For professional investors and qualified investors only

ESG VIEWPOINT

A brief review of the 2023 US proxy season and what to expect in 2024

Andrew Droste
Vice President

At a glance

- We briefly review key takeaways from the US proxy season in 2023, which included a record number of shareholder proposals going to a vote and a rise in anti-ESG shareholder proposals.
- Looking into 2024 we expect the Universal Proxy Card rule to increasingly influence boards around board quality and shareholder rights.
- We expect anti-ESG efforts to grab plenty of headlines. Investors meanwhile look set to continue to focus on material ESG issues and strategies.
- Artificial intelligence is likely to remain a key theme as investors look to focus on its impact on boardrooms and business performance.

US proxy season 2023 review

- Director election support remained largely consistent year over year (YoY), while independent chair shareholder proposals rose substantially.
- The Universal Proxy Card (UPC) rule has significantly influenced proxy contests.
- Say-on-pay (SOP) failures were down, although average support was consistent YoY.
- A record number of shareholder proposals went to a vote; however, average support dropped substantially across environmental and social (E&S) proposals.
- Anti-ESG shareholder proposals were on the rise, though shareholder support dips even lower.

US Proxy Season 2023

Director election support remains largely consistent YoY, while independent chair shareholder proposals rose substantially.

Director election vote outcomes remained consistent compared to 2022; average shareholder support was roughly 95%, virtually unchanged from last proxy season. Similar to prior years, broken down by gender, women also consistently received higher average levels of support than men in 2023. Although an infrequent occurrence, we nevertheless saw failed director elections at companies like A.O. Smith, ArcBest, Ashford Hospitality Trust, Carriage Services, G-III Apparel, and Utah Medical Products (among others).

Governance-related shareholder proposals concerning board composition surged YoY due to independent board chair proposals doubling. Average support for these shareholder proposals remained steady at 30%. Although most S&P 500 companies separate the Chair and CEO, 40% still combine these consequential roles.

The Universal Proxy Card rule has significantly influenced proxy contests.

Some experts had posited the UPC era would lead to a substantial increase in the number of contests – others thought it would encourage poor behavior among activists seeking to pick off individual incumbent directors. We saw neither come to fruition. In fact, compared to 2022, proxy fights decreased as the UPC rule catalysed a significant increase in settlements – roughly 20% of contests never even went to a vote. This is likely due, in part, to the mutual understanding that barriers of entry have been lowered, which is (at least partially) the intended effect of UPC.

SOP failures were down, although average support was consistent YoY.

By the close of the 2023 US proxy season, we saw a greater than 40% decrease in the number of failed say-on-pay proposals compared to the end of the 2022 season. As of the beginning of the fourth quarter, there were just 10 SOP failures in the S&P 500 (versus 19 for the full 2022 reporting year), and 44 failures total among the Russell 3000 (compared to 67 during all of last year) according to the Farient Say on Pay Tracker. Nevertheless, average SOP support remains largely similar to 2022 at roughly 90% support.

A record number of shareholder proposals went to a vote; however, average support dropped substantially across E&S proposals.

Much like 2022, 2023's proxy season saw higher shareholder proposal volumes coupled with lower average shareholder support. Reasons for the former include a lower number of SEC No-Action requests from issuers and a lower fraction of withdrawn proposals by proponents. (Both conditions likely stem from the SEC's Staff Legal Bulletin (SLB) No. 14L, released in November 2021, which broadly loosened the interpretation of certain exclusions companies availed themselves of in prior years to keep proposals off the ballot.)[1]

As to decreased average support for environmental and social (E and S) proposals, this trend has continued since peak support levels in 2021. In 2023, support for E-related shareholder proposals averaged about 18%, compared to 27% in 2022 and 46% in 2021. S-related proposals averaged roughly 15% support in 2023, compared with 22% support in 2022 and 32% average support in 2021. As the world's largest US-based institutional investors have pulled back their support for E&S proposals, unsurprisingly, market winds have followed. BlackRock published its Investment Stewardship Voting Spotlight in the third quarter, noting it had supported roughly 7% of E and S shareholder proposals in 2023 (down from 22% in 2022 and 47% in 2021). Similarly, Vanguard supported 2% of E&S shareholder proposals in 2023 (down roughly ten percentage points from the year prior, and more than twenty percentage points lower compared to 2021).

Some thought the UPC era would lead to more contests or poor behavior from activists. Neither has come to fruition (yet)

[1] See Shareholder Proposals: Staff Legal Bulletin No. 14L (CF) (Nov. 3, 2021).

In the 2023 proxy season, Columbia Threadneedle Investments supported roughly 49% of E-related proposals, 55% of S-related proposals, and 26% of blended E and S proposals. Overall, we supported 48% of all shareholder proposals that went to a vote. As detailed in our **Corporate Governance Guidelines**, we typically support requests to improve board accountability, shareholder rights, executive pay practices, and overall environmental, social and governance (ESG) disclosure where we agree with both the broader matter highlighted as well as (importantly) the implementation process proposed. We also frequently support shareholder proposals asking companies to report on implementation of environmental and social policies and assessments where there is cause for concern (e.g., where the issuer lags strategic peers in disclosure).

Anti-ESG shareholder proposals were on the rise, though shareholder support dipped even lower.

Anti-ESG shareholder proposals filed in 2023 increased by roughly 60% compared to 2022. According to the **Sustainable Investments Institute**, as of August, the average support for these proposals stood at just 2.4%. This is, in fact, lower than the average support garnered in 2022, which was 3.4%. (Note: The SEC's resubmission threshold for a shareholder proposal is currently 5%; this means that companies may omit shareholder proposals that fail to receive 5% or more support during their first year on the annual general meeting (AGM) ballot.[2])

Of the Anti-ESG proposals filed, the majority dealt with S-related matters; of those, roughly two-thirds concerned DE&I-related initiatives. The most recent example as of the writing of this Viewpoint was at Procter & Gamble, where the National Center for Public Policy Research called for a "Civil Rights Audit." The resolved clause requested that the board "commission an audit to assess the impact of the Company's policies on non-BIPOC (Black, Indigenous and people of color) and non-Latinx/a/o/e communities."[3] The supporting statement goes on to read that "[t]he people left out – those discriminated against – are straight white civilian men."[4] The proposal received 4% support.[5]

Anti-ESG shareholder proposals increased by roughly 60% in 2023

What to expect in 2024

- UPC rule will greatly influence boards, particularly around board quality and shareholder rights.
- 25's the new 33: i.e., 25% is the new threshold for defining meaningful shareholder proposal support.
- Record number of shareholder proposals filed (again).
- 2024 political expenditures and anti-ESG efforts will consume headlines and airwaves.
- Investor lexicons shift to 'sustainability' speak, but an internal thematic focus on material ESG strategies remains.
- Greater investor focus on how artificial intelligence (AI) will affect boardrooms and bottom lines.

What to Expect in 2024

UPC rule will continue to influence boards, particularly around board quality and shareholder rights.

In December of 2022, hedge fund, Land & Buildings (L&B), secured the very first victory of a contested election under the new UPC framework. Due to governance concerns at Apartment Investment and Management Company (AimCo), the incumbent director, Michael Stein, was voted down and replaced with L&B nominee, Jim Sullivan. At the 2023 AGM in September, Sullivan was re-elected with almost 99% support – the highest support among all directors – and management placed shareholder-friendly bylaw amendments on the ballot, both of which passed.[6] Interestingly, the company had committed to improving on governance concerns raised by the dissident after the contest was initiated in H2 of 2022; however, investors considered this to be too little, too late.

What the aforementioned settlement rate, AimCo contest, and subsequent proxy fights have taught us this past year, is that boards must be proactive – proactive with their approach to measuring and acting on opportunities related to board quality, to expediting timelines concerning the enhancement of various shareholder rights. Although the number of contests decreased YoY, we can expect to see numbers rise now that 2023 has set valuable precedent in both the courts and on AGM ballots.

Notably, although the number of governance-related shareholder proposals have continued to fall, UPC-related shareholder proposals (dubbed "fair election" proposals) are likely to rise. Issuers will need to consider the intended (and unintended) effects of codifying insulative UPC-related bylaw amendments. Leveraging the P&G AGM

[2] See 17 CFR 240, 85 FR 70240, here.
[3] See P&G's DEF 14A, pages 89-90, for the entirety of the proposal's text here.
[4] I.d.
[5] See here for P&G AGM results.
[6] See here for AimCo AGM results.

once more, the latest example of these proposals received roughly 43% support. (See the proposal in its entirety **here**.)

On board quality and shareholder rights, we suggest robust board evaluations to better measure performance and identify opportunities. Our 2023 **Corporate Governance Guidelines** note that "boards should implement an evaluation process that considers the effectiveness of the entire board, its committees, including the contributions made by each member." We also believe that large-cap companies, in particular, should conduct independent board evaluations "on a periodic basis (typically every three years)." If done properly, these evaluations should, inter alia:

- measure board and management culture
- assess director stakeholder engagement
- determine whether requisite time is spent on strategy
- reveal whether board education is necessary (or desired) in particular areas
- identify procedural- and process-related inefficiencies
- benchmark peer and best-practice governance structures and shareholder rights
- for succession planning and committee placement purposes, identify gaps in director skills and backgrounds relative to the company's current and future strategic priorities.

Disclosure in some form of the above, preferably in the proxy, is also crucial to ensure investors understand why the board composition and governance structure is in their best interests.

25's the new 33

Historically, a prudent governance practice for many issuers has been to address – or be at least partially responsive to – shareholder proposals that achieve around one-third support. This rule-of-thumb may be changing in the US market. Average support for shareholder proposals fell to 23% in 2023. This is the lowest recorded average support analysing back to 2013. The closest comparator during that period traces back to 2017, where average support for shareholder proposals stood at 29%. Average support since 2013, however, has been roughly 32%, with the high watermark reaching over 36% average support in 2021. Provided this new benchmark in 2023 (23%), we believe companies will likely need to consider presenting some form of discussion or related disclosure to shareholder proposal topics that receive at least one-quarter of the vote, if trends continue.

Record number of shareholder proposals filed (again).

We expect to see another record year of shareholder proposals in 2024 as the regulatory dynamic since the release of SLB 14L remains. Furthermore, the standardisation of E&S disclosure continues to develop, which will lead to an increase in proposals asking for alignment. For example, the Taskforce on Nature-related Financial Disclosures (TNFD) finalised their recommendations in September, and the International Sustainability Standards Board (ISSB) finalised IFRS S1 and S2 in June. Beyond resolutions concerning disclosure alignment, TNFD is also likely to increase the number of nature- and biodiversity-related proposals compared to previous years, aided by this new framework. We also believe that climate-related resolutions will continue to grow as proponents seek to file at smaller companies. Overall, the current regulatory environment is ripe for yet another banner (and busy) year.

2024 political expenditures and anti-ESG efforts will consume headlines and airwaves.

With the 2024 presidential election around the corner, expect to see increased investor engagement on disclosure, management, and board oversight of political spending and lobbying. If the two major-party candidates remain identical to that of 2020, 2024 is likely to throw the US into further hyperpartisanship. As we saw in 2020, no company – especially a largecap company – is impervious to associated reputational risks (barring a choice to simply not spend).

Another knock-on effect of the election year will be continued emphasis on anti-ESG strategies. The topic is deeply political, from presidential candidates referencing ESG strategies in pejorative ways, to state officials summoning 'pro-ESG' investors before their legislatures. In assessing the lack of aggregate market inflows to anti-ESG strategies, including the record-low support for related shareholder proposals, we believe the headline attention is unwarranted. Nevertheless, we see this coverage continuing throughout 2024.

Investor lexicons shift to 'sustainability' speak, but an internal thematic focus on material ESG strategies remains.

Although the private investor led anti-ESG movement perspective has objectively been more bark than bite, anti-ESG, pro-energy, and/or 'anti-woke' state official efforts have effectively challenged many investors and issuers' treatment and usage of the data. Asked about the impact of anti-ESG efforts in the US, Larry Fink earlier this year noted "[w]e lost about $4 billion of flows from various states; but, in long-term flows last year, we were awarded $400 billion," adding that "last year in the [US] our clients entrusted us with an additional $230 billion… so, you tell me." Nonetheless, the world's largest US investors have categorically moved away from referring to ESG and have, instead, underscored materiality and long-term sustainability.

Although this market-wide recalibration has been viewed as potentially damaging from the standpoint of ESG's long-term credibility, growing pains in this space were necessary. For some, it's ushered in a more focused and standardised approach to

We expect another record year of shareholder proposals in 2024

disclosure and strategic initiatives. For others, it's led to an overcorrection and dismantling of environmental and social risk management. Ultimately, irrespective of what it's referred to as, the identification and pricing of E, S and G risks through improved data disclosure is here to stay.

Greater investor focus on how AI will affect boardrooms and bottom lines.

2023 signalled a fundamental shift in the way society interacts with AI. With the release of ChatGPT in late 2022, and its subsequent explosive user growth, 2023 became the year that AI seemingly catapulted us into the future. Although the inherent benefits of AI seem obvious from an efficiency and output perspective, the trade-offs are incalculable (and, in some expert opinions, potentially dire). This has left issuers and their boards somewhat puzzled as to the speed at which they should integrate AI into their businesses.

Expect investors to ramp up their fact-finding missions vis-à-vis AI in 2024. Technology and financial services companies, in particular, should be prepared to discuss where they stand in the strategic adoption curve, how it's currently being used, whether it's directly consumer-facing, and what risk management processes are in place concerning data annotation and privacy.

During engagements, boards and corporate secretaries alike may also be asked about their adoption of AI. In the near future, it's not inconceivable to imagine boards leveraging this technology during board meetings to ideate and make better strategic decisions. Moreover, management will be able to more effectively (and possibly more objectively) present summaries, data dashboards, and board books using AI programs that generate initial drafts. In any event, it's crucial that boards and management teams are discussing this.

Get to know the author

Andrew Droste, Vice President

Andrew leads Columbia Threadneedle's North America Corporate Governance engagement and proxy voting. He also specialises in power and utilities as well as financial institutions. Andrew joined from the Carbon Tracker Initiative think tank, where he was Head of Stewardship and responsible for engaging asset managers on integration of energy transition pathways. Prior to Carbon Tracker, Andrew consulted public and private C-suites and boards on material ESG matters at Russell Reynolds Associates after having worked on the stewardship and proxy voting teams at both BNY Mellon and Nuveen. Andrew has a law degree from Northeastern University School of Law and a Bachelor's in Government from Suffolk University.

To find out more visit **columbiathreadneedle.com**

COLUMBIA THREADNEEDLE INVESTMENTS®