RBC BlueBay Asset Management

What is the road ahead for shareholder proposals?

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Responsible Investment team

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> "U.S. companies have seen substantial growth in the number of environmental and social (E&S) SHPs on their ballots."

Will the potential for greater costs and declining investor support lead to a drop in shareholder proposals at U.S. companies?

When thinking about proxy voting, headline-grabbing topics like artificial intelligence, climate change, and union relations may not be the first things that come to mind. But ESG[1] topics like these are the subject of an increasing number of shareholder proposals (SHPs) each year. While U.S. companies are including a growing number of shareholder proposals on the agendas at their annual general meetings (AGMs), the abundance and topical nature of these SHPs may lead to a bumpy road ahead for their proponents, and the companies and investors involved.

Traffic jam

In the aftermath of the U.S. Securities and Exchange Commission (SEC) relaxing its rules around no-action letters in 2021 (see below), U.S. companies have seen substantial growth in the number of environmental and social (E&S) SHPs on their ballots. According to research by ISS, 625 E&S-related proposals were submitted at Russell 3000 Index companies in 2023, up from 450 in 2020[2]. Of these proposals, 356 went to a vote in 2023, up from around 200 in 2020[3]. This marked the second consecutive year that E&S-related SHPs on the ballot had been at a record high.

SEC no-action letters

Since the issuance of the first no-action letter in 1976, no-action relief under SEC Rule 14a-8 has allowed companies to exclude SHPs from the annual proxy with SEC staff approval.

A Staff Legal Bulletin issued by the SEC in November 2021 outlined a change of approach. Less weight would be given to the argument that the SHPs were seeking to micromanage the company, and social policy issues would no longer be assessed purely on how they related to the company at hand.

1 The term Environmental, social and governance (ESG) refers to a set of aspects, environmental, social and governance related, that may be considered in investment. Environmental factors refer to how the company interacts with the environment, and vice versa. Examples include climate change and natural resource management. Social factors refer to how the company interacts with its employees, customers, and communities. Examples include labour practices and community relations. Governance factors refer to how the company governs itself. Examples include board structure and independence, and bribery and corruption. This refers to ESG integration/analysis and relates to equity holdings. Certain asset types, such as cash or cash equivalents, do not integrate ESG factors.

2 Institutional Shareholder Services, 2023 Proxy Season Review United States – Environmental & Social Issues, Kathy Belyeu, Michael Ellis, Enver Fitch, and Hailey Knowles.

3 Not all SHPs filed necessarily end up on the voting ballot. SHPs can be withdrawn by proponents via engagement or by the company through SEC review, for instance.

But an interesting paradox has emerged amidst this increased volume of SHPs. While the number of proposals being voted on keeps going up, shareholders are supporting fewer of them.

Since peaking in 2021, the average level of support for E&S-related SHPs at U.S. companies has declined. E&S-related SHPs received roughly 31% support in 2021, but only roughly 19% support in 2023. The 2023 level was the lowest average level of support for E&S-related SHPs in 10 years, and of the 356 proposals voted on in 2023, only eight received majority support. This was down from thirty-nine receiving majority support in 2021[4].

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Research from Barclays shows that the trend is continuing in 2024. By mid-April, the number of E&S-related SHPs had increased by over 10% compared to the same timeframe in 2023[5]. By early June, the level of support for E&S-related SHPs stood at 19% for 2024, in line with 2023 support levels. However, only three E&S-related SHPs had received majority support[6].

We believe multiple factors are contributing to these lower support levels, including the quality of SHPs making their way to the ballot.

Detour ahead

The change to the SEC's approach in 2021 has made it harder for companies to exclude a proposal from a ballot. In our view, this is contributing to the increase of SHPs on company ballots. However, quantity does not equal quality.

In 2023, we observed a higher volume of SHPs that, in our view, lacked a clear linkage to materiality and shareholder value. We believe one contributor to this trend is that special interest groups – from both the progressive and conservative sides of the ideological spectrum – have been using shareholder proposals to push their preferred agenda.

Looking at the SHP landscape in 2023 and 2024, the range in quality of these proposals is wide. Most remain well-crafted proposals, and permit flexibility to boards where appropriate, link back to shareholder value, and focus on material issues. But we believe a meaningful number of recent SHPs contain problematic features. Typically, we think they are overly prescriptive and seek to micromanage the company. In the worst cases, we believe some SHPs leave the reader feeling like there is not a link to the business at all and that the proponent has an ulterior motive.

To that end, we believe some proponents are submitting proposals not to improve the company or because they believe it is beneficial to shareholder value, but for self-publicity. These proponents can generate some headlines and demonstrate action to their clients, beneficiaries, or donors. But, in our view, fulfilment of the SHP is unlikely to benefit shareholders – an important threshold for investors when making voting decisions on an SHP.

At RBC Global Asset Management (RBC GAM), we believe that proposals should be included on the proxy ballot for consideration by shareholders as long as they deal with appropriate issues and are not used to raise personal matters, politically or ideologically motivated requests, or to garner publicity. We believe the recent departure from materiality and shareholder value of some SHPs is contributing to poorer quality proposals, driving the reduction in support they are receiving.

Of course, as shareholders, these proponents are well within their rights to continue to submit these proposals. After all, different shareholders have different perspectives on what is material to a company's success and this diversity of views can benefit investors as well. What may appear as ideologically motivated to one shareholder can appear to be a driver of shareholder value to another. Similarly, as shareholders, we will continue to vote on SHPs in a manner that we believe to be additive to shareholder value.

With all that said, we believe the increased volume, nuance, politicization, and prominence of lower-quality SHPs have all contributed to more difficult voting decisions for investors. Companies are facing similar challenges and, in some cases, have explored new methods to handle them.

[4] 2024 Proxy Season Preview. United States – Environmental & Social Issues. Institutional Shareholder Services. Kathy Belyeu et al. (No. 1).
[5] US Proxy Season: Early Season Check-Up, Jessica Whitt and Alexa Walls, Barclays, 16th April 2024.
[6] 2024 Proxy Season, June Update On Voting Trends + Spotlight On Climate Shareholder Proposals, Sara Mahaffy and Emir Akdogan, RBC Capital Markets, 16th June 2024.

Pulled over

Amidst these challenges, Exxon Mobil pushed back on these recent trends heading into its 2024 AGM. After receiving a climate-related SHP, rather than accepting it, the company took the proponents to court to determine whether the proposal was acceptable. Specifically, Exxon argued that the SEC was not properly enforcing its rules on the resubmission of SHPs[7]. This litigation led to an interesting byproduct for proponents, investors, and companies to consider – costs.

Commencing litigation meant that Exxon likely had to bear a higher cost. However, the proponent now also had higher costs as well; far higher than they likely planned for when submitting the proposal. Even without litigation, SHPs can be costly for companies. Expenses from reviewing SHP applicability, engagement with the proponent, and legal advice all falls on the company. SEC data from 2020 claimed that one shareholder proposal can cost a company more than $100,000[8]. In absolute terms, there is little upfront cost for the proponent in submitting a proposal, regardless of the support levels it expects to receive. Although proponents must meet the market's filing requirements (e.g., share ownership levels, share ownership history), the financial hurdle for proponents submitting SHPs is relatively low.

Exxon continued to pursue the litigation even after the proponents withdrew their proposal. The company's lawsuit was eventually dismissed after six months following a commitment by the one of the proponents not to submit – or work with others to submit – similar proposals at the company in the future. Whether intentionally or not, the legal process and costs may have deterred the proponents, and could serve as a case study for future SHP proponents and companies.

While this was a novel mechanism to contest SHPs, we believe that many companies would be reluctant to appear as though they do not value shareholder views by pursuing litigation. Nevertheless, we believe companies will keenly review this outcome. Companies are typically better set up for handling expensive litigation than shareholder proponents. If even a small number of other companies choose to adopt Exxon's litigious approach, proponents may think twice about submitting a proposal in the future – an outcome that could be detrimental to the stewardship and corporate governance process.

Exxon has faced criticism from investors for its litigation. A statement by the Council of Institutional Investors[9] and statements from other institutional investors have pushed back against the approach[10], and Glass Lewis, a proxy voting advisor, recommended that investors vote against certain Exxon board members because of the legal action[11]. However, this had a limited impact. The targeted director still received roughly 87% support from shareholders[12], indicating that most Exxon shareholders did not disapprove of the actions taken[13].

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On the other hand, the case drew the attention of advocacy groups like the U.S. Chamber of Commerce, which criticized the SEC's alleged enabling of politicization of the SHP process[14].

Early signs indicate the new road pioneered by Exxon remains a novel one. Despite the greater leniency shown in the SEC's interpretation of SHPs in recent years, the route of appealing to the SEC to issue a no-action letter has regained some of its former popularity. As of April 2, 2024, the SEC had received nearly 50% more no-action requests in 2024 than in the same period in 2023[15].

A fork in the road

Whether it is through the substantial increase of SHPs that investors now need to study, the politicization of SHPs, or litigation, the SHP system has changed.

We believe best practice in the SHP process involves retaining a focus on creating shareholder value, encouraging better corporate governance, and seeking long-term engagement with companies. If the market continues down the current road, SHPs could lose their effectiveness in the stewardship process. We believe voting on SHPs can be a powerful tool to encourage management of material risks and opportunities[16], and hope that a return to a focus on materiality can help ensure that the SHP system will retain its effectiveness into the future.

7 Among other requirements, SHPs resubmitted from previous AGMs need to meet certain requirements for inclusion on the ballot, including specific support thresholds at the previous AGM(s). https://www.sec.gov/files/rules/final/2020/34-89964.pdf.
8 Final Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, SEC.
9 Leading Investor Group Defends SEC as Fair Arbiter of Shareholder Proposals as ExxonMobil Goes to Court, Council of Institutional Investors, 8th February 2024.
10 Notice of exempt soliciatation(s), Exxon Mobil, May 2024.
11 Exxon Mobil Corporation Proxy Paper. Glass, Lewis and Co., LLC, 10 May 2024.
12 2024 Annual Shareholder Meeting. ExxonMobil.
13 RBC GAM voted for the election of the director in question, given the ongoing nature of litigation at the time of the AGM.
14 US Chamber of Commerce, The SEC Must Put a Stop to the Politicization of the Shareholder System, Evan Williams, June 2024.
15 SEC Sees More Companies Asking to Swat Away Investor Proposals, Bloomberg, 2 April 2024.
16 RBC GAM uses proxy voting to signal our views on material issues to management teams and boards of directors, for applicable types of investments. Although we may file a shareholder proposal to address a material issue as part of our escalation process, we use this method sparingly.

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