WALTER SCOTT

BNY MELLON | INVESTMENT MANAGEMENT

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COMMENTARY

Standing opposite Milan's imposing neoclassical stock exchange is a 36-foot-high statue of a hand. Carved from the same Carrara marble as Michaelangelo's *David*, the hand's middle finger is raised in an internationally recognised gesture of contempt.

Known colloquially as *Il Dito* (the Finger) the statue's exact meaning is unclear. Whilst some consider it a rebuke to the world of banking and finance in the aftermath of the global financial crisis, others see it as a comment on the fascist-era origins of the *Palazzo Mezzanotte*, the building in which the exchange is housed. Following a recent regulatory overhaul, investors in companies listed on the *Borsa Italiana* might feel it encapsulates the attitude of Italian policymakers towards shareholders.

In February, the Italian Parliament approved a new law aimed at simplifying the regulatory framework of the country's capital markets and improving their competitiveness. Amongst other changes, the legislation permits companies listed in Milan to hold AGMs behind closed doors, making permanent a temporary measure introduced during the Covid-19 pandemic. Embraced by some companies as more cost and time efficient, the change left many investors unimpressed.

"The removal of the right to attend an AGM (whether virtually or in person) is an unwelcome development"

In a letter to Italy's Ministry of Economy and Finance, the International Corporate Governance Network (of which Walter Scott is a member) urged a rethink, criticising the impact of the reforms on shareholder rights. We concur. The removal of the right to attend an AGM, whether virtually or in person, is an unwelcome development and contrary to good corporate governance. The AGM is an important forum for investors, particularly smaller investors, to question a company and air their views.

Reflecting our thinking on this issue, we have already voted against one Italian company's proposal to incorporate the change into its Articles of Association. Whilst the business may be acting in line with the new law, that does not make it the right thing to do by shareholders.

A WIDER ISSUE

The debate around the importance, or otherwise, of AGMs forms part of a wider discussion currently taking place in investor and corporate circles about shareholder rights more generally. Few topics generate more heat in this area than shareholder proposals.

This year's proxy season saw the number of proposals in the US rise for a fourth consecutive year. Whilst the overwhelming majority of these might crudely be categorised as 'pro-ESG' there was also a marked rise in proposals critical of corporate ESG initiatives, inevitably referred to as 'anti-ESG' proposals.

"Too many proposals lack genuine relevance to the company"

Yet despite the ongoing proliferation of proposals, shareholder support remains anchored at historically low levels. Only 4% of those submitted at this year's proxy season received majority support. To a degree, this suggests that many shareholders are still too willing to take management teams on trust, rather than give consideration to genuine proposals aimed at improving a company. More commonly, however, it reflects the fact that not only do too many proposals lack genuine relevance to the company but that many also fail to represent the best long-term interests of shareholders.

It is this frequent disconnect between the validity of proposals and the time and money companies must spend in addressing them that is causing a degree of disillusionment in boardrooms. In 2020, the Securities & Exchange Commission (SEC) estimated that the cost to a company of considering a shareholder proposal was between US$50,000 and $150,000.

VIEWS FROM THE BOARDROOM

These frustrations were much in evidence when a member of the Research team attended the Fall Conference of the Council of Institutional Investors (CII) in Brooklyn, NY. The CII brings together long-term asset owners and institutional investors to discuss corporate governance matters. Its events are rarely, if ever, echo chambers, comprising speakers with disparate views and perspectives. This lack of homogeneity is welcome in a sphere that is increasingly divided along partisan lines.

Having received an early, if unscheduled, glimpse of the opposing views that would be on show when a group of climate protesters disrupted the opening panel discussion (a 'vigorous' security response soon restored order), conference attendees could look forward to an agenda that included talks from two high-profile CEOs, Jamie Dimon of JP Morgan and Darren Woods of ExxonMobil.

Few CEOs have the public standing of Jamie Dimon. After 18 successful years at the helm of America's largest bank, people tend to listen when he speaks. So, his assertion that AGMs are a "frivolous waste of time" that have been "hijacked by special interest groups" was always likely to grab the attention of a room full of engaged shareholders. Similarly, his claim that he would "love" to take JP Morgan private to avoid the excessive litigation and regulation of the public-listed realm.

"Few CEOs have the public standing of Jamie Dimon"

Despite his obvious distaste for the increasingly politicised nature of AGMs, Mr. Dimon was less combative than his Exxon counterpart Darren Woods. The oil and gas giant made headlines earlier this year by taking legal action against two investors to stop them filing a climate-related shareholder proposal. Controversially, the company continued with its lawsuit even after the proponents withdrew the resolution, a decision that attracted the disapproval of investor groups. Rather than litigate, they argued, Exxon should have sought resolution through the SEC's intermediation process.

Lamenting the number of politically motivated shareholder proposals Exxon receives each year, Mr. Woods justified the litigation by accusing the proponents of seeking to shrink the company and drive it out of business. Furthermore, he pointed out that the proposal was effectively a resubmission of proposals rejected by shareholders in the previous two years and therefore dubbed it an abuse of the shareholder proposal system.

In the view of Mr. Woods, the behaviour of the proponents was not that of legitimate shareholders, but rather activists looking for publicity. And despite the case being dismissed by a Texas district judge, he did not rule out Exxon pursuing a similar course of action in future.

STAKING OUT A MIDDLE GROUND

Given we do not invest in Exxon, we have not considered in depth the proposal in question nor whether we would have given it our support. On first inspection, however, it did not appear to be particularly unreasonable in the context of other climate-related proposals. Yes, it requested that the company introduce more ambitious medium-term emission reduction targets and reduce spending on hydrocarbon exploration. This could be interpreted as a request to shrink the company. But the proposal also spoke to the likely shrinking of the hydrocarbon market as the global economy transitions and highlighted what the proponents see as the risks of Exxon's current fossil-fuel strategy to its cost of capital, revenues and the future viability of its assets. These should be legitimate concerns for shareholders. As such, we think Exxon's reaction to the proposal disproportionate.

Where we do agree with both Mr. Woods and Mr. Dimon, however, is that too many shareholder proposals have questionable merit. Whilst we welcome in theory the increase in shareholder scrutiny of recent years, the reality is frequently disappointing, not to mention time consuming for all concerned.

In many cases, the poor quality of shareholder proposals has been due to the prioritisation of social and political agendas over shareholder interests. Frustratingly, proponents too often refuse to acknowledge that their proposals could have materially negative financial implications for the company in question.

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This does not lead us to argue, as some have, that shareholder proposals prioritising the social or environmental 'good' are illegitimate. However, proponents should be able to evidence, or at least construct a robust argument, that the pursuit of these goals is linked to the long-term financial prospects of a business.

Ultimately, we view shareholder proposals as a rather blunt tool. Dialogue with management is our preferred route to addressing areas of concerns – if we have a question, we pick up the phone. But given they are likely to remain a major feature of proxy season for the foreseeable future, an improvement in tenor would be welcome.

Shareholders have rights that are important to protect but they also have responsibilities. A more considered approach to shareholder proposals would signal that those responsibilities are being taken seriously. Less quantity, more quality and we might see fewer proposals getting *Il Dito* from management teams.

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