

EY Center for Board Matters What boards should know about ESG developments in the 2021 proxy season

Efforts to advance corporate progress on environmental, social and governance (ESG) matters continued to gather momentum and generate the biggest headlines in the 2021 proxy season.

These efforts were bolstered by constructive company-investor engagements, record levels of support for environmental and social shareholder proposals, governmental actions on climate and social-related matters, and regulatory developments on ESG reporting.

Investors are growing more urgent in their demands that companies address ESG risks and opportunities – and demonstrating more willingness to use their votes to accelerate progress. Companies are responding. This year saw a significant uptick in companies using their proxy statements to clarify how environmental and social matters are addressed and highlight new climate ambitions and commitments related to diversity, equity and inclusion. More companies are also aligning executive pay with ESG objectives.

These developments reflect increasing conviction among companies and their stakeholders that integrating ESG into strategy, risk management, human capital initiatives and governance – and communicating ESG performance – is a business imperative.

To help boards keep pace with evolving investor and regulatory expectations and ESG disclosures in proxies, this report examines five ESG developments from the 2021 season and offers key takeaways and questions for boards to consider.¹

¹ Vote results and shareholder proposal data for 2021 are as available for meetings through June. Proxy disclosure data is based on the 79 companies on the 2021 Fortune 100 list that filed proxy statements as of June 22. All other data is full year and based on the Russell 3000 index unless otherwise specified.

In brief

- ▶ Unprecedented support for environmental and social shareholder proposals shows that investors are willing to vote against management to speed progress.
- ▶ Companies are responding to investor interest by enhancing proxy disclosures around ESG governance and highlighting key ESG ambitions and commitments.
- ▶ Regulatory developments, including the SEC's expected rulemaking on climate risk disclosure, are shaping company reporting and investor expectations on ESG.

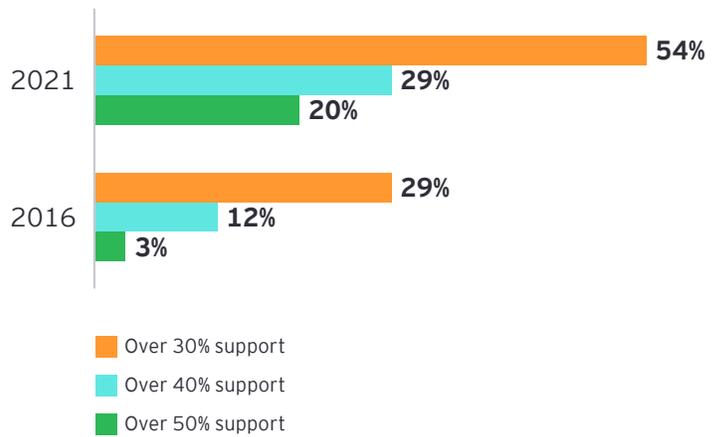
1 Investors showed record support for environmental and social shareholder proposals

The 2021 proxy season has seen record levels of support for shareholder proposals on environmental and social topics in ways that clearly signal to directors the importance of this strategic issue. For meetings through June 30, 20% of environmental and social shareholder proposals that went to a vote received greater than 50% support. That's up from 12% last year and just 3% five years ago. It is worth noting that at 50% support, many investors consider voting against incumbent directors the following year if the company is deemed to have taken insufficient action to address the proposal.

While the substantial increase in support may have surpassed expectations, it was not a surprise given that some investors had indicated an increased willingness to vote in favor of shareholder proposals. Most prominently, heading into proxy season BlackRock announced that it may support a proposal if management is "on track," but BlackRock believes that voting in favor might accelerate progress. BlackRock further stated it would be more likely to support a shareholder proposal without waiting to assess the effectiveness of engagement "given the need for urgent action on many business-relevant sustainability issues."² Vanguard also signaled the potential for increased support, saying it would still consider the proposals on a case-by-case basis and that it would be likely to support proposals that are disclosure-oriented and support reasonable enhancements to company practices.³

“Some investors had indicated an increased willingness to vote in favor of shareholder proposals.

Support for environmental and social shareholder proposals by threshold



Source: Analysis by EY Center for Board Matters

Environmental and social shareholder proposal topics securing majority support this year

- ▶ Diversity, equity and inclusion
- ▶ Climate-related matters, including greenhouse gas emissions and deforestation
- ▶ Corporate political spending and lobbying activities, including climate lobbying
- ▶ Human rights and labor practices
- ▶ Plastic pollution

Source: Analysis by EY Center for Board Matters

² "Our 2021 Stewardship Expectations," BlackRock website, December, 2020.

³ "Summary of the proxy voting policy for US portfolio companies," Vanguard, April 1, 2021.

Some of the top environmental and social proposal topics in the spotlight this year include:

Diversity, equity and inclusion (DEI) – Following a year of profound economic and social upheaval and a renewed national focus on racial justice, both the volume and support of shareholder proposals on DEI matters increased substantially. Around 130 proposals related to DEI topics were submitted for meetings through June. Most of the proposals were withdrawn; the proposals that went to a vote averaged 42% support, and 31% of the proposals voted received majority support. This compares to around 90 proposals for all of 2020, which averaged 25% support and of which 18% secured majority support.

The most prominent DEI-related proposals address increasing board diversity, executive diversity or both, which averaged 59% support, or asked companies to report data aligned to the disclosure framework of the US Equal Employment Opportunity Commission's EEO-1 Survey (EEO-1 data), which averaged 70% support. For each of these proposal types, most of the proposals were withdrawn, generally because



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companies and proponents found common ground and reached an agreement, and 67% of the proposals voted on received majority support. Additional prominent DEI proposal topics included those asking companies to publish a report assessing the effectiveness of their DEI programs as well as related to the impact of company business practices, products and services on communities of color and racial justice.

Climate – With science indicating that the world must get to net-zero emissions by 2050 to avoid a climate catastrophe, there is growing urgency around combatting the climate crisis that is reflected in this year's shareholder proposal landscape. Around 70 shareholder proposals addressing climate risk and opportunities were submitted for meetings through June. Most of the proposals were withdrawn; the proposals that went to a vote averaged 51% support, and 41% of the proposals voted received majority support. This compares with around 60 proposals in 2020, which averaged 40% support and of which 33% received majority support.

While the proposals have different variations and nuances, the most prevalent proposals relate to how companies plan to reduce their greenhouse gas (GHG) emissions to align with the Paris Agreement's goal of limiting global temperature increases to 1.5 degrees Celsius. Most of these proposals were withdrawn, with those going to a vote averaging 55% support and with 57% of voted proposals receiving majority support. Other prominent climate-related proposal topics relate to how companies are managing physical and transitional climate-related risks and opportunities.

Say on climate proposals

A new, closely-watched proposal this year sought a shareholder advisory vote on companies' climate strategies and progress, similar to the now mandated say on pay vote. We are hearing mixed perspectives from investors on the initiative, with some viewing a 'say on climate' vote as an effective tool for holding companies to account on their decarbonization plans and others raising concerns that the votes could provide a rubber-stamp for inadequate climate strategies and take the focus away from director accountability. The EY Center for Board Matters tracked seven of these proposals, which averaged 29% support and none securing majority support. Proponents plan to file many more of these proposals for 2022.⁴

⁴ "2021 proxy preview," As You Sow website, March 19, 2021.



Political and lobbying spending – In the wake of developments around the 2020 US election season, including some lawmakers’ challenges to the results of the presidential election, the attack on the US Capitol and efforts to pass more restrictive voting laws, investors are paying renewed attention to corporate political and lobbying spending and the related risks to companies. While the number of proposals submitted on this topic has dropped from approximately 90 in 2020 to around 80 this year, average support for the proposals has grown from 36% last year to 44% so far in 2021. Around a third (32%) of this year’s voted proposals received majority support, up from just 11% last year.

Whether focused on political spending or lobbying, the proposals generally call for board oversight and disclosure of direct and indirect corporate expenditures in these areas. Proponents are often focused on indirect spending through trade associations and social welfare organizations and how expenditures align with the company’s policies and values related to environmental and social issues.

A notable subset is explicitly focused on climate lobbying and has averaged 59% support, with 71% of the voted proposals receiving majority support. The proposals highlight the proponents’ view that lobbying activities that are inconsistent with meeting the goals of the Paris Agreement raise reputational risks and that companies can play a constructive role in enabling policymakers to take action.

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Investors are paying renewed attention to corporate political and lobbying spending and the related risks to companies.

Key board takeaway

Investors are growing more urgent in their demands that companies address business-relevant environmental and social risks and opportunities. Record-setting support for environmental and social shareholder proposals demonstrates the increasing willingness of investors to use their proxy votes to hold companies and individual directors to account on ESG matters. As investors grow more willing to vote against management to push accelerated progress, engagement becomes more crucial to understanding investor expectations and voting rationales. Boards can:

- ▶ Ask how shareholder engagement is helping the company understand investor expectations and interpret and respond to voting results.
- ▶ Review how the company’s response to shareholder proposal submissions aligns with its ESG ambitions.

2 More companies clarified how environmental and social matters are governed

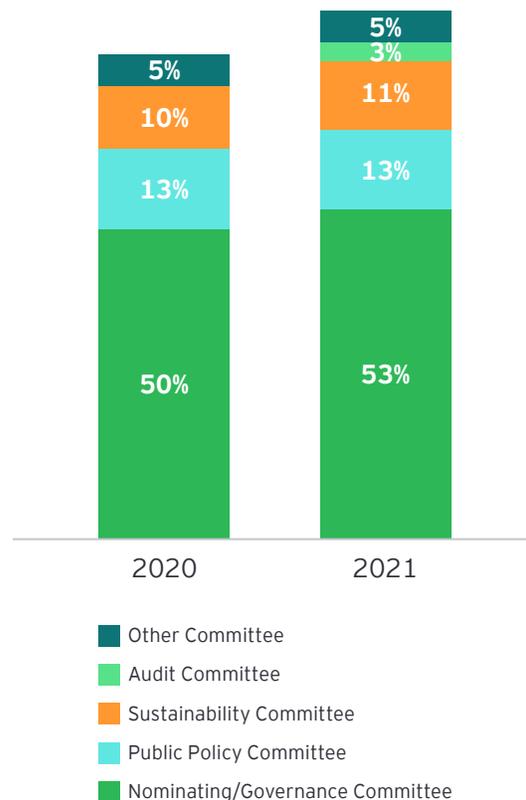
In response to heightened interest from key stakeholders, this year, more Fortune 100 companies used their proxy statements to clarify how environmental and social matters are governed and highlight related changes, such as expanded committee mandates to address ESG oversight needs, key executive appointments such as chief sustainability or diversity officers, and new management-level ESG steering committees.

Key proxy disclosure trends the EY Center for Board Matters has identified for 2021 include more companies disclosing oversight of environmental and social matters by board committees and providing insights into management-level ESG structures and reporting to the board.

Nominating and governance committees are usually charged with sustainability matters

This year 85% of Fortune 100 companies disclosed that a committee of the board oversees environmental sustainability or corporate social responsibility matters, up from 78%. The majority (53%) of boards have charged the nominating and governance committee with related oversight responsibilities, though some stress that the full board is also actively overseeing sustainability risks and opportunities. Companies describe related oversight responsibilities in different ways, commonly using terms such as sustainability, corporate social responsibility, ESG, or environmental, social and community initiatives.

Committee oversight of environmental sustainability or corporate social responsibility matters (% Fortune 100)



Source: Analysis by EY Center for Board Matters



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A majority of compensation committees are now charged with human capital matters

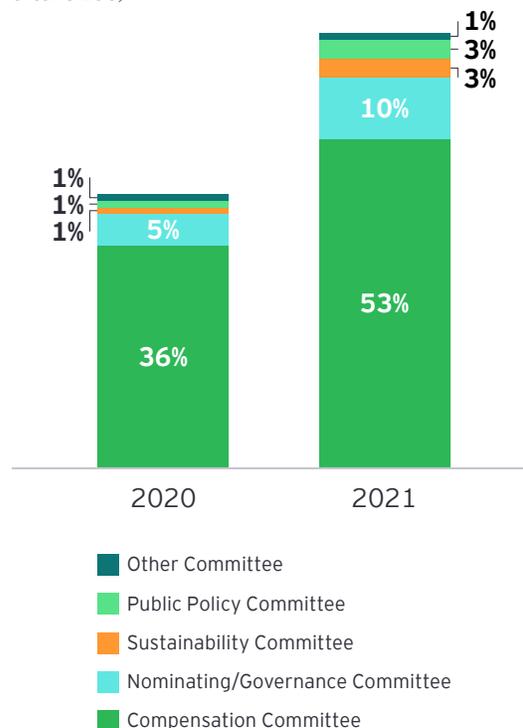
This year 70% of Fortune 100 companies stated that diversity and inclusion or other human capital matters are overseen by a committee of the board, up from 44%. Compensation committees have emerged as the preferred oversight structure, with 53% of Fortune 100 company boards now assigning it certain human capital oversight responsibilities. How these human capital oversight responsibilities are described and what they include vary, but nearly all of the relevant committees (93%) state that oversight includes diversity and inclusion.

Companies highlighted management level ESG structures and reporting to the board

A majority (59%) of Fortune 100 companies used the proxy to provide insights into management-level structures for sustainability, DEI or both. These disclosures generally outlined the executive roles and functions that lead sustainability or DEI efforts and their reporting structure, often highlighting newly established senior-level positions or teams dedicated to these priorities. One commonly highlighted management structure is a cross-functional leadership council or steering committee, comprised of senior leaders and subject matter experts, which guides company strategy related to sustainability or DEI and drives related performance.

Around half of Fortune 100 companies also provided insights into how management is reporting to the board on environmental and social topics. The specificity of these disclosures varied, with many companies stating that the board or a committee receives regular or periodic updates from management on the topic at hand and others providing more detail. Notably, 10% of companies disclosed the point person or function reporting to the board and said that such

Committee oversight of workforce diversity or other human capital matters (% Fortune 100)



Source: Analysis by EY Center for Board Matters

reporting occurs at least annually. For example, the company's DEI Council reports quarterly to the compensation committee on the company's progress against its DEI commitments, or the Chief Governance Officer or Vice President of Environment and Sustainability meets with the corporate governance committee quarterly to discuss the company's sustainability objectives.

Key board takeaway

Investors want to understand how boards are governing environmental and social practices and impacts and integrating relevant considerations into strategy and risk oversight. In response, most Fortune 100 boards are assigning related responsibilities to board committees and companies are enhancing their disclosures. Boards can:

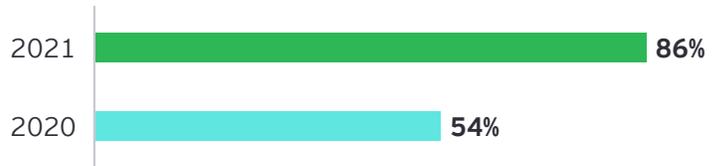
- ▶ Assess whether the proxy statement and the board's governing documents make clear how the board is overseeing ESG matters.
- ▶ Consider whether providing more information regarding how management is reporting to the board

on these issues and how the board is obtaining an external perspective beyond management could build investor confidence in the board's oversight.

3 More companies disclosed the board's racial/ethnic diversity

With DEI in the spotlight, disclosures regarding the racial and ethnic diversity of boards have become standard practice across the Fortune 100. In 2021 the companies voluntarily disclosing the board's racial/ethnic diversity climbed to 86%, up from 54%. Whether racial/ethnic diversity is advancing in Fortune 100 boardrooms is less clear. Among the companies disclosing the board's racial/ethnic diversity, that level of diversity averaged 25% this year, in line with 24% in 2020.

Companies that disclosed the board's racial/ethnic diversity (% Fortune 100)



Source: Analysis by EY Center for Board Matters

Fortune 100 board diversity statistics

Average gender diversity



Average racial/ethnic diversity*



Average overall diversity*



*Based on the companies that disclosed the board's racial/ethnic diversity and/or overall diversity across gender, race or ethnicity. Source: Analysis by EY Center for Board Matters

How companies make these voluntary disclosures varies. The most common approach is to disclose the racial/ethnic diversity at the board level, often alongside disclosures related to the board's gender diversity and its overall combined diversity across gender, race and ethnicity. These disclosures are usually made in graphic form using pie charts or other visual representations, such as those used here to reflect Fortune 100 board diversity statistics. Some disclose the specific demographics represented on the board, but most do not provide that level of detail. Twenty-nine percent disclose racial/ethnic diversity at the individual director level, often

marking directors as racially diverse as part of a matrix. Only 15% identify the specific race or ethnicity of individual directors. A few companies also disclosed other categories of diversity. The most common of these were directors born or currently living outside of the US and veteran or LGBTQ status.

These expanded disclosures address growing stakeholder pressure for companies to prioritize board diversity, enhance board effectiveness and set the tone at the top for corporate DEI commitments. Board diversity was among the top engagement priorities investors shared with us this year.



Institutional investors are now starting to incorporate related disclosure expectations and diversity thresholds into their proxy voting policies. At the same time, state legislatures like California have enacted requirements related to board diversity. Nasdaq has proposed new listing rules regarding board diversity, and the SEC's current regulatory agenda includes rulemaking related to board diversity disclosures.

These disclosures likely will continue to evolve and be shaped by investor preference, peer and leading practices, directors' willingness to self-identify and their comfort levels related to the specificity of the disclosures, as well as regulatory developments.

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Board diversity was among the top engagement priorities investors shared with us this year. Institutional investors are now starting to incorporate related disclosure expectations and diversity thresholds into their proxy voting policies.

Key board takeaway

The pressure on boards to diversify continues to grow, and voluntarily disclosing the board's racial and ethnic diversity has become the norm across the Fortune 100. As investors seek to hold companies to account for progress, companies that do not disclose their boards' racial and ethnic composition may face director opposition votes. Boards can:

- ▶ Challenge how board recruitment practices and succession planning enhance board diversity.
- ▶ Communicate both the board's current demographics and the steps it is taking to advance diversity in the boardroom.

4 More companies highlighted climate goals and reporting commitments around workforce diversity

Climate risk and DEI are among the top investor stewardship priorities for 2021, based on our conversations with more than 60 institutional investors in the fall of 2020. Around two-thirds of those investors told us they are asking their portfolio companies for robust diversity disclosures inclusive of the workforce and boards, calling DEI central to a company's ability to innovate and embrace change. Additionally, around two-thirds of investors said they are calling for corporate action and disclosures on climate change, citing the urgency to fundamentally reorganize the economy over the next decade to avoid the most catastrophic outcomes.

This year's proxy disclosures demonstrated that companies are paying attention, taking action and using the proxy to highlight related efforts for their investor audience.

Companies highlighted new climate ambitions

Nearly 80% of Fortune 100 companies disclosed in their proxy statement initiatives or commitments related to climate risk, with half of those disclosing climate-related key performance indicators such as GHG emissions or intensity reductions and attaining carbon neutrality goals. A majority (57%) of companies this year also disclosed greenhouse gas reduction goals in the proxy, up from 35% last year. Notably, one-third of Fortune 100 companies highlighted goals or ambitions to achieve carbon neutrality or net-zero greenhouse gas emissions by 2050 or sooner, in line with the goal of the Paris Agreement. Just 8 percent highlighted such goals in their 2020 proxy statements.

Companies committed to increased transparency around workforce diversity

Just over 90% of Fortune 100 companies disclosed in their proxy statements initiatives or commitments related to workforce diversity, up from 61% last year. Nearly 40% disclosed related performance metrics such as diverse representation in leadership, and 23% disclosed specific goals related to advancing workforce diversity. Particularly noteworthy this year is that 48% either disclosed their commitment to publish

Companies highlighting ESG initiatives, performance and goals in the proxy statement (% Fortune 100)

	2021	2020
Climate risk		
Disclosed initiatives or commitments related to climate risk	78%	67%
Disclosed climate-related metrics	42%	37%
Disclosed GHG emissions reduction goals	57%	35%
Workforce diversity		
Disclosed initiatives or commitments related to workforce diversity	91%	61%
Disclosed workforce diversity metrics	39%	29%
Disclosed workforce diversity goals	23%	10%

Source: Analysis by EY Center for Board Matters

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or said they already publicly report EEO-1 aligned data. Among the investors we spoke with last fall who are engaging companies on workforce diversity matters, most said they want disclosure of EEO-1 data at a minimum to help ensure comparability.

Proxy statements are not the primary vehicle for communicating environmental goals and performance. Publishing a sustainability report has become standard practice for large

companies, and last year the SEC introduced new requirements for registrants to provide disclosures about human capital in their 10-K filings.⁵ Notably, nearly 90% of Fortune 100 companies cited in their proxy various current or upcoming ESG-related reports and sections of the company website where investors could find more information. Therefore, this

report's data may understate, for example, the number of Fortune 100 companies making net-zero commitments or committing to disclose their EEO-1 data. This report's findings show that many companies are voluntarily highlighting their ESG efforts, performance and goals in the proxy statement to address critical areas of investor interest.

Growing focus on integrating ESG into executive pay

As companies prioritize the development and communication of ESG strategies, boards and particularly compensation committees are weighing whether and how to align key ESG goals to executive pay to incentivize management. Our review found that two-thirds of the Fortune 100 either currently incorporate ESG considerations into the executive compensation program or have made changes to do so in the coming year, up from about a half last year.

Workforce diversity was the most cited ESG pay consideration. A majority (52%) of companies disclosed diversity-related considerations in incentive pay decisions, such as diverse leadership representation, diversity metrics across the workforce, supplier spend with diverse firms, support for racial equity and inclusion in the communities in which the company operates, and Black employees' engagement scores. Only 20% of companies specifically cited climate-related considerations related to incentive pay, including factors such as GHG emissions or intensity reduction, pursuing science-based targets for carbon reduction, investing in low-carbon technologies and increasing renewable energy use.

Other companies more generally reported that the company is currently or will in the future consider ESG or corporate responsibility in incentive pay decisions, which may include diversity and inclusion, climate-related and other environmental factors. An additional handful of companies (4%) disclosed that the compensation committee is actively exploring the feasibility of integrating ESG into the executive pay program.

How companies are incorporating ESG into executive pay is taking different forms. Some common approaches we're seeing are incorporating ESG factors into strategic and leadership pay goals, assigning a weighting to ESG factors in annual incentive plans, or using an ESG pay modifier. Our review found that only 5% of companies disclosed ESG metrics used to determine pay.

Amid the trend toward integrating ESG into executive compensation decisions, some are urging caution, noting that pay goals can lead to unintended consequences and that the right metrics may be challenging to define and assess. ESG measures should be sufficiently specific and relevant to the company's overall strategy. Robust processes and controls must serve as a foundation to help ensure that ESG metrics are reliable.

Key board takeaway

Many investors view the integration of material ESG opportunities and risk into strategy as among the biggest drivers of strategic success in the current business environment and prioritize related matters such as climate risk and DEI in their stewardship. Communicating relevant environmental and social performance and goals in the proxy statement and other channels may help highlight for investors the company's related achievements and strategic objectives as well as related board oversight.

- ▶ Consider how corporate reporting in the proxy statement and other channels addresses investor requests for enhanced ESG disclosures and commitments.
- ▶ Consider whether the proxy is appropriately reflective of the board's oversight of ESG practices, strategic objectives and risk management, as well as alignment with compensation practices.

⁵ "How do you value your social and human capital?" *ey.com*, March 18, 2021.

5 SEC signaled a heightened focus on climate change and ESG disclosures

The SEC is actively considering new regulatory initiatives on ESG and is expected to take action on rules that would require disclosures of climate change and other ESG matters. The SEC's semiannual regulatory agenda, published in June 2021, lists short- and long-term regulatory actions it plans to take, including rulemaking about disclosures related to climate change and other ESG topics such as board diversity and human capital.

SEC Chair Gary Gensler noted in testimony before a House subcommittee and reiterated in a recent speech that he has requested that the SEC staff make recommendations on proposed rules regarding disclosures about climate risks and human capital. He expects this to be an initial step in the SEC's broader efforts to update the disclosure regime.

These developments continue the SEC's enhanced focus on climate change and ESG that was initiated under Commissioner and former Acting SEC Chair Allison Lee. Among a number of ESG-related directives and appointments, Commissioner Lee requested public comment on how the SEC can best regulate climate change disclosures. The SEC has received more than 500 letters in response. While the comment letters include diverse perspectives, frequent areas of focus include:

- ▶ Whether there should be a global set of ESG disclosure standards,
- ▶ The use of existing frameworks to leverage in developing disclosure requirements,
- ▶ Implications for securities liability depending on whether the required disclosures are furnished or filed, and
- ▶ The placement, timing and transition of required disclosures.

As the SEC considers climate risk and other ESG-related rulemaking, global efforts to harmonize sustainability reporting continue to accelerate. The proposed International Financial Reporting Standards (IFRS) Foundation's International Sustainability Standards Board (ISSB) is expected to launch in November. Building on existing frameworks by major standard-setters such as the Sustainability Accounting Standards Board (SASB)⁶ and the Global Reporting Initiative (GRI), the ISSB will be tasked with developing and maintaining global sustainability-related financial reporting standards that are relevant to enterprise value.

Regional ESG regulatory efforts around the globe also continue to unfold. Notably, the EU proposed in April a new Corporate Sustainability Reporting Directive that proposes to mandate ESG disclosure and require limited assurance of sustainability information. The EU also is developing a specific taxonomy and action plan for sustainable finance. The extent of the impact of these initiatives on companies based in the US is not yet known.

These developments will continue to drive change in company ESG disclosures and investor stewardship priorities and expectations.

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⁶ In November 2020, the International Integrated Reporting Council and the Sustainability Accounting Standards Board announced their intention to merge into the Value Reporting Foundation, which was officially formed in June 2021.



Key board takeaway

The SEC is expected to take action on rules that would require expanded disclosures related to climate change and other ESG matters. It also is expected that a newly created ISSB will begin to introduce a minimum global framework for sustainability-related financial reporting standards, with climate indicated as a priority. Many companies are preparing for future sustainability disclosures and committing to transparency and accountability before they are mandated. Boards can:

- ▶ Ask how the company is seizing the opportunity to prepare for future ESG disclosure requirements, including putting robust processes and controls in place with a supporting audit trail.
- ▶ Ask how the company's ESG reporting aligns to external frameworks such as SASB and GRI.
- ▶ Confirm that the board is getting the information it needs to understand the private market and regulatory initiatives related to ESG.

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It also is expected that a newly created ISSB will begin to introduce a minimum global framework for sustainability-related financial reporting standards, with climate indicated as a priority.

Going forward

ESG developments continue to accelerate as the urgency around sustainability risks grows, global regulators step up the pace, and stakeholder pressure increases. For their part, companies are increasing the breadth and detail of their ESG-related reporting to provide an accurate and comprehensive narrative about their response to sustainability-related risks and opportunities. Boards have an opportunity and a responsibility to help shape company strategy development, risk management and communications accordingly. A key part of the board's work should be building and bolstering director competency around company-specific ESG matters, keeping up with investor and market expectations and regulatory developments, and understanding evolving leading practices.

Questions for the board to consider

- ▶ How is the shareholder engagement program helping the company understand investor expectations and interpret and respond to voting results? Are board members directly involved in those conversations?
- ▶ How is the board keeping pace with regulatory and market developments related to ESG?
- ▶ Is the company's ESG reporting designed to meet regulatory expectations and aligned with leading external frameworks and underpinned by robust disclosure processes and controls?
- ▶ How are ESG oversight responsibilities allocated among the full board and key committees? How does the board ensure appropriate coverage and avoid either duplication of effort or gaps in oversight?
- ▶ Does the company's proxy statement and governing documents make clear how the board is overseeing ESG?
- ▶ How has the board in its oversight considered the ESG expectations and stewardship priorities of key investors as well as the views of proxy advisory firms and ESG ratings providers?
- ▶ What steps is the board taking to advance its diversity? How is it communicating those efforts and the board's current diversity to investors?
- ▶ Are there opportunities to efficiently highlight key ESG performance metrics and goals in the proxy statement and direct investors to more comprehensive information?
- ▶ Are executive pay practices aligned with key strategic ESG objectives?

Summary

Stakeholder demands related to topics like climate risk, diversity, equity and inclusion, and corporate political accountability are growing in urgency, and many companies are taking related action. This report identifies key ESG developments coming out of the 2021 proxy season to help boards understand and respond to changing investor expectations, proxy voting and disclosure trends and regulatory developments.

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