Looking ahead to the 2019 proxy voting season

Most North American public companies hold their annual meetings between April and June each year. Investors are now gearing up for what looks to be another interesting proxy voting season in 2019. As an active, engaged and responsible owner, RBC Global Asset Management (RBC GAM) strives to stay at the forefront of emerging environmental, social and governance (ESG) trends. We have summarized here several issues to watch during the 2019 proxy voting season.

**Board diversity**

Diversity continues to be one of the most prominent ESG issues for investors. Currently, all TSX-listed issuers are required by the *Canada Business Corporations Act* (the Act) to disclose their gender diversity policy. However, recent changes to the Act will expand disclosure requirements beyond gender diversity to consider other forms of diversity. The Canadian government approved these changes in May 2018 under Bill C-25. Applicable regulations are only in draft form and must still be adopted. But it is expected that companies governed by the Act will be required to comply with these enhanced disclosure requirements by the 2020 or 2021 proxy season. For now, investor focus remains primarily on the issue of gender diversity at the board level. However, as with the regulations, concerns are broadening to include other forms of diversity and other levels of the organization. As disclosure on other forms of diversity improves, we expect more investor action as investors seek to integrate this information into their proxy voting processes.

**A focus on gender diversity**

Disclosure requirements on gender diversity have been in effect for a number of years and therefore investors are well-positioned to assess a company’s level of commitment. Generally speaking, progress on the issue has been slow and many investors are taking action via engagement and voting. Major proxy advisory firms like Institutional Shareholder Services (ISS) and Glass, Lewis & Co. have introduced new gender diversity voting policies. These will be in effect for the 2019 proxy voting season.

RBC GAM has strengthened its voting policy on gender diversity in light of a general lack of progress on the issue to date. We are also committed to advance the goals of the 30% Club Canadian Investor Group, to which RBC GAM is a signatory.

For 2019, we have adopted the following policy:

1. We now require a minimum of two female directors on company boards. This has increased from our previous requirement in 2018 of one female director.
2. If a company’s board has fewer than two female directors, we will vote against all incumbent directors of the nominating committee.

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2. Executive Summary of 2019 Proxy Voting Guidelines Updates, ISS, November 2018. Note: At S&P/TSX Composite-listed companies and other “widely held” TSX-listed companies, ISS will recommend a “withhold” vote for the chair of the nominating committee if the company has no female directors on the board and has not adopted a formal written gender diversity policy. ISS’ policy will expand to Russell 3000 and S&P 1500 listed companies in early 2020.
3. Proxy Paper Guidelines - Canada, Glass Lewis, 2019. Note: At S&P/TSX Composite and Russell 3000 listed companies, Glass Lewis will recommend a “withhold” vote for the chair of the nominating committee if the company has no female directors on the board. Additionally, Glass Lewis may recommend a “withhold” vote for the chair of the nominating committee if the company has not adopted a formal written gender diversity policy.
4. RBC GAM has strengthened its voting policy on gender diversity in light of a general lack of progress on the issue to date. We are also committed to advance the goals of the 30% Club Canadian Investor Group, to which RBC GAM is a signatory. For 2019, we have adopted the following policy:
   - We now require a minimum of two female directors on company boards. This has increased from our previous requirement in 2018 of one female director.
   - If a company’s board has fewer than two female directors, we will vote against all incumbent directors of the nominating committee.
Overall, we expect to see an increase in levels of opposition across asset managers and owners on the election of board members at companies lacking board gender diversity.

**Shareholder proposals**

Shareholder proposals are a good way to gauge which ESG risks are top of mind for investors. In 2018, highlights included:

- A record number of shareholder proposals were withdrawn after successful engagements with companies.
- Nine environmental and social shareholder proposals received majority support, up from six in 2017.
- The issues of climate change, political spending and board diversity were the subject of the most shareholder proposals.⁷

As of the end of February 2019, ISS reported fewer shareholder proposals filed at U.S. companies compared to the same time last year. There were 395 filed in 2019 vs. 450 in 2018.⁸ Among these shareholder proposals, the issues of climate change, political spending and board diversity were represented in great numbers. The number of shareholder proposals related to human rights issues also increased significantly.⁹

**Environmental and social shareholder proposals**

As of the end of February 2019, shareholder proposals on environmental and social issues outnumbered those filed on governance issues. The most common social proposal categories were political activities, human rights and human capital. The most common environmental proposal categories were climate change, environmental impact and sustainability.

There has also been an increase in the number of shareholder proposals that are often referred to as “sustainable governance.” These proposals ask for:

- Companies to provide enhanced disclosure on how they are overseeing their ESG risks.
- Boards to report on the steps they take to manage certain ESG risks.
- Companies to better align executive compensation with ESG risk management.

**Still on the radar: Political activities**

Investors remain focused on enhanced disclosure surrounding companies’ political activities in two key areas: lobbying and political donations. The goal is to ensure companies’ activities in these areas are aligned with the company’s stated strategy. As a result, investors are scrutinizing trade association membership and donations to political groups or individuals that seek to influence government regulation.

With increased investor focus on climate change, it is worth noting the work of the Climate Action 100+ initiative.¹⁰ This is a group of over 320 investors backed by over $33 trillion in AUM who are engaging with the world’s largest corporate greenhouse gas emitters to improve governance, reduce emissions and strengthen their climate-related financial disclosures. Their actions now include filing shareholder proposals on lobbying expenditures. The goal is to determine whether companies’ lobbying expenses contradict their public positions on climate change.

**On the rise: Human rights issues**

As noted above, the number of shareholder proposals related to human rights issues has increased. As in prior years, we continue to see proposals asking for:

- Human rights risk assessments in company operations and supply chains
- Disclosure on business activities in conflict areas
- Requests for companies to adopt a human rights policy

However, we are also seeing new proposals focused specifically on the human rights of immigrants and refugees. In 2018, the high-profile social issues of gun violence and the opioid epidemic made their way onto ballots. They were two of the nine environmental and social shareholder proposals to receive above-majority support. It appears that the trend of prominent social issues making their way onto ballots is set to continue.

**Sector focus: Information and communication technologies**

A number of issues plagued the world’s largest Information and Communication Technologies companies in 2018:

- High-profile data breaches
- Allegations of election interference

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³**https://www.iccr.org/sites/default/files/2019_ICCRproxyresolutionsandvotingguidelinr_0.pdf** Note: The Interfaith Centre for Corporate Responsibility (ICCR) is one of the largest investor coalitions that uses shareholder advocacy to pressure companies to better manage their ESG risks. Consequently, they are one of the biggest filers of shareholder proposals on human rights issues. The ICCR filed 43 human rights-related shareholder proposals for 2019, compared to 26 proposals in 2018.

⁴**http://www.climateaction100.org/*
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- Use of technology to target certain vulnerable groups
- Hate speech on social media platforms
- Media reports on surveillance, censorship, and the commercialization of user data

In the wake of the numerous data privacy issues, investors are seeking enhanced disclosure on companies’ oversight of the content being shared on their platforms and the handling of user data.

Top of mind: Climate change
Climate change will likely be a major area of focus for shareholder proposals this proxy season and a number of investor initiatives and coalitions are focused on accelerating action to tackle its most significant impacts. Most proposals fall into two categories:
- Emission reductions
- Carbon asset risk

For the emissions reduction proposals, shareholder proponents are increasingly asking companies to adopt greenhouse gas (GHG) emission reduction targets and report on progress. This is a significant shift in focus from past requests for reporting on a company’s approach to GHG emission reduction targets. As discussed in more detail below, there is some indication that the U.S. Securities Exchange Commission (SEC) may view such shareholder proposals as overly prescriptive. The shift in shareholders’ focus reflects investor sentiment that more concrete action is needed on the issue of climate change.

The issue of carbon asset risk has become more prevalent as shareholders continue to show signs of dissatisfaction with the quality of climate-related disclosure. A number of obstacles exist for investors trying to assess their portfolios’ climate-related risks. Investors and shareholder proponents are seeking a better understanding of how companies are navigating the transition to a low-carbon economy and how they are considering the risks climate change poses to the global economy.

The publication of the Task Force on Climate-related Financial Disclosures’ (TCFD) final recommendations in 2017 should help address these issues.

The U.S. Securities Exchange Commission
The SEC has announced that they will be reviewing the shareholder proposal process. This could potentially lead to a tightening of shareholder proposal rules and result in fewer shareholder proposals on the ballot. The revision is still ongoing and will not have an impact this proxy voting season. However, the SEC’s interpretation of the “ordinary business” rule is of much interest to shareholders.¹¹

By way of background, in 2018 shareholders were alerted to a potential change in SEC interpretation of the ordinary business rule. At that time, the SEC allowed EOG Resources, Inc. to exclude a proposal that asked the company to adopt GHG emission reduction targets.¹² The SEC’s reason was that the proposal qualified for the “micromanagement” exception.¹³ This was the first request of its kind to be approved by the SEC and has been said to indicate a shift in SEC interpretation.¹⁴

More recent SEC decisions include:
- In February and March of 2019, J.B. Hunt Transport Services and Devon Energy Corporation were allowed to exclude a GHG emission reduction target shareholder proposal on the grounds of micromanagement. The SEC viewed the proposals as a requirement for the companies to adopt targets and viewed this as an attempt to micromanage the companies.¹⁵
- In March 2019, Anadarko Petroleum Corporation’s request to exclude a proposal asking for reporting on how the company plans to reduce its emissions and align its operations with the Paris Agreement was denied. Since the proposal requested only enhanced reporting, the SEC likely did not view the proposal as an attempt to micromanage the company.¹⁶

As the SEC responds to exemption requests, investors are gaining clarity on how it is interpreting the ordinary business rule. This will have a significant impact on the 2019 proxy voting season in terms of the number of shareholder proposals that investors will see on the ballots and the nature of future proposals. However, the issue is still unfolding. The SEC is behind in reviewing requests due to the late 2018/early 2019 U.S. government shutdown.

¹⁰Note: Under the ordinary business rule, a company is allowed to exclude a proposal that is deemed to deal with matters relating to the company’s ordinary business operations. See https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2018/trilliummiller022618-14a8.pdf
¹¹See https://www.forbes.com/sites/davidblackmon/2018/05/02/sec-ruling-on-eog-resources-shareholder-resolution-may-signal-a-shift-in-policy/#8a5e14ee24c5
¹²See https://www.forbes.com/sites/davidblackmon/2018/05/02/sec-ruling-on-eog-resources-shareholder-resolution-may-signal-a-shift-in-policy/#8a5e14ee24c5
¹⁶See https://www.forbes.com/sites/davidblackmon/2018/05/02/sec-ruling-on-eog-resources-shareholder-resolution-may-signal-a-shift-in-policy/#8a5e14ee24c5
The backlog adds another layer of complexity to proxy voting season. For example, the funds of the New York City Retirement Systems (the Funds) sued TransDigm Group Inc. after the company decided to exclude a shareholder proposal. The proposal asked the company to adopt a policy aligned with the Paris Agreement to manage GHG emissions. The company had requested an exemption from the SEC under the ordinary business rule, but had not received a response due to the backlog. The lawsuit filed by the Funds alleged that the company was improperly excluding the proposal from its proxy.

The two parties eventually settled and the company withdrew its exemption request. Shareholders were allowed to vote on the proposal at the company’s upcoming annual meeting.

Looking forward, it is very difficult to assess how many shareholder proposals will be on ballots this proxy season. The final numbers will depend in part on:

- The potential shift in interpretation of the ordinary business rule
- The current backlog at the SEC
- Shareholders who are willing to take legal action over their right to file shareholder proposals

**Increasing levels of engagement**

Ahead of proxy season, shareholders and issuers are reaching agreements on a wide variety of shareholder proposal topics. Many companies are committing to improve their practices or reporting. Such agreements generally result in withdrawn proposals. Indeed, the number of withdrawn proposals has been high heading into proxy season – particularly those related to climate change.

For example, members of the Interfaith Centre on Corporate Responsibility (ICCR) have filed 250 resolutions at 163 companies for the 2019 proxy season. They have also reported that they are involved in 349 additional dialogues with companies. The lower number of proposals relative to engagements is significant. According to the ICCR, the number of resolutions filed and the number of active dialogues has historically been equal.

Many investors generally view engagement as the most effective vehicle of change. Rising numbers of withdrawn proposals and engagement activities may indicate an increased willingness of issuers to engage with investors. In our view, if the SEC proceeds with its recent interpretation of the ordinary business rule or further tightens rules on the filing of shareholder proposals, engagement will become an even more important shareholder advocacy tool.

**Conclusion**

Overall, the 2019 proxy voting season is shaping up to be an eventful one. Spurred by slow progress and investor dissatisfaction, we are seeing renewed investor focus on pressing ESG issues like board gender diversity and climate change. A number of new shareholder proposal topics will be put to vote, reflecting the dynamic nature of investment stewardship and the increasing level of investor sophistication on ESG issues. It was a record year in 2018 for the number of environmental and social shareholder proposals that received majority support (and the average level of shareholder support for environmental and social proposals also increased). Therefore, we expect a high level of investor support on many of the shareholder proposals filed during the 2019 proxy voting season.

Proxy voting is a key part of how RBC GAM conveys its views on a range of important issues to the boards and management of its investee companies. RBC GAM remains committed to a thoughtful and informed approach to ensure our votes are cast in the best interest of our clients.

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