWS did not see the firm fit for election as an auditing firm in 2021.

ISS and Glass Lewis, who retain the majority influence over the German corporate institutional ownership, were a little more cautious in their assessments and words of warning.

Other reasons for dissent were the regular rotation of auditing firms. After a certain number of years (usually 10), a firm is no longer considered independent. Local investors also require a 5-year rotation of a lead auditor at the same firm.

Further dissent was identified at the Volkswagen AG 2021 shareholder meeting for the ratification of Ernst & Young. Non-audit fees reported exceeded actual audit fees, raising doubts over independence.

Investor behavior

Whilst shareholder associations were at the forefront of denying ratification votes of Ernst & Young in 2021, the main reason for dissent from institutional investors remained tenure, resulting in concerns over auditor independence. Another concern was non-audit fees being higher than reported audit fees.

Dissent from investors such as Lyxor Asset Management, Aviva Investors, BNP Paribas Asset Management, and Legal & General Asset Management was identified at German shareholder meetings, citing the above criteria. Other large investors such as Blackrock, Union Investment, and UBS Investment Management supported a proposal at the adidas group AG shareholder meeting.

In relation to ratification votes of Ernst & Young in connection with the above-mentioned criticism, only individual pension funds followed suit and issued negative votes. Larger institutional asset managers seemed to be giving the benefit of the doubt in 2021.

Outlook

The role of the auditor as well as the scrutiny applied by shareholders prior to meetings will increase in 2022. If the 2021 season and amount of discussion around this subject are any indication, the ratification and/or election of the auditor will be the way shareholders can voice discontent.

For German companies, there is a specific list of action items published as guidance under the FISG:

- As of January 2022, all publicly listed companies are **required to establish an audit committee.**
- Audit committees now need to have **two financial experts** represented, one with in depth audit experience.
- The **quality of the audit** will be assessed by the company's' committee.
- The enforcement of the FISG will be in the hands of the **Bundesanstalt fuer Finanzsdienstleistungsaufsicht (BaFin)** and no longer have a designated department.
- Compulsory rotation of auditing **firm will be every 10 years** and rotation of the **lead auditor every 5 years.**
- **Audit and consulting services** of the same firm will be **prohibited**.

In direct connection with the 2022 shareholder meeting season, institutional shareholders and proxy advisors will focus on the election of supervisory board candidates as well as the installation of audit committees and transparent communication.

The publication of a board skills matrix as well as early communication about steps each company is taking to implement new regulatory requirements will aid the market in supporting implementation.

In France, after the implementation of the EU audit reform in 2016, the practice of double audit as well as strict requirements in relation to rotation (including a cooling-off period), have taken corporations on a different path. Whilst there is no conclusive evidence of improved audit quality, there is the certainty of more work for auditing firms than in any other European market.

The pressure on the auditor will keep increasing in years to come. One example is the recently published letter to audit firms by the Dutch shareholder association **Eumedion**, adding a new criteria of auditor to support **climate risk assessment**.

In a similar move, on 1 November 2021, several UK-based investors representing $4.5 trillion of investment have written to the big four to warn them of their potential opposition to the election of the auditor in 2022 should they fail to integrate climate change accounting into their auditing duties.

The significance of say-on-climate resolutions in Europe

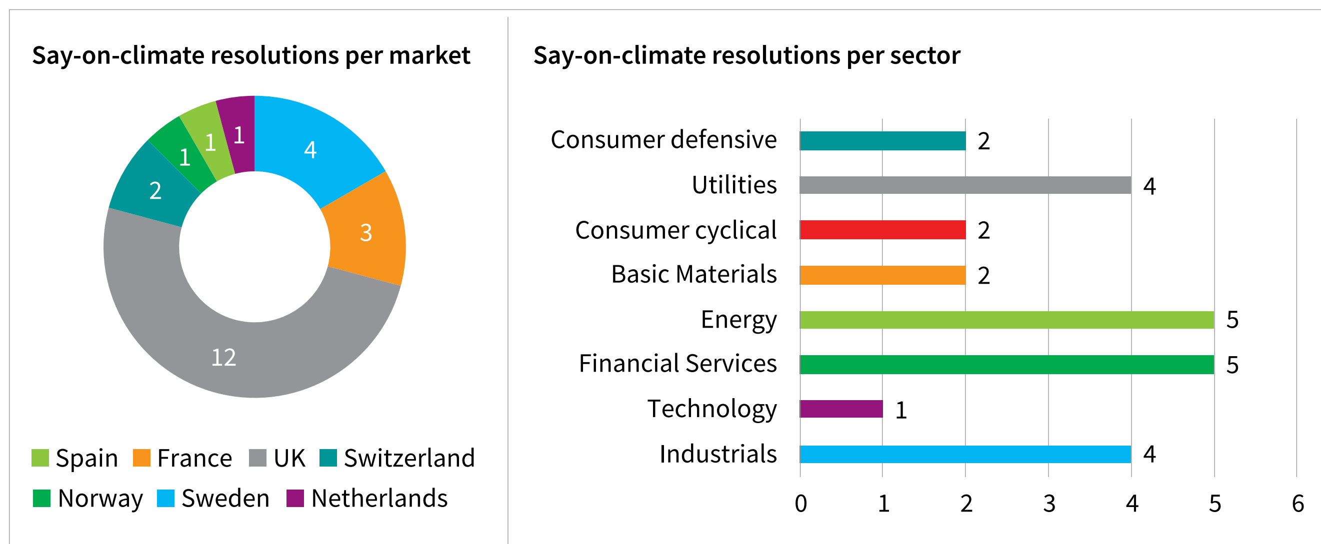
Since 2015, companies have been pressured by stakeholders to design environmental strategies that align business models with Paris Agreement climate goals.

After the signing of the agreement, which calls for global warming to be capped at 1.5°C compared with pre-industrial levels (1850–1900), initial investor engagement focused on educating companies on the Task Force on Climate-related Financial Disclosures (TCFD) framework. Investors and companies acknowledged the framework helps consider the issue, but the implementation needs technical guidance segued to more in-depth projects, plans, and discussions. Climate urgency in investor demands has sharpened the need for businesses to act and has accelerated the pace toward physical-impact assessment and transition planning.

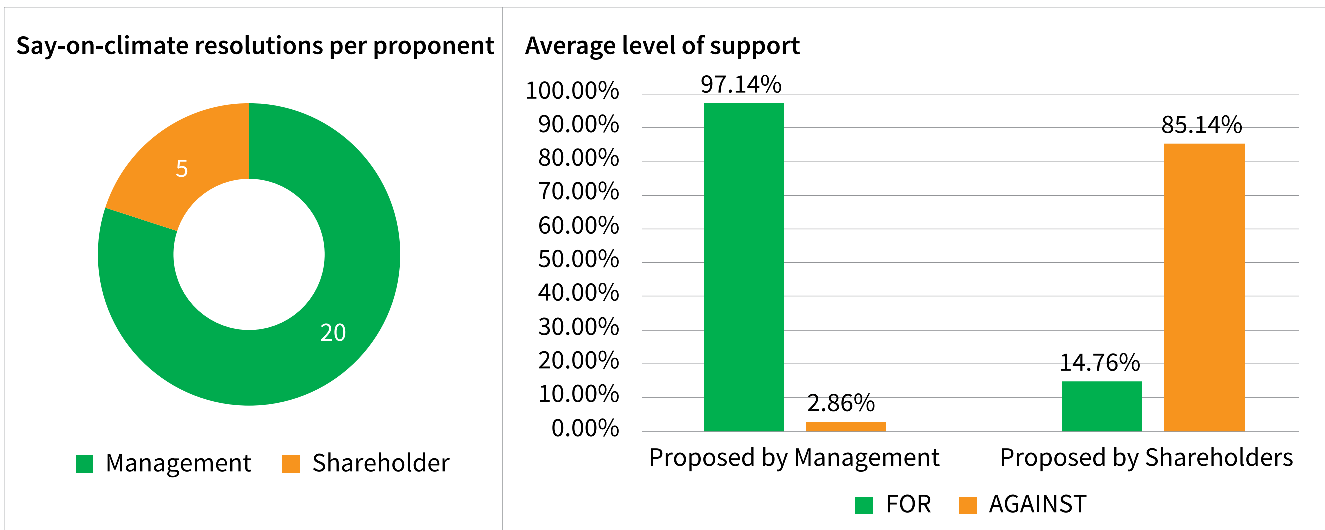
In 2021, "say-on-climate" resolutions emerged across the globe, particularly in Europe. A say-on-climate resolution can be submitted by a company or its shareholders. This non-binding vote aims to consult shareholders on the climate strategy of listed companies with the objective to ensure a permanent dialogue on environmental issues.

Ahead of this season, investors have made it clear how they will vote. For example, Brunel Pension Partners, a founding member of the Transition Pathway Initiative (TPI) representing £30 billion of eight, UK-based, local-government pension funds, published in its voting policy[1] in February 2021, stating it will "vote against the re-election of the company chair where a company has not at least reached level 4 of the TPI framework in Europe."

Say-on-climate resolutions in Europe at a glance



1 https://www.brunelpensionpartnership.org/wp-content/uploads/2021/02/voting_guidelines.pdf

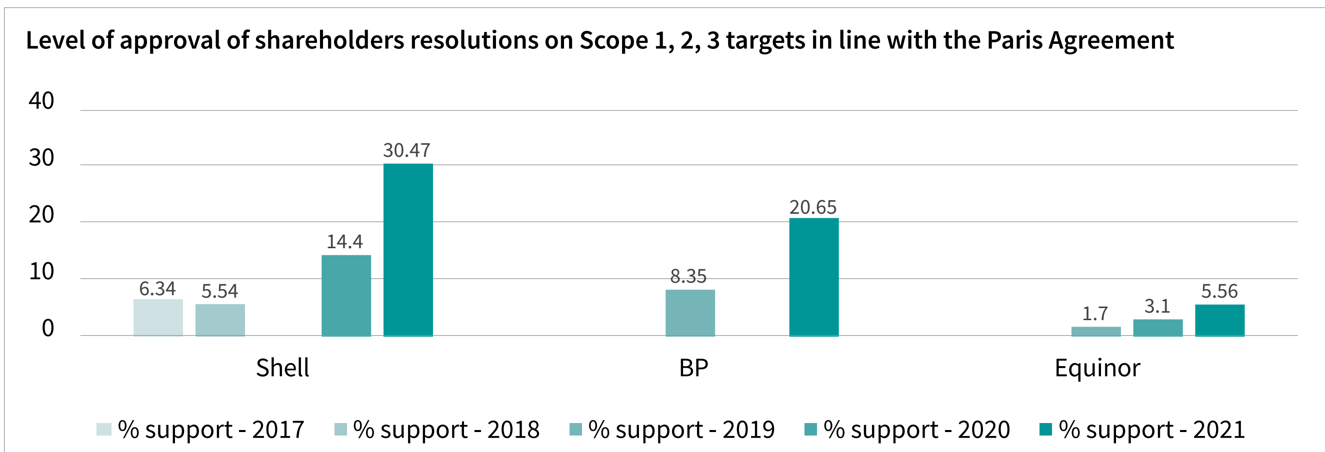


In Europe, 23 companies voted in 2021 on resolutions related to climate. Five of them came from shareholders. Management from these companies recommended votes against all of them. UK companies took the lead in considering resolutions related to climate, with votes taken at 12 companies.

Resolutions tended to fare better when management came up with climate proposals and asked shareholders to approve them. Of the 20 companies that submitted their own strategies, the average level of support reached 97.14%.

A focus on shareholder proposals in the energy sector

We observed continuity in the energy sector, with Shell, Equinor, and BP facing shareholder proposals similar to previous years.



In-favor votes doubled at Shell (from 14% in 2020 to 30% in 2021) and BP (from 8% to 20%) and progressed slightly at Equinor (reaching more than 5%). Concern over Scope 1, 2, and 3 targets and alignment with Paris Agreement objectives is undoubtedly growing.

These resolutions filed by Follow This follow the same approach: “To set and publish targets that are consistent with the goal of the Paris Climate Agreement: to limit global warming to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C. These quantitative targets should cover the short-, medium-, and long-term greenhouse gas (GHG)

emissions of the company’s operations and the use of its energy products (Scope 1, 2, and 3).”

Reactions from proxy advisors

ISS has been in favor of all management proposals, while Glass Lewis supported less than a half of them, including Royal Dutch Shell’s transition strategy.

If the two proxy advisors do not have a formal policy on say-on-climate proposals, ISS launched in March 2020 its Climate Voting Policy based on principles developed from widely recognized international frameworks, such as the TCFD’s disclosure requirements.

In July 2021, ISS started a consultation with institutional investors, public company corporate directors, and all other interested market constituents to reflect the growth of various investor initiatives around climate change and in the use of say-on-climate votes. The results on the topic of say-on-climate for investor respondents highlighted a lack of the following: “detailed disclosures (such as according to the TCFD framework), a long-term ambition to be aligned with Paris-type goals, a strategy and capital expenditure program, reporting on lobbying aligned with Paris goals, and a trend of improvement on climate-related disclosures and performance” are considered as ‘dealbreaker’.”

ISS also stated in their voting policy that they will “vote against or withhold from directors individually, on a committee, or the entire board, due to poor risk oversight of environmental and social issues, including climate change.”

As for Glass Lewis, they “will generally recommend against management and shareholder proposals requesting that companies adopt a policy that provides shareholders with an annual Say on Climate vote on a plan or strategy. When companies bypass that step, and place their climate plans up for an advisory vote, Glass Lewis will evaluate these climate plans on a case-by-case basis.[2]” This position explains the number of negative recommendations given on these resolutions.

Starting from 1 January 2022, the proxy advisor will also “recommend voting against the governance chair of boards which fail to provide explicit disclosure concerning the board’s role in overseeing these issues.”

Future overview

Say-on-climate resolutions represent a number of challenges for investors and companies, particularly the absence of legal clarity or codified best-practice standards. As Glass Lewis stated in April 2021, “Given the rapidly emerging nature of these votes and the absence of any standardized set of criteria for them, it is still too early to definitively outline best practices.[3] ” By extension, the multiplication of such resolutions may urge the need for legal framework and standards, which will address potential greenwashing from companies, as well as undue shareholder pressure and costs.

There is no sufficient framework that would allow companies to determine the impact of their activities on climate change and establish reporting or compare results over the years with peers. This also applies to investors, who lack a benchmark that would allow them to make company-by-company comparisons.

2 “Say on Climate Votes: Glass Lewis Overview”, 27 April 2021

3 “Say-on-climate votes: Glass Lewis overview”, 27 April 2021

These obstacles leave room for different future scenarios. For example, companies that put forward management proposals to shareholders for approval of climate transition plans are expected to be better prepared to meet the expectations of the TCFD. However, the absence of clarity might provide a grey area that raises legitimate problems and expectations, but for which responsibilities and responsible parties have not been yet defined.

Hypothetically, risks that arise due to this ambiguity could be partially addressed by the Corporate Sustainability Reporting Directive (CSRD), a new European-Union directive. It extends sustainability reporting requirements to all large and listed companies.

As listed by the European Commission, the directive will:

- Extend the scope to all large companies and all companies listed on regulated markets;
- Require the audit of reported information;
- Introduce more detailed reporting requirements and a requirement to report according to mandatory EU-sustainability-reporting standards;
- Require companies to digitally "tag" the reported information, so it is machine-readable and feeds into the European single access point envisaged in the capital markets union action plan.

Before adopting any standards, the commission will consult the Member States Expert Group on Sustainable Finance and seek the opinion of the European Securities and Markets Authority. If European Parliament and Council reach agreement, then the commission should be able to adopt the first set of reporting standards under the new legislation by the end of 2022. Therefore, companies would apply the standards for the first time to reports published in 2024, covering financial year 2023.

Possible developments

The say-on-climate momentum follows a trend of initiatives around climate in Europe:

On 30 July, the Institutional Investors Group on Climate Change (IIGCC) published "Investor Position Statement: A call for Corporate Net Zero Transition Plans," which was signed by 53 investors collectively representing more than $14 trillion in assets under management. In this statement, investors called for not only say-on-climate votes, but board oversight of net-zero transition plans and corresponding disclosure as, "this enables investors to determine which directors of the Board, in addition to the Chair, should be engaged with and potentially (as a last resort) voted against when a plan hasn't been provided or implementation is insufficient.[4]"

If no directors in office are deemed qualified to provide oversight of climate transition, shareholder votes to replace incumbent directors with climate experts are increasingly possible.

In the United Kingdom, from 1 January 2021, the Financial Conduct Authority (FCA) has set out a requirement for all premium-listed UK companies to comply with TCFD recommendations, disclose how they are considering the impacts of climate change, and on a comply-or-explain basis report against the TCFD framework. Full mandatory climate-related financial disclosure requirements will come into force across the UK economy by 2025, for which could be the first draft of an elaborated

4 https://www.iigcc.org/download/investor-position-statement-vote-on-transition-planning/?wpdmdl=4798&refresh=6103b7c61998f1627633606

framework on climate strategy. Companies are required to identify and then disclose details of material risks and opportunities arising from climate change under differing future climate scenarios. Complying with TCFD recommendation would facilitate the evaluation of a say-on-climate resolution coming from management, as well as provide a way to track progress over the years.

In early September, the "Forum pour l'Investissement Responsable" (FIR) in France called all the SBF120 companies to submit a say-on-climate resolution at their next AGM. The organization recommends to split the vote into two parts: climate strategy and its application. This strategy needs to include:

- An ambition contributing to the global goal of carbon neutrality by 2050 declined into quantitative GHG emissions reduction targets covering Scopes 1 and 2 and the most material Scope 3 emissions of the company. They must be refer to 1.5 ° c warming scenarios.
- Short- and medium-term milestones to initiate immediate transformations and achieve rapid significant emission reductions.
- The presentation of a detailed action plan to achieve set objectives and explain the compatibility and proportionality of the short-, medium-, and long-term goals with a 1.5 ° C warming scenario in-line with the Paris Agreement.

In addition, the FIR wants executive compensation to integrate the objectives of decarbonization in variable compensation criteria.

Another development could be the integration of science-based targets in climate strategies. Using science-based targets would allow companies get ahead of regulatory risk as governments could take an increasingly strong regulatory position on GHG emissions or because investors might strengthen their positions on climate change. The Carbon Trust stated in 2018 that "These targets are not based upon what is easy to do, desirable to shareholders, or demanded by customers. They are objective goals based on our most advanced understanding of how greenhouse gas emissions impact the climate." By complying with these targets, companies would reduce the obstacles and difficulties of corporate reporting and communicate to investors and regulators their commitment to long-term sustainable growth.

These initiatives are crucial and clearly shape the future of a common framework for say-on-climate resolutions. The commitment to transition to environmental strategies that align business models with Paris Agreement climate goals will be crucial when designing the strategy that will be put to a vote at AGMs. Some questions remain, and the focus on capital expenditure strategy, which would also need to be consistent with the climate strategy and the Paris Agreement goals, will be fundamental.

Companies will need to prove that their investments make sense in a more constrained environment. Therefore, as Steve Waygood, Chief Responsible Investment Officer at Aviva Investors said: "Providing a roadmap and aligning capital expenditure with a finite carbon budget are clear indicators to investors of a shift in company strategy, providing milestones against which to assess progress.[5]"

5 "Global investors support BP's net zero ambition and capex consistency test in AGM statement", 26 May 2020, IIGCC

2021 say-on-climate resolutions

Issuer	Country	Sector	Resolution Text	Proponent	% For	% Against
Aena	Spain	Industrials	Advisory Vote on Company's Climate Action Plan	Management	96.37	3.63
Atos	France	Technology	Opinion on the Company Ambition in Terms of Decarbonisation	Management	97.1	2.9
Aviva	UK	Financial Services	Approve Climate-Related Financial Disclosure	Management	99.95	0.05
Barclays	UK	Financial Services	Approve Market Forces Requisitioned Resolution	Shareholder (Market Forces)	14.04	85.96
BP	UK	Energy	Approve Shareholder Resolution on Climate Change Targets	Shareholder (Follow This)	20.65	79.35
BHP Group	UK	Basic Materials	Approve the Climate Transition Plan	Management	84.90	15.10
Calida Holding	Switzerland	Consumer Cyclical	Presentation of Sustainability Report	Management	87.31	12.69
Equinor	Norway	Energy	Instruct Company to Report Key Information on both Climate Risk and Nature Risk	Shareholder (Follow This)	5.56	94.44
Ferrovial	Spain	Industrials	Advisory Vote, as from the 2022 AGM, on the Company's Climate Strategy Report	Management	98.11	1.89
Ferrovial	Spain	Industrials	Advisory Vote on Company's Greenhouse Gas Emissions Reduction Plan	Management	99.34	0.66
Glencore	UK	Basic Materials	Advisory Vote on Climate Action Transition Plan	Management	94.36	5.64
H & M Hennes & Mauritz	Sweden	Consumer Cyclical	Approve Annual Proxy Vote and Report on Climate Change Policy and Strategies	Shareholder (Fondazione Finanza Etica)	2.65	97.35
HSBC Holdings	UK	Financial Services	Approve Climate Change Resolution	Management	99.71	0.29

Iberdrola	Spain	Utilities	Advisory Vote on Company's Climate Action Plan	Management	99.97	0.03
Investec	UK	Financial Services	Approve Disclosure of Emission Reporting	Management	99.97	0.03
National Grid	UK	Utilities	Approve Climate Change Commitments and Targets	Management	99.00	1.00
Nestle	Switzerland	Consumer Defensive	Approve Climate Action Plan	Management	99.39	0.61
Ninety One	UK	Financial Services	Approval of Approach Towards Climate Change	Management	97.38	2.62
Royal Dutch Shell	Netherlands	Energy	Request Shell to Set and Publish Targets for Greenhouse Gas (GHG) Emissions	Shareholder (Follow This)	30.47	69.53
Royal Dutch Shell	Netherlands	Energy	Approve the Shell Energy Transition Strategy	Management	88.74	11.26
Severn Trent	UK	Utilities	Advisory Vote on Climate Change Action Plan	Management	99.44	0.56
SSE	UK	Utilities	Approve Net Zero Transition Report	Management	99.96	0.04
TotalEnergies	France	Energy	Report on Sustainability	Management	91.88	8.12
Unilever	UK	Consumer Defensive	Approve Climate Transition Action Plan	Management	99.58	0.42
Vinci	France	Industrials	Approve Company's Environmental Transition Plan	Management	98.14	1.86

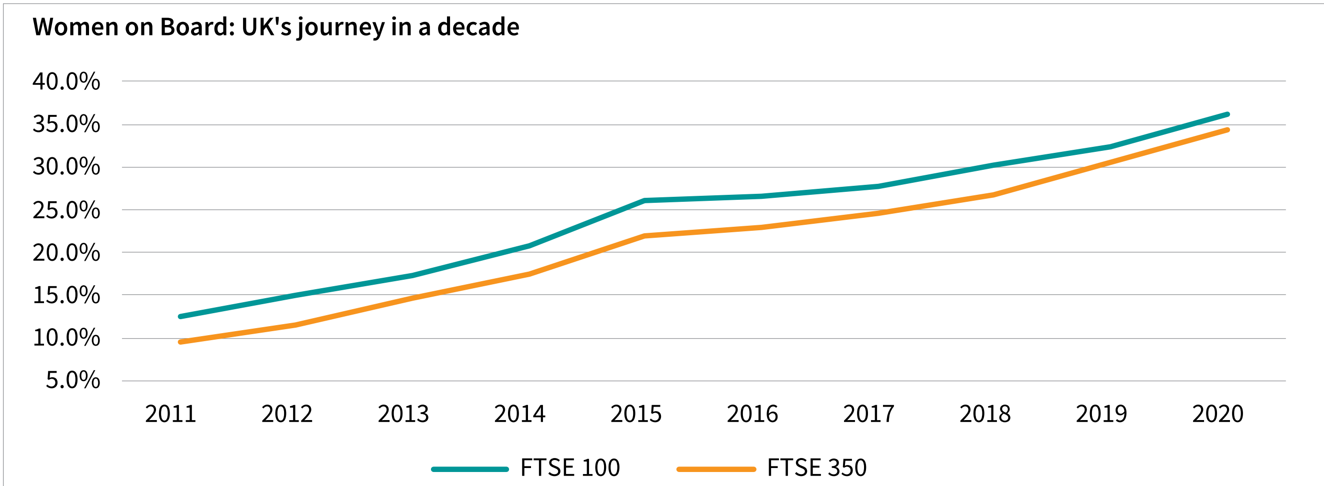
Board Diversity

Diversity on corporate boards continues to be one of the key areas of focus for companies and their investors and remains an important topic when it comes to engagement and proxy voting. Discussion about diversity is no longer exclusively dominated by gender, although there is still a long way to go until expectations are fully met on this topic globally. Beyond gender, diversity in boardrooms could be measured by various elements such as ethnicity, age, nationality, skills, expertise, and experience of directors. Female representation on boards has been the main trigger and a starting point for key stakeholders including regulators, investors, and other advocates to encourage companies to enhance the culture and make up of their boardrooms in order to benefit from a wider range of perspectives.

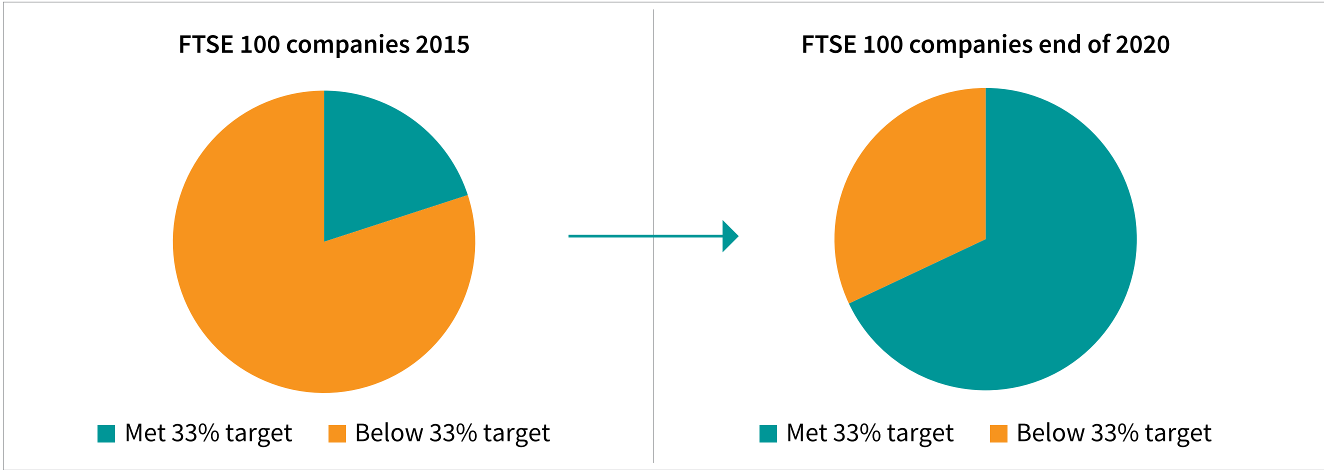
Across Europe, the combination of regulatory pressure and policy changes in the past few years has driven this transformation. Countries such as France, Spain, Norway, and Iceland have introduced laws requiring that women comprise at least 40% of boards at publicly listed companies. In France, a draft law will require 30% and 40% representation of women within executive committees by 2027 and 2030, respectively. Considering the loose legal definition of executive committees (in contrast with boards of directors) the interpretation of the law may leave room for potential disconnection between companies and their shareholders. The quota in Germany is set at 30%. This year, the German cabinet introduced new legislation that requires larger public companies with more than three management board members to have at least one woman on their management boards. German companies also have an obligation to set a diversity target for both management and supervisory boards. Listed companies in the United Kingdom aim for a third of their leadership roles to be occupied by women, although the voluntary target is expected to increase to 40% by as early as end of 2021.

An important milestone in the United Kingdom

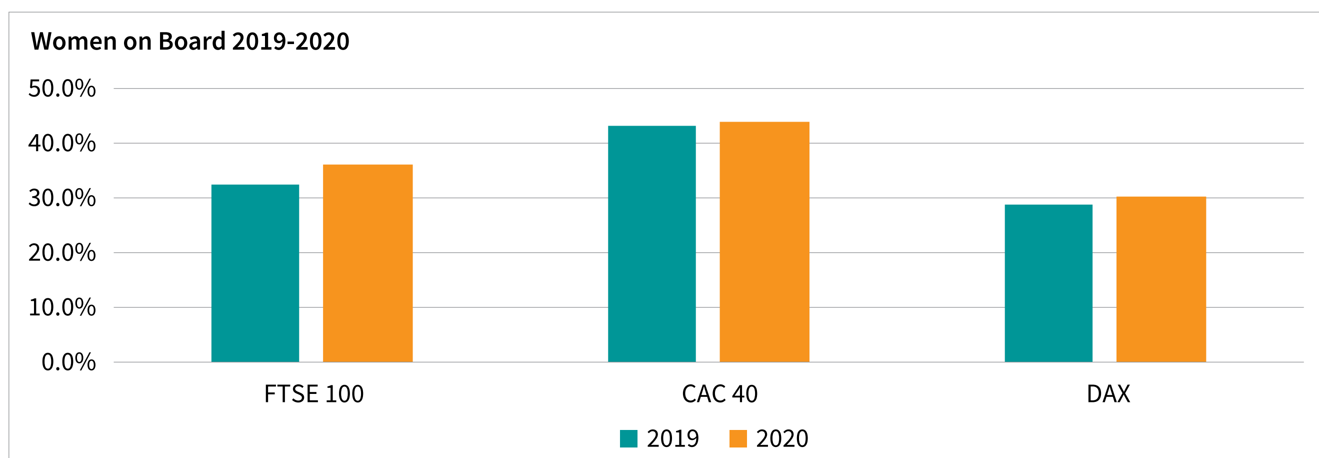
In 2016, the UK government called for an independent review to ensure that “talented women at the top of business are recognised, promoted and rewarded.” The review, which was conducted by Sir Philip Hampton and the late Dame Helen Alexander, focused on increasing female representation on FTSE boards and in senior executive positions. Accordingly, a voluntary target was set for FTSE 350 companies to aim for a third of their leadership roles to be occupied by women by the end of 2020. The ambitious initiative quickly gained the support of key stakeholders such as the influential institutional investors, global and local proxy advisors, the Investment Association, and the FRC.



By the end of 2020, the representation of women on the boards of FTSE 100 and FTSE 250 companies reached 36.2% and 33.2%, respectively, exceeding the target set by Hampton-Alexander. There have been significant improvements on an individual basis, too. Within FTSE 100, 68 boards have met or exceeded the target compared with just 20 back in 2015. More than half of all FTSE 100 companies now have 40% or more women on their board. Within FTSE 250, over 60% of companies have met the targets compared with just 13% of companies back in 2015. Although these targets have been set on voluntary basis, overall 63% of FTSE 350 companies have reached the goal of 33% of board positions held by women. Notably for the first time, there are no longer any all-male boards within FTSE 350. Aston Martin Lagonda Global Holdings Plc was the last remaining all-male board, which appointed a woman to their board at the end of January 2021. However, there were still 16 companies within FTSE 350 with only one woman on their boards.



FTSE 100 companies have made good progress towards the voluntary target, even exceeding expectations by over 3% in 2020. But how did they fair compare with other major European markets? In France, the percentage of women on boards of CAC 40 companies reached 43.8% in 2020, up from 43.1% in the previous year. The Cope Zimmerman law, which came to effect in 2011 when the share of women on boards was estimated to be between 12% to 14%, set the quota for board gender diversity at 40% for CAC 40 companies and has been a key contributor in making France one of the best performing countries in terms of board gender balance today. Germany has seen improvements, too, as the percentage of women on boards of DAX companies reached 30.2%, up from 28.9% in 2019. Almost all other major European markets performed well and reached or exceeded their quotas in 2020.



The success of this game-changing initiative has paved the way for the United Kingdom to stretch the gender diversity target even further and start focusing on other aspects of diversity. Over the summer of 2021, the FCA has conducted a consultation to improve transparency for investors on the diversity of listed company boards and their executive management teams. According to the FCA consultation, new comply-or-explain targets would ask that at least 40% of the board should be women, at least one of the senior board positions should be a woman, and at least one member of the board should be from a non-white, ethnic minority background. The proposed changes are subject to FCA board approval and could come to effect by late 2021.

The United Kingdom is aiming to take the lead with respect to promoting ethnic diversity within boardrooms. The ethnicity target set by the FCA has been in-part inspired by the work of the independent review conducted by Sir John Parker in 2017, “the Parker Review,” which considers how to improve the ethnic and cultural diversity of UK boards to “better reflect their employee base and the communities they serve.” It recommends FTSE 100 companies have at least one director within the board from an ethnic minority background by the end of 2021 and for FTSE 250 companies to do the same by end of 2024. It also recommends that companies report diversity of culture, geography, and nationality alongside ethnicity. In a March 2021 publication, data from this review revealed that as at the end of 2020, 75% of FTSE 100 companies had ethnic representation on their boards.

Investor behavior

After a few seasons of engagement around the topic, many institutional investors, including some of the world's largest asset managers, believe the time has come to take a more proactive approach against companies that have failed to demonstrate meaningful actions towards board diversity goals. Many have now introduced policies to vote against management of companies who do not have at least one female board member. The 2021 proxy season saw an increasing number of investors vote against board members at companies that failed to comply or explain their plans to reach their respective diversity targets set by law or best-practice goals.

During the proxy year 2020-2021, BlackRock voted against 1,862 directors at 975 unique companies globally for concerns related to board diversity. BlackRock continues to focus on leadership issues and has stated that "We have been asking companies to disclose their approach to board diversity for several years. When disclosure is insufficient for us to assess board diversity — particularly in markets where we consider demographic diversity a priority, where we have been raising the issue, and where gender diversity remains inadequate — we typically vote against the re-election of members of the committee responsible for nominating directors." In relation to UK companies, BlackRock expects that "large company boards should adopt the recommendations of the Parker and Hampton-Alexander Reviews with a view towards more voting action against boards not exhibiting diversity in 2022."

In its 2021 CEO letter, State Street Global Advisors (SSGA) warned companies that starting in 2022, they will vote against the chairperson of the nominating and governance committee at companies in the S&P 500 and FTSE 100 that do not have at least one director from an underrepresented community on their boards.

Legal & General wrote to their investee companies earlier this year, warning that, if they do not have at least one board member from an ethnic minority background by 1 January 2022, they will consider voting against the chair of the nominations committee. "The goal is to see all of the FTSE 100 having someone with an ethnic background on their board," said Clare Payn the Senior Global ESG and Diversity Manager at Legal & General.

Since the beginning of 2021, the vast majority of votes against directors in Germany and France have been driven by concerns around lack of independence and consequent negative recommendations by ISS and Glass Lewis. In the United Kingdom, at least 20 companies, including four within FTSE 100—Bunzl, Informa, JD Sports, and Ocado—received significant shareholder opposition with 20% or more votes against the re-election of directors due to concerns over lack of diversity. Company failure to meet the target of one-third of women on the board in the United Kingdom was closely correlated with increased voting opposition on the re-election of the chairpersons of nomination committees. Across Europe, BlackRock, Aviva, Legal & General, abrdn, Allianz Global, and Royal London have been amongst the institutional investors who have frequently voted against the re-election of directors this year.

In 2021, the best performers within FTSE 100 have been Diageo with 60% and Severn Trent with 55.6% women on the board, respectively, both of which have become the first companies in the history of the FTSE 100 to have a majority of woman on the board. Ocado Plc with 16.6% women

on the board had the lowest ratio. In France, the luxury group Kering lead the way in terms of diversity on several aspects, notably women representation (58%). Its competitor, LVMH showed a less gender-diverse board (47%), especially when including the two men censors that are not included in the legal calculation of gender diversity (then at 41%).

Proxy advisors

Proxy advisors have also taken a harder stance on diversity-related issues when making recommendations to institutional investor clients. Both ISS and Glass Lewis now recommend voting against FTSE 350 nominations committee chairpersons with less than one-third of women on the board. The Investment Association (IVIS) will Red Top FTSE 350 companies with less than 30% women on boards or less than 25% on executive committee and direct reports.

Glass Lewis expects the boards of all companies on mid- or large-cap European indices to be composed of at least 30% of directors of each gender by 2022. Glass Lewis has no current policy regarding representation of ethnic minorities on boards, however it expects a “board to be accountable if it has failed to address shareholder concerns regarding ethnic diversity.” Overall in Europe, the most common concern cited for a negative recommendation was the lack of board or committee independence.

Chair of the nominations committee is pivotal in diversity goals

There is now an increasing appetite publicly and within the investor community to focus on board diversity beyond gender with a focus on ethnicity. For example, companies with a highly concentrated customer base or significant operations in specific countries would find it difficult to justify their failure to appoint an appropriate director representing that specific community. For continental Europe in particular, it remains to be seen how ethnic diversity will be measured by investors, considering that regulations currently restrict the collection of this type of data.

Effective board evaluation and recruitment strategies go hand in hand to ensure companies make meaningful progress towards reaching their diversity goals. The traditional recruitment pool of current or ex-CEOs and CFOs has been a barrier for women getting appointed as board members, since these executive

positions have been predominantly held by men in Europe. The number of women in executive roles remains alarmingly low. Therefore, it would be important to consider recruitment outside the tradition pools while ensuring the quotas and targets for gender diversity extend to executive roles in addition to board of director positions.

While diversity does not guarantee success for a business, it ensures that a board is well equipped to help companies execute their strategies, achieve their goals, and minimize the risk of failure. Good progress has been made in Europe, but even in countries with well-established gender targets there is still plenty of room for improvement. This is evident in the United Kingdom, where around 30% of FTSE 350 companies have yet to meet the 33% gender-diversity target. Ultimately, board diversity is linked to the accountability of the nominations committee chair. If targets cannot be met, to minimize the chances of negative recommendations by the proxy advisors and potential shareholder opposition at AGMs, companies are encouraged to consider (i) providing sufficient explanation, in particular if a target was missed due to exceptional circumstances, (ii) disclosing progress and year-on-year improvements towards their internal targets, and (iii) making a public commitment to reach targets by the following shareholder meeting.

The common ground for all topics addressed in this review is around board accountability. More and more, stakeholders will look to boards, drawing on evidence from shareholder literature and projects, with increased increase pressure regarding responsibility. The sovereign power exercised by shareholders, well ahead of any activism threat, requires vigilance, proactivity, and a strategic distribution of key accountability within a board.

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