

ESG Shareholder Proposals: The Current Canadian Landscape

by **Victor Guo**

Trends over recent years

A small but growing universe of investors have become quite familiar with the use of shareholder proposals as a tool to voice their opposition to management on wide ranging ESG topics at Canadian public companies. Between January, 2021 through to June, 2023, there have been 161 ESG-related shareholder proposals that have gone to ballot. While corporate Canada's most recognizable names have historically been the primary targets of shareholder

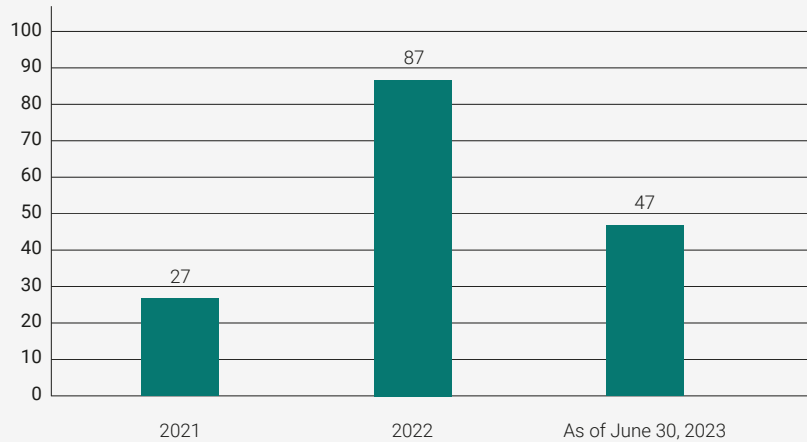
proposals, the increasing volume of ESG proposals suggests more companies including mid-cap Issuers will soon be dedicating significant board and management time and energy in responding to the latest "hot button" ESG topics. In 2022, Canadian Issuers saw a massive 300% increase in the number of shareholder proposals on the ballot over the prior year and the half year stats for 2023, while not as high as in 2022, are similarly notable.



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NUMBER OF ESG SHAREHOLDER PROPOSALS ON THE BALLOT



Source: Morrow Sodali Analysis, ISS Corporate Solutions Voting Analytics, as of June 30, 2023

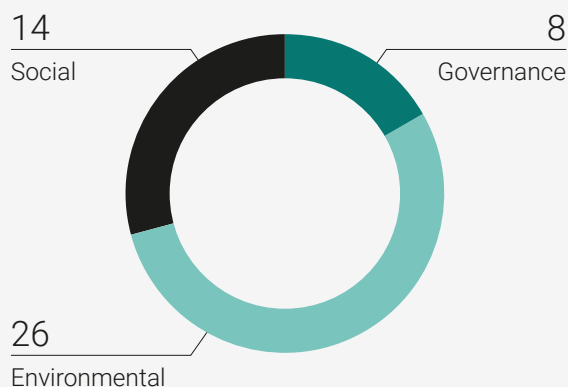
Despite the sheer number of ESG shareholder proposals received, the shareholder approval rate of those proposals remains low. Of the 161 ESG related shareholder proposals in the past 3 years, only five proposals or 3.1% received majority support from shareholders as confirmed by the affected companies in their post AGM vote reports.

In evaluating those shareholder proposals, proxy advisors Institutional Shareholder Services, Inc. ("ISS") and Glass Lewis & Co. ("Glass Lewis") have exercised a balanced approach by taking a deep dive in carefully reviewing both pros and cons of the proposals through the lens of the long-term best interest of shareholders. Both proxy advisors have well developed expertise in recognizing shareholder groups who tend to be more radical and overly aggressive as proponents

of ESG issues. Proxy advisors' long term critical thinking has resulted in few shareholder proposals receiving both advisors' endorsement which in turn, has led to the low success rate of the shareholder proposals. While management teams and boards have been successful in the short term in repelling damaging shareholder ESG proposals, it is worth noting that more and more institutional shareholders are adopting their own voting guidelines when dealing with ESG issues and proposals, thus there is an increasing number of institutional shareholders not following the proxy advisory voting recommendations. Such development should cause issuers to pay more attention to and be thoughtful when responding to those shareholder proposals, particularly elaborating and articulating a detailed plan that speaks to how best to integrate ESG factors into their long-term business vision.

Overview of ESG Shareholder Proposals in 2023 Proxy Season

SNAPSHOT OF 2023 ESG SHAREHOLDER PROPOSALS UP TO AND INCLUDING JUNE 30, 2023



Source: Morrow Sodali Analysis, ISS Corporate Solutions Voting Analytics, as of June 30, 2023

ENVIRONMENTAL PROPOSALS

Out of the total 47 ESG shareholder proposals, the largest group, numbering 26, was environmental related proposals. The biggest environmental issue appeared to be related to emissions reduction and net-zero targets. In 2023, a total of nine such proposals were submitted to Canadian companies, representing approximately 35% of the environmental-related proposals. Coming in second were advisory votes on environmental policies (say on climate) where seven of those proposals were submitted to financial institutions. Canada's five big banks have long been targeted for shareholder proposals and environmental related proposals are no exception. As could be expected, the banks were followed by several large energy issuers. It is worth noting that Dollarama received an E&S blended proposal, asking for reporting on

both emissions and gender targets whereby such targets are relevant, of high strategic significance and consistent with the company's overall ESG strategy. During the 2023 proxy season, none of the environmental-related shareholder proposals received majority shareholder approval except the climate lobbying proposal at Cenovus where importantly, management had supported the proposal, and which had also been endorsed by both ISS and Glass Lewis.

SOCIAL PROPOSALS

In 2023 social proposals followed closely behind environmental issues with a total of 14 social-related proposals. Human rights proposals were the most prevalent representing approximately 29% of the social-related proposals, followed by racial equity report and audit of which all such proposals were submitted by SHARE, representing approximately 21% of the social-related proposals. In terms of the targeted issuers, social-related proposals had been received by issuers across various industries, with financial and consumer discretionary being the two most targeted sectors. None of the social-related shareholder proposals had garnered enough shareholder support for approval during the 2023 proxy season, although it is worth noting that the racial equity audit proposal at RBC garnered over 42% shareholder voting support, representing the most heavily supported non-approved shareholder proposal during the period.

GOVERNANCE PROPOSALS

Lastly, there were eight governance-related proposals during the period, representing the lowest category among the ESG related proposals. It is not surprising that the E&S proposals have exceeded the G (governance) proposals over time, as investors' focus on E&S continues to heat up. Five of the governance proposals were related to compensation, with three of them requiring the disclosure of the CEO compensation to median worker pay ratio on an annual basis and were all submitted to Canadian banks. Similar to the social-related proposals, none of the governance-related shareholder proposals had garnered enough shareholder support for approval during the 2023 proxy season.

KEY TAKEAWAYS

Below are some notable observations on the trends and developments over ESG shareholder proposals in the 2023 proxy season.

- Canadian companies are experiencing an increasing trend whereby shareholder proponents are submitting proposals that have been tested successfully in other markets such as the US and Europe. Obviously battle tested proposals have a higher likelihood of success and issuers would be well served to obtain insight on how particular proposals have been received in other jurisdictions in order to properly assess the veracity of a proposal. It is critical that assessment is conducted as early as possible to maximize the time available for development of strategy and perhaps negotiation.
- Shareholder proponents are getting more sophisticated by leveraging the voting power of major institutional shareholders through engagement requests to seek support.
- Some shareholder proponents are expanding their solicitation efforts through the request of obtaining shareholder lists from issuers and using social media such as Twitter and public interviews to increase awareness.
- Issuers are finding that it is more challenging to negotiate with shareholder proponents in the hopes of making them withdraw their proposals.

As the evolving dynamics of dealing with ESG shareholder proposals have become more challenging, issuers need to be strategic, thoughtful, and succinct when contemplating management responses. Regardless of how offside or damaging a proposal may be, responses need to be comprehensive, evidence based, and care taken to effectively communicate why the proponents' asks are unreasonable for the company and importantly will negatively impact shareholder value. A high-quality management response will lead to a greater likelihood of garnering support from proxy advisors, which remains a critical first step. However, issuers should not rely solely on proxy advisors' support. As mentioned, many institutional shareholders now have their own individualized policy voting guidelines of which some are high-level and entail a high degree of discretion when evaluating shareholder proposals. Recognizing the psychology at work whereby society, primarily through social media, is prone to be highly reactive to any corporate activity portrayed in a negative light is an important step for boards and management teams to take to successfully address a shareholder proposal. Remember that institutional investors' ESG teams are likely influenced by social media, and they may be, to some extent, evaluated in part on how they position the institutional investor through a social media lens. As always, effectively engaging with top institutional shareholders to ensure they understand the consequences of a shareholder proposal from a long-term shareholder perspective becomes another critical element to secure the final successful shareholder vote on shareholder proposals.

It is safe to say the ESG game will continue to evolve as the stakes get higher.

