Environmental, Social & Governance Investing

Shareholder Proposals on ESG Investing: Benefit or Burden?

By Mathew Hough

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In recent months, the SEC and legislators have proposed rules meant to limit shareholder activism — and particularly investors' focus on so-called "ESG investing." ESG investing considers environmental, social, and governance factors when making investment decisions. ESG principles are wide-ranging but may include proposals to require companies to increase disclosures related to political contributions and lobbying, their gender pay gap, or their carbon footprint. Many argue that the consideration of ESG principles is beneficial to a Company's long term returns — lowering risk and ensuring the sustainability of company policies and practices.

In April 2019, the Republican-controlled Senate Committee on Banking, Housing, and Urban Affairs (the "Banking Committee") called on the SEC to restrict institutional investors, fund managers, and proxy advisory firms from including ESG principles in their shareholder proposals. The motivation behind this call to the SEC was, in part, certain senators' belief that ESG proposals burden companies with the added expense of reporting on metrics that are, arguably, unimportant to investors. Evidence, however, points to the contrary: in 2018, ESG proposals comprised the largest category of shareholder proposals on proxy ballots.

Lawmakers and researchers have also suggested increasing the monetary threshold for shareholders to introduce proposals, which would further limit shareholder activism. Under current SEC rules, shareholders who hold at least $2,000 of a company's stock, and have held that stock for at least a year, may submit a shareholder proposal for consideration on a company's proxy ballot. However, James Copland, Senior Fellow and Director of Legal Policy at the Manhattan Institute, recommended at a Banking Committee hearing that the SEC increase the monetary threshold to "a material percentage" of the company's shares, though he did not provide an

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exact amount. Concurring, Senator Pat Toomey (R-PA) claimed that "the threshold[s] for introducing [shareholder proposals] are clearly too low. People who have no real financial interest in the company are nevertheless able to tie up huge amounts of resources on behalf of that company." Senator Toomey even suggested that ESG proposals are partly responsible for the decline in the number of companies that are currently going public.

Mr. Copland and Senator Phil Gramm (R-TX) also suggested that the Committee seek to implement rules limiting the role of proxy advisors. Committee Chairman Mike Crapo (R-ID) questioned whether proxy advisors who proposed increasing ESG disclosures were "voting to drive productivity in our economy and increase investors' return on their hard-earned investments" or were instead acting as "intermediaries" to advance certain investors' "environmental, social and other political policies." Crapo's question implies that ESG proposals damage companies' bottom lines.

However, critics of the Banking Committee's concerns argue that these fears are overstated and that studies show that better governance, social, and environmental practices often result in stronger financial results. For example, according to a 2012 Deutsche Bank report, which reviewed over 100 studies, ESG investing "works for investors and for companies both in terms of cost of capital and corporate financial performance" and thus "can be a clear win for investors and for companies"

In addition to potential financial benefits, proponents of ESG principles argue that the ability to make ESG proposals is a right owed to shareholders as owners of the company. These proponents claim that the current SEC rules are stringent enough, including the thresholds for shareholder proposals. For instance, shareholders may only submit for consideration one resolution per year, per company and if that proposal fails to garner sufficient shareholder support, it cannot be reintroduced for at least three years.

Moreover, ESG proponents assert that these proposals add accountability where it is sorely lacking and otherwise help make companies more competitive in the global market for products and services. For example, according to Calvert Research and Management, in 2011, "[J]ust 20 percent of the S&P 500 provided any type of reporting on relevant ESG risks. Today, 85 percent of companies in the S&P 500 actively report on ESG risks factors." As Senator Sherrod Brown (D-OH) stated, "Investors know there are many environmental, social, or political risks that could reduce long-term value, but companies are not providing that information. Enhancing and standardizing these disclosure requirements will merely bring the SEC up-to-date with other rules around the world." While the perception around ESG investing appears to follow party lines, one thing is certain: ESG investing is on the rise and shows no signs of slowing.

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