Davis Polk

State Street Stewardship Report Focuses on Key Themes

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In July, State Street released its **2017 global stewardship report**. North America makes up 30% of its proxy voting but 67% of its engagements. All voting and engagement activities are centralized within the stewardship team. About 85% of engagements are classified as active, where the investor seeks direct dialogue with companies. Factors used in identifying target companies for active engagement include: the size of State Street's holdings, companies with poor long-term financial performance, companies identified as lagging in ESG standards, priority themes and sectors based on State Street's assessment of emerging ESG risks and any outstanding concerns from prior engagements.

Besides trying to affect company-specific changes, State Street also wants to be a leader in influencing market participants such as asset owners, managers, regulators and proxy advisory firms. The report cites its focus on the need for board refreshment in the U.S. market, and of course, the push for gender diversity through its Fearless Girl campaign, as two examples of its thought leadership.

One of the themes State Street focused on during 2017 was independent board leadership, supporting 10 shareholder proposals seeking independent board chairs while voting against or abstaining on 34 of them. According to the report, the significant improvement that companies have shown in strengthening the lead independent role, particularly by expressly identifying involvement in strategy as a responsibility of the job description, has led to a decline in the overall support of these shareholder proposals. The report names three U.S. companies that it engaged with and the outcome of those discussions in the form of enhanced proxy disclosure or more formalization of the lead director duties.

State Street is known for being one of the first major investors to question director tenure back in 2014. While, like other investors, State Street is calling on boards to enhance gender diversity overall, it also wants boards to consider whether female directors are chairing boards or committees to drive wider diversity efforts. In addition, the firm is concerned with the lack of disclosure around women in leadership or senior management roles at companies.

Climate change is clearly a key thematic area for State Street, which supports nearly half of the shareholder proposals asking for 2 degree scenario disclosure and about a third of other key environmental proposals. The climate-related topics for engagement include board oversight, scenario testing and portfolio resilience, technological investments, strategies to manage emissions, climate risk disclosure and reporting and public policy engagement. The biggest change State Street has observed over the last few years is that most directors serving on the boards of companies in high-impact sectors, such as oil and gas, are better informed about climate risks. However, the report states that those directors struggle to communicate how they are addressing those risks other than at a high level. In 2018, it will expand climate risk analysis to sectors such as agriculture, transportation and insurance.

On the topic of pay strategies, State Street focuses on compensation and wages throughout organizations, as it views wage strategies as part of human capital management systems. For CEO compensation, its top concerns include poor structure or poor disclosure and also excessive pay. Quantum was added to the framework for analyzing pay this year, along with a preference for operational metrics for short-term pay, and a balance of PSUs and RSUs for long-term pay, with PSUs based on at least a three-year performance period and linked to long-term metrics.

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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