Net Zero and Proxy Voting:
2022 US Proxy Season Preview

ESG and impact investing advisory with the goals of risk management and value enhancement

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The 2021 US proxy season witnessed record levels of support for climate-related shareholder proposals. Proxy advisor Institutional Shareholder Services (ISS) reported that the median support level for such proposals in 2021 was 48.9%, up from 37.6% the previous year[1].

The 2021 US proxy season also saw investors seeking to influence companies' management of climate-related risks by deploying a variety of tactics beyond filing and supporting shareholder proposals. Investors moved beyond requests for disclosures and pushed for proactive board oversight of climate risks. The most notable of these efforts was activist firm Engine No. 1's successful proxy contest at Exxon Mobil that resulted in the election of three new board members. "Vote No" campaigns targeting directors for alleged failures of climate-risk oversight also hit a record high. In addition, the Children Investment Fund's "Say on Climate" Initiative sought to secure a recurring dedicated ballot item that would give investors an advisory vote on company climate transition plans.

As the 2022 US proxy season gets underway, it's worth asking whether the trends we saw in 2021 will continue, while also evaluating how developments since then will influence investors' voting in 2022 and beyond.

Developments Since the 2021 US Proxy Season

In the time that's elapsed between the end of the 2021 US proxy season and today, there have been several private and public sector developments with significant implications for investors' engagement on climate change.

Investor Initiatives

The 26th UN Climate Change Conference of the Parties (COP26), which took place from October 31 through November 13 2021 in Glasgow, advanced the momentum for climate action, as demonstrated by the slew of net-zero pledges from governments and institutional investors ahead of the conference. Among the key announcements made at COP26 was the release of a progress report by the Glasgow Alliance for Net Zero (GFANZ) – a collective effort bringing together net-zero finance initiatives such as the Net Zero Asset Managers initiative (NZAM) and the Net Zero Asset Owners initiative (NZAO) – announcing that financial sector commitments to limit global warming to 1.5 °C now exceeded $130 trillion[2] in assets. NZAM comprises over 230 signatories with assets under management (AUM) totaling $57.5 trillion, while NZAO works with over 70 signatories with over $10 trillion in assets. Both initiatives work through partners and investor networks such as the Climate Action 100+, an investor-led initiative backed by 617 institutional investors with assets of over $65 trillion that engages with over 160 of the world's largest corporate greenhouse gas (GHG) emitters on climate change.

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Regulatory Developments

On the policy front, the Biden Administration's "whole of government" approach to combating climate change has resulted in regulatory changes that will have implications for the proxy season. In November 2021, the Securities Exchange Commission (SEC) issued guidance related to the exclusion of shareholder proposals under Exchange Act Rule 14a-8[3]. The new guidance will likely result in the exclusion of fewer shareholder proposals, including those that request companies to adopt targets and timeframes to address climate change if the request is not overly prescriptive in dictating how management must do so.

Also, in March 2022, the SEC's Division of Examinations named ESG among its examination priorities. As part of examinations, the SEC will review the voting of client securities in accordance with proxy voting policies and procedures, including whether the votes align with the firm's ESG-related disclosures and mandates[4].

Proxy Advisor Policy Developments

Another notable development since the 2021 proxy season is proxy advisors' expanding conception of what constitutes governance failure and the circumstances under which adverse votes for directors are warranted. The US proxy voting guidelines of the two leading, independent, third-party proxy advisory firms—ISS and Glass Lewis—both contain policy language related to board oversight of ESG.

- In 2021, **Glass Lewis** updated its US proxy voting guidelines regarding board-level oversight of environmental and social issues, informing companies and investors that it would note when boards of companies in the S&P 500 index do not provide clear disclosure concerning board oversight of environmental and/or social issues[5]. In 2022, Glass Lewis began recommending votes against the governance chairs of companies in the S&P 500 who fail to provide explicit disclosure concerning the boards' role in overseeing environmental and social risks[6].
- **ISS** made a significant change to its US proxy voting guidelines after the 2021 proxy season, adopting a "Climate Accountability" policy that applies to US-based companies that do not disclose climate risks and opportunities in line with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations and do not have quantitative greenhouse gas disclosures and targets covering a significant portion of their activities[7]. While targets for Scope 3 emissions will not be required for 2022, the policy states that "targets should cover at least a significant portion of the company's direct emissions." The policy also states that "expectations about what constitutes minimum steps to mitigate risks related to climate change will increase over time."

Snapshot of Shareholder Climate Activist Organizations' 2022 Priorities, Targets, and Tactics

Proxy voting guides published by shareholder activist organizations provide an indication of whether and how developments such as the SEC's guidance regarding the exclusion of shareholder proposals or momentum behind net-zero will appear on ballots and be reflected in voting in 2022.

Key Players Engaging in Shareholder Climate Activism

- **The Interfaith Center on Corporate Responsibility (ICCR)** – which recently turned 50 - is a coalition of over 300 global institutional investors currently representing more than $4 trillion in managed assets. ICCR members filed 103 resolutions calling for action on the climate crisis, a 91% increase over the 54 resolutions filed at this time last year. This increase in climate-related shareholder proposals likely reflects the impact of SEC guidance curtailing the exclusion of such proposals. Resolutions call for audited reports on the impact of a net-zero by 2050 scenario; disclosures related to just transition; alignment of retirement plans with climate goals; and concern about the use of carbon credits. For the 2022 proxy season, ICCR members filed nine proposals at top US banks Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, and Wells Fargo – considered the world's largest

- financiers of the fossil fuel industry – asking the banks to fulfill the recommendations issued by the UNEP FI and the IEA in their "Recommendations for Credible Net-Zero Commitments" and IEA "Net-Zero by 2050 Roadmap" reports respectively[8].
- **As You Sow** has a 30-year track record of representing investors across a broad range of ESG issue areas. So far, As You Sow has filed 9 proposals related to climate change that will appear on ballots in 2022. For instance, As You Sow filed a shareholder proposal asking Berkshire Hathaway to disclose how it intends to measure, disclose, and reduce the GHG emissions associated with its underwriting, insuring, and investment activities in line with the Paris Agreement. Another resolution urges Exxon Mobil's Board of Directors to seek audited reports assessing how the IEA's Net-Zero by 2050 pathway assumptions would affect its financial statements[9].
- **Majority Action** ran Vote No campaigns against 19 US oil and gas, electric power, and financial services companies lacking alignment with a 1.5°C scenario in 2021. As a result, 27 targeted directors saw support decrease by 4.4% on average compared to 2020 levels. In 2022, Majority Action has expanded its campaign, targeting board chairs and/or lead independent directors at 27 companies across 5 sectors - electricity generation, oil and gas, banks, insurance, and agribusiness[10].

A Test for NZAM, NZAO, and CA 100+ Signatories

On March 30, the CA 100+ released its second annual Net Zero Company Benchmark. The Benchmark is designed to assess the performance of target companies against the CA 100+ initiative's three goals of emissions reduction, governance, and disclosure. In the press release announcing the publication of the report, CA 100+ stated that "while 69% of focus companies have set commitments to achieve net-zero emissions by 2050 or sooner, overall [the] Benchmark finds companies have failed to show progress across key indicators, including disclosure of 1.5°C-aligned medium-term emissions targets and capex strategies," and that "the Benchmark sets urgent engagement priorities for $68 trillion investor-led initiative ahead of US and European proxy season."

While the CA 100+ does not explicitly identify engagement priorities for initiative supporters, it does flag shareholder proposals that it believes investors should consider during proxy season. In 2021, the CA 100+ highlighted fourteen proposals appearing on target company ballots. Six of these proposals received majority votes. As of April 1, the CA 100+ has flagged four proposals for the 2022 proxy season. These proposals include resolutions asking Berkshire Hathaway to adopt TCFD reporting, Imperial Oil to align capital expenditure with the IEA Net Zero Scenario, and Phillips 66 and Valero Energy to adopt GHG reduction targets[11].

However, as we saw in the 2021 proxy season, investors are increasingly moving from requests for additional disclosure to demands for accountability and improved board oversight of climate-related risks, by voting against directors. Majority Action's Vote No campaign is targeting several companies that are covered by the CA 100+ initiative. Emissions reductions at these companies are vital if the 1.5°C Paris goal is to remain viable. The Vote No campaigns will be a test for NZAM and NZAO signatories and the ISS climate accountability policy.

NZAM signatories commit to "implement[ing] a stewardship and engagement strategy, with **a clear escalation and voting policy,** that is consistent with our ambition for all assets under management to achieve net-zero emissions by 2050 or sooner"[12]. Similarly, NZAO signatories commit to "advocating for, and engaging on, corporate and industry action, as well as public policies, for a low-carbon transition of economic sectors in line with science and under consideration of associated social impacts"[13].

The Majority Action Vote No campaign is urging investors to vote against the board chair and/or lead independent director at the following CA 100+ companies that have not made a commitment to Net Zero by 2050: Berkshire Hathaway; NextEra Energy; Chevron; Exxon Mobile; Kinder Morgan; Marathon Petroleum; Phillips 66; Valero; and Bunge Ltd. The levels of support the board chair and/or lead independent directors receive at these companies will reveal the extent to which NZAM and NZAO supporters are willing to vote against directors at the highest emitting companies that have not committed to achieving net-zero emissions by 2050. If the vote totals supporting the re-election of these directors do not decline significantly, it is likely that NZAM and NZAO signatory voting policies will be subject to intense scrutiny.

Another factor that will influence support levels for board members at these companies is whether ISS will advise investors to vote against directors. As noted above, the ISS policy does not require US-based CA 100+ companies to have made a net-zero commitment, just targets that "cover at least a significant portion of the company's direct emissions." However, companies also must have "detailed disclosure of climate-related risks, such as according to the framework established TCFD" to avoid receiving adverse vote recommendations.

The updated CA 100+ benchmark identifies the following companies as not having fully committed to implementing the recommendations of the TCFD: Berkshire Hathaway; NextEra Energy; Exxon Mobile; Marathon Petroleum; Phillips 66; and Bunge Ltd.

A key question for investors is whether ISS will interpret a failure to commit to net-zero and only partial alignment with the recommendations of the TCFD as "taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy." If ISS recommends investors support the re-election of directors at these companies, investors and activist organizations are likely to question whether the policy adequately supports asset managers and owners that have made net-zero commitments.

Conclusion

Released on April 4, the third installment[14] of the Intergovernmental Panel on Climate Change's (IPCC) Sixth Assessment Report reiterates that immediate and drastic reductions in emissions are necessary if the world is to limit global warming to 1.5°C above pre-industrial levels. Given the urgency of action, the approach investors take towards director elections at high emitting companies and climate-related shareholder proposals during the 2022 proxy season will be closely monitored.

The results of a handful of shareholder meetings over the next few months will reveal whether investors perceive voting to uphold the status quo as a risk, or whether the regulatory changes and growth in AUM pledged to net-zero initiatives that have occurred over the last year have sufficiently incentivized investors to change their approach to stewardship and voting to reflect a commitment to the goals of the Paris Agreement.

Commenting on the IPCC report, UN Secretary-General António Guterres stated, "Some government and business leaders are saying one thing, but doing another." Proxy season is an opportunity for investors to put their commitments into action and demonstrate that the pledges that came out of Glasgow and various initiatives such as the NZAM, NZAO, and CA 100+ are more than words. Whatever the outcome, the days of investors being able to make pledges or highlight their involvement in net-zero initiatives without changing their approach to engagement and voting are likely numbered.

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