DIVERSITY OF THOUGHT: AN INTERVIEW WITH GWEN LE BERRE OF PARAMETRIC PORTFOLIO ASSOCIATES

A TRULY LONG-TERM VIEW: AN INTERVIEW WITH BRIDGET MURPHY OF WASHINGTON STATE INVESTMENT BOARD

VOTING NEWS

PROXY MONTHLY
As the year draws to a close news in the world of corporate governance may have slowed down but that doesn’t mean there weren’t some big stories.

ESG was in the headlines a lot this month. In the US it was recently revealed that the SEC is writing to investors asking them to explain how they define their ESG funds. The evidence requested included a list of the stocks investors had recommended to clients, models for judging which companies are environmentally or socially responsible, best- and worst-performing ESG investments and proxy voting records that related to how investors decided to vote on ESG issues.

Critics of ESG funds have argued that investors should only be concerned about returns and that the term ESG itself has no enforceable or common meaning. Despite this, investment in ESG funds has increased from $2.83 billion in 2015 to $17.67 billion this year through November.

Meanwhile, on the other side of the pond, the EU has become the first global regulator to agree a system for classifying sustainable financial products. The new rules will mean that any EU-listed company with more than 500 employees will have to disclose how much of its revenues and capital expenditure are based on activities that are environmentally friendly and fund managers with large amounts of assets under management will have to calculate how much of their portfolios qualify for the green standard.

The reason for this new system is that the EU wanted to stop so-called greenwashing where products can be labelled as green without any independent verification. The new deal means scientists and academics will begin drawing up criteria to define sustainable investments.

Staying with the EU and ESG theme, as world leaders gathered for COP 25 to discuss climate change a group of investors with more than $37tn in assets signed an initiative calling for an end to fossil fuel subsidies, the phasing out of thermal coal used in power generation and a “meaningful” price for carbon.

A major concern for investors is the treatment of so-called stranded assets, such as oil, coal and gas reserves, which may have to remain in the ground depending on climate legislation. A number of European countries have said they will have net zero carbon emissions by 2050 but the majority have not yet enacted policies to that effect.

This month we have two interviews. Our first is with Gwen Le Berre, Head of Responsible Investing at Parametric Portfolio Associates. In the interview, we discuss a range of topics including how Parametric will be tackling the issue of board diversity in 2020 and why more people should be concerned about cybersecurity.

Our second interview is with Bridget Murphy, Corporate Governance Officer at Washington State Investment Board. Diversity is high on their agenda as well but other topics we discuss include IPOs and the latest SEC reforms.

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nick.dawson@proxyinsight.com
Could you provide a brief overview of how Parametric Portfolio Associates approaches its proxy voting responsibilities?

Parametric is a rules-based asset manager. Our clients typically target indices, so we have a passive investment philosophy. For active ownership, that means that we are very long term focused universal owners. We consider ourselves to be permanent sources of capital and we take a fiduciary view, always looking out for the best long-term interests of our clients.

Our proxy voting guidelines are principles based and we keep these long-term concepts at heart when we formulate them. At a high level, we want the companies we invest in to have great governance and to consider their impact on the environment and on the community they operate in. A central idea is that we want to safeguard investor capital for the long run by supporting qualified, independent boards that show accountability and responsiveness to shareholders and to shareholder proposals that are prudent and relevant.

Our focus is on the election of directors because they are the shareholder representatives in the boardroom. We think that they are best positioned to help management with company strategy and mitigate all risks, including ESG risks, to achieve long-term sustainable performance. Our main focus is board quality and board composition. We find that to be pretty paramount.

What are the corporate governance issues that Parametric focused on in the 2019 proxy season?

The election of directors is where we spend a lot of time. In 2019, we voted against directors where we thought there was a lack of independence on the board, non-independent directors on key committees or when boards were not as responsive to shareholder concerns as we would like them to be.

In 2019, we saw more focus on the climate proposals. There has been much more investor support for them overall. They typically gathered around 30% investor support, which is twice as high as they were 15 years ago.

Proxy access is also an area that we have kept the pulse of. We are very supportive of the concept. We believe that it is a fundamental right that should be afforded to shareholders. While it is very rarely used (we’re still waiting for the first use case in the US), it’s a helpful accountability mechanism.

What issues does Parametric plan to concentrate on this coming proxy season?

In 2020, we are looking at several topics. One of the main ones that we’ll be focussing on is gender diversity on the board. We believe that diversity of thought leads to better decision making. We’ve seen a lot of progress in the past few years. 2019 was the first year when there is no longer an S&P 500 board that doesn’t have a woman on it. That is encouraging.

We are seeing that progress trickle down to smaller companies. Today about 23% of directors in the S&P1500 are women. That’s a two percentage point improvement in the last year. While there is a lot of progress, we’re still not where we could be or where we need to be. In 2020, Parametric is going to start voting against the chair of the nominating committee when there isn’t a single woman on the
board. We’ll be contemplating if that policy is strong enough or if we need a more stringent policy over time.

Another topic that is top of mind is ESG disclosure. Data quality is incredibly important for not just active ownership or proxy voting, but for ESG portfolio construction as well. Today, more capital is being allocated to ESG funds. There’s more scrutiny from regulators. Companies are also interested in improving their disclosures.

Unfortunately, ESG data is still not standardized, and not very comparable. The industry has been struggling with the lack of ESG data quality for years. We’ll be looking at what we can do to move the needle there.

Parametric opposed the majority of omnibus stock plans in the US this proxy season. What do you look for in an omnibus stock plan?

We want executive compensation to be strongly linked to sustained company performance. A well-designed stock plan should reward executives when stock prices rise and when shareholders and employees are also seeing the benefits. But executives should also feel the downsides of the falling stock price in their compensation.

We don’t like plans that encourage excessive risk-taking for management or incentivize them to pursue strategies that promote short term price fluctuations to the detriment of the long-term price performance. Again, we’re always invested in the stock for the long run - so making sure that executives’ incentives are appropriately aligned with shareholders is important for us.

We like to see challenging performance targets in plans that don’t overly dilute existing shareholders voting power. We don’t like when awards are overly concentrated in the hands of executives and would rather see awards more evenly distributed amongst employees. After all, a company’s performance is the result of all the employees’ hard work, not just the executives’.

That’s the number one reason why we vote against these types of plans. We find it excessive when the named executives are being awarded more than 15 percent of the total awards granted in the last fiscal year. We also vote against plans when they have a high average burn rate or when they overly dilute existing shareholders.

As pay often dominates the proxy season, are there any corporate governance issues that you feel are not receiving the attention they deserve?

There has been more scrutiny of board composition in the past few years, but board composition still needs attention. For example, we’d like to see more diversity. While there has been a lot of focus on gender diversity, we’d also like to see more diversity in other director characteristics like their expertise, industry, race, geography, culture, and age.

The 2019 PwC director survey reported that 49 percent of board members think that one or more of their colleagues should be kicked off the board. That number has been going up over the last 3 years.

Finally, cybersecurity doesn’t necessarily get the attention it should. We live in a scary time where all companies are targets. It’s hard to manage those risks. Not many people are well equipped to know how to go about managing them. Cybersecurity and data privacy are areas that directors should all be putting more effort into.

Parametric is affiliated with a number of ESG related groups. How important is this to your work?

We see these organizations as our partners. When I think about active ownership, I see three
“WHEN IT COMES TO HOW WE VOTE, WE HAVE FORMULATED OUR OWN PUBLICLY AVAILABLE GUIDELINES AND WE HAVE OUR OWN VIEWS.”

areas of focus: proxy voting, engagement, and advocacy. The ESG organizations we work with help in all these areas, but they are especially important in the advocacy area.

Parametric is a signatory to the PRI. We are also a gold sponsor of CII, and work with CERES and ICCR. They all contribute to helping us keep up with industry trends. The industry is evolving faster today than it has in the past two decades.

It also helps us connect with like-minded peers. You can think of these organizations as a way to help us leverage the collective wisdom of the markets to help us think through issues and form our own views. I was chair of the corporate governance advisory group at CII last year and I believe there was a lot of value in those closed doors candid conversations.

These organizations are also important when there is so much going on at the SEC. I think that the proposed proxy advisory regulations should raise some red flags for all investors. These organizations are lobbying the SEC and Capitol Hill on investors’ behalf to try to fight very problematic proposed regulatory developments.

You say in your voting policy that you utilize ISS. How much do you rely on their research?

ISS is one of the various proxy advisers that Parametric uses. We also use Glass Lewis and Si2 among other data sources. ISS helps us operationally get our votes to the market. The vote administration is a key service they provide.

Proxy advisors also aggregate proxy voting data, and summarize proxy statements. They really are a market solution to help with the volume that we face and to allow investors to be more focussed on companies that may have more problematic governance issues. But when it comes to how we vote, we have formulated our own publically available guidelines and we have our own views.

If you could introduce one corporate governance reform, either in the US or internationally, what would it be?

If I could introduce anything in the US, I would look into true majority voting standards. At the end of the day, investors are pretty cautious with their votes against directors. Typically, there’s only approximately 40 of directors in the US out of 30,000 that don’t get 50 percent support from shareholders. When shareholders are that concerned about a director’s performance, I don’t think boards should allow them to continue to serve.

A second corporate governance reform I want to see is universal proxy. We should also be able to use universal proxy cards for proxy contests. I’m hoping that the SEC can get us there. It should just be a fundamental right that shareholders especially in extremely controversial material situations can express their exact views.

Thank you Gwen.
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Proxy Insight
Could you provide a brief overview of how Washington State Investment Board approaches its proxy voting responsibilities?

The WSIB views proxy voting as an essential responsibility within our role as a steward of public trust funds. Since our investments range across virtually all markets and all asset classes, and yet our resources for corporate governance are necessarily limited, our proxy voting and our use of compiled information from proxy advisory service firms are vital to our ability to advocate for effective long-term value creation in the public markets.

To this end, the WSIB has worked with our Board members to identify several asset stewardship priorities: long-termism/shareholder rights; diversity of boards and management teams; and sustainability. These priorities guide our proxy voting policies and implementation.

We also assess the views and analysis from peers and valued industry organizations, such as the Council of Institutional Investors and Ceres, in analyzing specific management and shareholder resolutions so that our voting patterns align with our stated policies, especially on diversity, climate and matters related to shareholder rights.

In recent years, the Board has reiterated and strengthened its emphasis on board diversity.”

In the past two years, we have aligned our public company engagement activities with these priorities, particularly on diversity and climate. Most recently, we have allocated new resources to assessing and monitoring sustainability, in an effort to integrate workable metrics into our investment processes.

How much does your role as a state pension fund factor into the way you approach proxy voting?

As a public pension fund, we take a truly long-term view and believe the proxy voting ballot is one of the most effective tools for positively influencing companies toward greater board accountability, genuine transparency, and increased focus on long-term growth strategies.

This long-term view toward value creation is core to WSIB’s mission of maximizing return at prudent levels of risk for the exclusive benefit of our beneficiaries.

In recent years, the Board has reiterated and strengthened its emphasis on board diversity, and we have built out our proxy voting and engagement activities accordingly. Our view is that better diversification of boards will ultimately translate into better governance, better oversight, and greater insight at the companies where we derive value.

With the withdrawal of WeWork’s IPO earlier this year do you think that institutional investors are more willing to say no to tech companies’ poor corporate governance?

The WSIB does not have capital invested in WeWork specifically, but it will be interesting to
see whether this company’s experience creates any sort of tipping point for governance practices more broadly. We have seen numerous examples of technology companies and others attempting to dampen or defeat shareholder rights through multi-class share structures. We are working with several organizations such as the Council of Institutional Investors to improve and protect the ability of investors to have a constructive voice in the corporate governance process.

The WSIB has a sizeable allocation to private markets, and in that context, we feel we have an ongoing responsibility to work directly and closely with our general partners to assess the governance structures of these investments before, during and after IPO.

What do you think of the SEC’s proposed reforms to proxy adviser regulation?

On balance, the latest SEC proposal has the potential to create harmful confusion and exacerbate the divisions between investors and companies. The WSIB plans to draft another letter to the SEC in order to summarize its concerns about the current draft of this proposal.

Our primary concern is that the proposed changes are not based on tangible data, and an overstep or a misstep by regulators can easily result in harmful constraints on a proxy voting system that is largely effective for both investors and companies.

When handled effectively, these measures help both companies and investors, and this mutual benefit should be the overriding objective. We would hope that any new set of requirements will take into account the reasonable needs of companies but without creating any chilling effect on the need for shareholders to raise vital issues and ideas.

If you could introduce one corporate governance reform, either in the US or internationally, what would it be?

It makes sense to consider a “cease and desist” order or another strict limitation on new listings with dual (or multi) class share structures until sunset provisions for such structures are in place. Otherwise, we are at risk of grandfathering in long-term changes to how ownership works in public markets without understanding and addressing long-term implications.

Thank you Bridget.

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Many important ESG reforms have come from the shareholder proposal process, especially in the U.S. market.”

While periodic refinements in the rules are helpful, we believe that such changes must not create a threat to the independence of proxy advisory research and must not undermine competition within the proxy advisory industry.

Another reform that the SEC is currently pushing for is stricter requirements for shareholder proposals. What are your thoughts on this?

The rules for shareholder proposals must balance the need for productive shareholder input with the need for an expedient input management process. Many important ESG reforms have come from the shareholder proposal process, especially in the U.S. market, such as a move toward majority voting standards, enhanced disclosure of corporate/political spending, and improved climate-related disclosures, as well as the separation of chair and CEO roles.

If you could introduce one corporate governance reform, either in the US or internationally, what would it be?
TSB executives pay the price for missing gender targets

Executives of UK bank TSB will miss out on a portion of their bonuses after failing to meet gender diversity targets. The bank scrapped plans to achieve near-gender parity in its senior ranks by 2020 as it was not expected to succeed.

TSB had intended to ensure its leadership was 45-55% female by next year, a pledge originally made three years ago. However, an internal review recently found that the bank’s progress had not been sufficient to meet the target before the deadline. In fact, the number of women in senior roles at TSB has fallen since 2017, from 41% to 38%. This is despite the appointment of Debbie Crosbie as the bank’s first female CEO earlier this year. As a result, the bank decided to scrap the 2020 target and set a new goal to achieve this level of gender diversity by 2025.

The target was one of the metrics used to set performance pay for this year, meaning executives as well as managers will miss out on a portion of their bonuses as a result. Officially, Catherine Douglas, director of SME banking, is in charge of gender diversity and inclusion at TSB but the pay packets of all executives will be impacted.

CalPERS reports one-fifth of public holdings at risk from climate change

In its first climate-risk disclosure report, CalPERS has said that roughly one-fifth of its public holdings could potentially face losses as a result of climate change.

The report stated that by having around 8% of its holdings in the energy sector, the pension fund manager could be at a loss, as “policy, market and technology changes may result in the loss of value and/or “stranding” of long-lived and carbon intense energy assets in our portfolio.” CalPERS also has around 6% of holdings in materials and building, and 3% in agricultural industries, which could also lose value as a result of rising sea levels induced by climate change.

The climate risk disclosure report is demonstrative of CalPERS using its holdings to pressure large polluters into reducing their carbon dioxide emissions, the main contributor to the rising global temperature.

However, as suggested in the report, this may not be enough to mitigate the effect carbon dioxide emissions are having on climate change. Just CalPERS’ global equity holdings resulted in at least 23.5 million tons of these emissions being released. As a result, the pension fund manager has joined other insurers and pensions funds in the pledge to make their portfolios carbon neutral by 2050.

Fiery AGM for Westpac

Australian banking giant Westpac endured a difficult AGM as investors took the company to task over a recent money laundering scandal. The bank received a second strike and suffered revolts against two of its directors.

35.9% of investors opposed the remuneration report, though this was a marked improvement from last year when about the same proportion voted in favor. Still, it was enough to land the company with a second strike and trigger a vote on whether to spill the board, which was supported by around 9% of shareholders.

Investors also rebuked directors Peter Marriott and Nerida Caesar. Caesar received 25.1% opposition, while Marriott was opposed by just over 42% of voted shares. ISS had recommended against both of these directors, with Glass Lewis agreeing when it came to Marriott due to his role as head of the audit committee.

Saudi Aramco labelled “polarizing” due to governance concerns

Oil colossus Saudi Aramco enjoyed the biggest ever IPO as trading in its shares commenced, but not all
“A PROPOSAL TO AWARD SHARES TO PLAYTECH’S CEO, MOR WEIZER, WAS OPPOSED BY 45% OF SHAREHOLDERS.”

investors are impressed. One analyst from investment bank Raymond James labelled the stock “polarizing” due to controversial governance.

Pavel Molchanov’s concerns largely revolve around the Saudi royal family’s tight control of the company. “It does not matter what independent investors or independent board members think, frankly,” Molchanov said, speaking to CNBC. The company is “98% owned by the Saudi government,” he said, so the “royal family calls all the shots.”

Corporate governance has been a recurring concern around Saudi Aramco’s IPO. In 2017, the company looked set for an overseas listing rather than an offering in Saudi Arabia. Critics accused international exchanges of lowering their governance standards in a bid to attract the mega-IPO. The London Stock Exchange, in particular, talked of creating a special listing class with more flexible governance standards for state-owned companies, which was widely interpreted as a bid to court Saudi Aramco.

Government review recommends changes to the audit industry

A UK government commissioned review of the audit industry conducted by Donald Brydon, the former chairman of the London Stock Exchange has made a number of recommendations including separating auditing from accountancy and redefining its purpose.

The report suggests auditors should be given a specific license to operate and separated out from accountants. It also recommends that the new regulator proposed by the earlier Kingman report, ARGA, should be responsible for training and certification.

The report also calls for a wider definition of a company audit. Rather than focusing on financial statements the report says auditors should “help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report.”

Playtech’s LTIP proposal скrapes through

A proposal to award shares to Playtech’s CEO, Mor Weizer, was opposed by 45% of shareholders at its EGM. The plan could award Mr Weizer up to £30 million. The gambling company has had problems with remuneration in the past, at the company’s AGM earlier this year its remuneration report and remuneration policy received 58% and 59% support respectively.

ISS and Glass Lewis had both opposed the proposal. Glass Lewis said “We have strong reservations regarding the terms of the award, whereby the CEO may be eligible for extremely large payouts based solely on share price performance, which may primarily reflect market forces rather than company or management performance.”

While ISS said “It is in fact quite indicative of the poor remuneration governance at the board that six months after putting forward a remuneration policy proposal, the company is seeking to make a one-off arrangement outside the existing framework.”

Fergal Sarsfield of Setanta Asset Management, Playtech’s largest shareholder, said “We are pleased that this long-term incentive package has been approved. Alignment of interest between management and shareholders is something we encourage and value highly. Importantly the package is designed to reward only exceptional long-term performance and the high performance hurdles are representative of the confidence management and shareholders have in the long-term growth potential of Playtech.”

ANZ & NAB avoid strikes on their remuneration reports

After both receiving strikes last year Australia and New Zealand Bank and National Australia Bank have successfully avoided further revolts this year with the remuneration report proposals passing by 89.9% and 97.0% respectively. Last year 88% of shareholders voted against NAB’s remuneration report and 34% were against ANZ’s.

Following the revolts both banks made sweeping changes to their remuneration plans, including slashing or deferring executive bonuses. Former head of ANZ NZ David Hisco gave up $7.4 million in shares and the other executives received 45% of their maximum bonus on average.

Meanwhile at NAB, the firm cancelled the bonuses of its entire executive team in 2019, stopped the payment of dividends on invested incentives and cancelled as much as $21 million worth of bonuses for its former CEO Andrew Thorburn. ISS and Glass Lewis had both announced their support for the remuneration reports and opposition to the spill resolution prior to the meetings.