Corporate Alert

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# BlackRock and State Street Proxy Voting Guidelines Update

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## Key Points:

- Large asset managers like BlackRock and State Street have recently published updates to their proxy voting guidelines primarily focusing on diversity and inclusion and climate risk disclosures.
- BlackRock's key changes include updating its voting behavior to address board quality and composition issues, emphasizing its commitment to net zero emissions and climate risk disclosures, alongside other changes related to human capital management, key stakeholder interests and executive compensation.
- State Street's updates include new voting guidelines to address racial and ethnic diversity, aligning its stewardship with the goals of Climate Action 100+ and encouraging companies to improve their R-Factor scores.

BlackRock Investment Stewardship ("BlackRock") recently updated its proxy voting guidelines with key changes with respect to board quality, diversity and inclusion and climate risk. While State Street Global Advisors ("State Street") has yet to publish updated proxy voting guidelines, it has provided key updates to its policies on racial and ethnic diversity and climate risk disclosures. In this alert, we cover the key changes to both proxy voting guidelines.

## Changes to BlackRock's Proxy Voting Guidelines

On December 10, 2020, BlackRock published its 2021 proxy voting guidelines alongside its updated investment stewardship global principles and its stewardship expectations for 2021. According to those stewardship expectations, BlackRock's voting guidelines detail how they implement their global principles in executing their stewardship activities, which include board and management engagement and holding companies accountable through proxy voting. BlackRock adopted key changes to its proxy voting guidelines addressing board quality; the transition to a low-carbon economy; key stakeholder interests; diversity, equity and inclusion; alignment of political activities with stated policy positions; and shareholder proposals. These changes, summarized and highlighted below, were adopted to reflect BlackRock's


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"continuing emphasis on board effectiveness alongside the impact of sustainability-related factors on a company's ability to generate long-term financial returns."

**Boards and Directors**. Under the new proxy voting guidelines, BlackRock has indicated that a board's failure to address or disclose material issues or act pursuant to its duties may require BlackRock to withhold votes from directors or members of particular board committees, including in the following situations:

- **Board Oversight**: BlackRock will consider voting against committee members and/or individual directors if a board has failed to exercise sufficient oversight over material Environmental, Social and Governance (ESG) risk factors or if a company has failed to provide shareholders with adequate disclosure to conclude that the board appropriately considered these risk factors.
- **Director Overboarding**: BlackRock will consider voting against a director if they are over-committed by serving on an excessive number of boards. A director who is a public company executive or fund manager[1] is deemed to be over-committed if they serve on more than two public boards.[2] This represents an expansion of the previous guidelines, which only applied to public company CEOs. A non-executive director is deemed over-committed if they serve on more than four public boards, which is unchanged from the previous guidelines.
- **Responsiveness to Shareholders**: BlackRock will consider voting against the relevant director, chair or senior committee member where:
  - There is an observed lack of board responsiveness to shareholders, evidence of board entrenchment or failure to adequately plan for board member succession.
  - Director(s) at the most recent election received less than 75 percent[3] of the shares voted, the board has not taken appropriate responsive action to address shareholder concerns and BlackRock also initially voted against the director(s).
  - The board fails to consider a shareholder proposal that receives **substantial**[4] support and BlackRock finds that the proposal will have a material impact on the business, shareholder rights or long-term value creation.
- **Board Composition**: BlackRock will consider voting against members of nominating and/or governance committees if, based on its assessment, "a company has not adequately accounted for diversity in its board composition within a reasonable timeframe." To that end, BlackRock now advises its portfolio companies to include at least two woman directors on their board and recommends that companies consider personal factors such as gender, ethnicity, race and age, as well as professional characteristics when selecting director candidates. BlackRock also expects companies to disclose their (i) preferred mix of competencies, experience and other qualities of board and management; (ii) candidate selection process; (iii) board self-evaluation processes; and (iv) board diversity demographics.[5]
- **Director Tenure**: BlackRock will consider voting against a board if, after considering the average board tenure in its evaluation process for board renewal, it finds that the board has an insufficient mix of short-, medium- and long-tenured directors.

**Climate Risk**. Larry Fink's 2021 letter to CEOs and the 2021 stewardship expectations and proxy voting guidelines all emphasize BlackRock's net zero commitment and its belief that "climate change has become a defining factor in companies' long-term prospects." To that end, BlackRock (i) expects companies to disclose how they are aligned with the goal of limiting global warming to well below 2° C, consistent with the global aspiration of net zero greenhouse gas (GHG) emissions by 2050, and (ii) may support shareholder proposals asking companies to disclose climate plans that align with BlackRock's expectations. In addition, BlackRock asks that companies disclose "financially material sustainability information" through established frameworks from the Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB). In particular, BlackRock expects companies to (i) disclose how they identify, assess, manage and oversee any sustainability-related risks pursuant to the TCFD's four pillars and (ii) publish reports using the SASB's industry-specific metrics and targets.

**Human Capital Management (HCM)**. HCM has been one of BlackRock's top priorities since 2017. Under the new proxy voting guidelines, BlackRock expects companies to disclose the information typically required under the U.S. Equal Employment Opportunity Commission's EEO-1 Survey including workforce demographics like gender, race and ethnicity and the steps that companies are taking to advance diversity, equity and inclusion. BlackRock may consider voting against relevant members of the appropriate committee or in support of relevant shareholder proposals if it believes that a company's disclosures or practices fall short of industry standards or are ineffective at overseeing the risks and opportunities inherent in HCM.

**Key Stakeholder Interests**. BlackRock's new proxy voting guideline will ask companies to disclose how they have determined their key stakeholders including employees; business partners (like suppliers and distributors); clients and consumers; governments and regulators; and local communities, as well as how they have considered these interests when engaging in business decision making. Companies are also expected to effectively address any adverse impacts their business practices may have on key stakeholders by overseeing and mitigating any material risks with the appropriate due diligence processes and board oversight.

**Executive Compensation**. BlackRock expects that a company's executive compensation structure be appropriately aligned with shareholder interests, in particular by generating sustainable long-term value, and will hold the relevant directors and committee members accountable for poor compensation practices. To ensure this alignment:

- Companies should incorporate appropriate and rigorous performance metrics consistent with corporate strategy and market practice when setting compensation plans.
- Compensation committees are expected to disclose when they have used discretion to set executive compensation, how and why that discretion was used and how it aligns with shareholder interests.
- Companies should avoid one-off or special bonuses for executives unrelated to actual performance or total compensation based on peer benchmarking rather than absolute outperformance.
- Incentive plans should be designed to foster sustainable achievement of results consistent with the company's long-term strategic initiatives.

## Changes to State Street's Proxy Voting Guidelines

On January 11, 2021, State Street published its CEO letter from Cyrus Taraporevala on its 2021 proxy voting agenda, indicating that its "main stewardship priorities for 2021 will be the systemic risks associated with climate change and a lack of racial and ethnic diversity." Accordingly, State Street also published new guidance for companies on what to expect from State Street's asset stewardship in 2021 relating to racial and ethnic diversity. The following discussion highlights these important changes in more detail.

**Racial and Ethnic Diversity**. Under the new guidance, State Street reiterated their expectations set out in an August 2020 letter to board chairs on the types of public disclosures that companies should be making regarding diversity and inclusion. In particular, State Street expects disclosures in the following five key areas:

- **Strategy**: the role diversity plays in the company's broader HCM practices and long-term strategy.
- **Goals**: what they are, when they are to be achieved, how they contribute to overall strategy and how they are managed and progressing.
- **Metrics**: at both the global workforce and the board level.
- **Board**: goals and strategy for racial and ethnic representation on the board, including how it reflects diversity of workforce, community, customers and other key stakeholders.
- **Board oversight**: how does the board execute is oversight role in diversity and inclusion.

Building upon that guidance, the CEO letter describes how State Street will implement the following voting guidelines to ensure companies are making these disclosures and "are forthcoming about the racial and ethnic composition of their boards and workforces":

- In 2021, State Street will vote against the Chair of the Nominating & Governance Committee of an S&P 500 or FTSE 100 company that fails to disclose the racial and ethnicity diversity of its board.
- In 2022, State Street will vote against the Chair of the Compensation Committee of an S&P 500 company that fails to disclose its EEO-1 report.
- In 2022, State Street will vote against the Chair of the Nominating & Governance Committee of an S&P 500 or FTSE 100 company with no board members from an underrepresented community.

**Climate Risk**. In November of 2020, State Street announced that it was signing on to Climate Action 100+,[6] an investor-driven global initiative fostering the transition to clean energy by engaging with the companies and sectors with the highest GHG emissions. State Street will spend 2021 focusing on those companies especially vulnerable to the transition risks of climate change while also continuing its engagement with companies in other less carbon-intensive sectors that still face the physical impacts of climate change. Furthermore, since 2018, State Street has urged its portfolio companies to use the TCFD framework to assess and report on climate risk. Under its previous proxy voting guidelines, State Street began taking voting action against board members in "laggard" companies last year, based on their R-Factor scores, if the board could not articulate how it planned to improve the company's score. In 2022, State Street plans to expand its voting action against companies that have, for multiple years, consistently underperformed their peers on their R-Factor scores.

[1] A fund manager refers to an individual whose full-time employment involves responsibility for the investment and oversight of fund vehicles and to those individuals who are employed as professional investors and provide oversight for those holdings. *Proxy voting guidelines for U.S. securities, BlackRock Investment Stewardship*, at 5 n.1, https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf (last visited Jan. 15, 2021).)

[2] In comparison, under the Institutional Shareholder Services' (ISS) 2021 proxy voting guidelines, an executive director is only deemed over-committed when they are the director of two public companies besides their own – in which case, ISS will still only withhold votes for the director's outside boards. *United States Proxy Voting Guidelines: Benchmark Policy Recommendations*, ISS, at 11, https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf (last visited Jan. 15, 2021). ISS will also only withhold votes for a non-executive director if they sit on more than five public company boards. Id. Under Glass Lewis' 2021 proxy voting guidelines, an executive director is considered over-committed when they serve on more than two public company boards; a non-executive director is only over-committed if they serve on more than five company boards. *2021 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice*, United States, Glass Lewis, at 19, https://www.glasslewis.com/wp-content/uploads/2020/11/US-Voting-Guidelines-GL.pdf?hsCtaTracking=7c712e31-24fb-4a3a-b396-9e8568fa0685%7C86255695-f1f4-47cb-8dc0-e919a9a5cf5b (last visited Jan. 15, 2021).

[3] Under the current ISS proxy voting guidelines, voting action will only be initiated if a director receives less than 50 percent of the shares voted and the company does not take responsive action to address issues that caused the high withhold/against vote. ISS, *supra* note 2, at 12. Conversely, under Glass Lewis' current proxy voting guidelines, when a director receives less than 80 percent of the shares voted, it prompts "a close examination of the underlying issues and an evaluation of whether or not the board response was warranted and, if so, whether the board responded appropriately following the vote, particularly in the case of a compensation or director election proposal." Glass Lewis, *supra* note 2, at 9.

[4] While "substantial support" is undefined in the proxy voting guidelines, BlackRock considers "30% or more votes in favor, a relatively high level of support," as stated in its stewardship expectations. *Our 2021 Stewardship Expectations: Global Principles and Market-level Voting Guidelines, BlackRock Investment Stewardship*, at 5, https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf (last visited Jan. 15, 2021).

[5] In terms of board composition, ISS will generally vote against or withhold from voting if there are no women on the board unless there was a woman on the board at the previous annual meeting and the board firmly commits to returning to gender diversity status within the year. ISS, supra note 2, at 11–12. Glass Lewis's board composition policy is similar to ISS's except that beginning this year, Glass Lewis "will note as a concern boards consisting of fewer than two female directors." Glass Lewis, *supra* note 2, at 26.

[6] For more information on the Climate Action 100+ program, see Climate Action 100+, https://www.climateaction100.org/ (last visited Jan. 15, 2021).

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