

State Street Stewardship Report Highlights the Investor's Approach to Targeted Engagement

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In its annual [stewardship report](#) covering 2015, State Street Global Advisors (SSGA) indicated that it had voted at 15,471 meetings in 81 countries. The investor voted against management proposals 12% of the time and in favor of shareholder proposals 14% of the time.

In light of the difficulty for passive index managers that are invested in thousands of companies globally to actively oversee their holdings, SSGA develops an annual stewardship program based on its strategic priorities by focusing on specific sectors and environmental, social and governance (ESG) themes. For 2015, SSGA's sector focus led them to engage with 48 pharmaceuticals and 95 consumer discretionary companies. The ESG themes included board refreshment and gender diversity, climate change and cybersecurity. These priorities were derived from client feedback, emerging ESG trends and developing macroeconomic conditions and regulation.

In addition to the sector and thematic priorities, SSGA targeted companies based on the size of its holdings, as well as companies with poor long-term financial performance within their sector, lagging market and industry standards when compared to the SSGA ESG screening tools, and those with outstanding concerns from prior engagements.

As "near perpetual holders of the constituents of the world's primary indices," SSGA wants to cast informed voting decisions coupled with targeted engagement. All voting and engagement activities on a global basis are centralized within its corporate governance team based in Boston and London, overseen by SSGA's investment committee. During 2015, SSGA engaged with 636 companies (429 in the U.S. and Canada). Approximately 65% of the engagements were active, driven by the stewardship priorities set out in its 2014 report. The remaining engagements were reactive, conducted to discuss proxy voting related issues.

Board composition issues have been a major objective for this investor in the last two years, especially director tenure. In their engagements in 2015, SSGA discussed with companies the need for robust board evaluation processes, director succession practices that ensure smooth transition of board members, and director recruitment processes that enhance diversity on the board. In 2014, SSGA took action against 342 companies globally due to board composition. Of these companies, 31% had refreshed their boards by 2015. In 2015, SSGA took action against 380 companies and voted against the re-election of 538 directors due to tenure concerns globally.

Executive compensation remains a continued topic of concern, even as the investor supported 92% of pay-related proposals globally in 2015. 27% of those pay proposals were screened for additional review, with nearly 40% of those from the U.S. and Canada. On average, SSGA supported the compensation practices/policies at the screened companies 48% of the time, voted against their practices 29% of the time and chose to track (support with reservation) 22% of the proposals due to some concerns with pay policies/structure at the company. Those companies are analyzed again the following year. For example, in 2015, SSGA voted against 20% of the companies that were tracked in 2014.

SSGA believes that companies should adopt a mix of equity awards, with a majority of long-term incentives paid through performance-based units instead of time-vested awards or stock options. In an engagement on compensation, SSGA may focus on the performance metrics, the rigor of the thresholds and the performance assessment period, with an expectation that companies adopt a minimum three-year performance assessment period for long-term incentive plans.

On environmental and social (E&S) issues, SSGA reviewed and voted on 275 shareholder items across its global holdings, 205 at North American companies. On average, SSGA supported 17% of those proposals and also abstained on 17%. During engagement, SSGA may communicate its expectations related to a company's disclosure pertaining to key ESG risks that impact the company's long-term strategy. The report provided an example where it engaged with a company that faced a lobbying proposal. SSGA requested that an itemized list of political contributions by candidate as well as the amount donated be disclosed on the website for federal and state candidates. In another case, SSGA asked a company to enhance its disclosure of specific quantitative metrics pertaining to methane emissions as they related to operations and undertook a multi-year engagement with the company on the quality of its emissions disclosure.

SSGA will track a company's responsiveness to its feedback and may abstain against E&S-related shareholder proposals if the company has made some improvements to its E&S policies/practices but is below market standards, and will support the proposals if the company has failed to implement changes. On E&S issues, SSGA will assess the quality of a company's ESG disclosure, the relative performance of a company's sustainability program compared to that of its peers, the underlying economics of its sustainability initiatives and the level of board involvement in oversight on the company's sustainability practices.

As an indication of the importance that SSGA places on E&S issues, in March of this year, SSGA announced that it launched a Gender Diversity ETF (Ticker: SHE), which seeks to track the performance of the SSGA Gender Diversity Index. The index comprises listed U.S. large capitalization companies with the highest levels within their sectors of gender diversity on their boards of directors and in their senior leadership.

For 2016, SSGA's sector focus is on IT, automotive and SIFI (systematically important financial institutions) companies. The ESG themes are board composition and leadership, supply chain management, pay strategies, climate change and water management.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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