NEUBERGER | BERMAN

Engagement at Its Core: Inside the NB25+ Advance Proxy Voting Initiative

Disruptive Forces in Investing

July 28, 2020

George Walker: Engaged ownership is fundamental to make our capitalist system work. One part of that is proxy voting. NB25+ is a new voting initiative this year at Neuberger Berman where we disclosed our position on 29 key votes ahead of the shareholder meeting. We believe we are the first large asset manager to do so. Our portfolio managers are truly defining what it means to be an owner by looking at what companies are doing and seeking to enhance value by focusing on material, environment, social and governance issues on behalf of shareholders. My name is George Walker and I'm your guest host on today's episode of Disruptive Forces, standing in for Anu Rajakumar as she focuses on more important things. She just welcomed a new baby boy at home. I'm here today with Jonathan Bailey whose team drove the NB25+ initiative with our portfolio managers to take a deep dive and learn more about the importance of advanced proxy voting disclosure. Jonathan, thanks for joining me today.

Jonathan Bailey: Thank you for having me.

George: As an active manager we choose the companies that we invest in, but that does not always mean that we agree with everything that management teams are doing. In 2019 we voted against management teams in 11 percent of the votes we cast. That's almost 50 percent more than the large passive managers did. We also supported shareholder proposals on environmental, social and governance topics in a majority of cases compared to levels of support as low as 12 percent by some passive managers. Our experienced portfolio managers and analysts exercise judgment in deciding how to cast each vote, which is why we don't blanket vote 100 percent for or against anything. But our voting record on key issues like climate change, gender pay equality and political lobbying disclosure speaks for itself. To start, how did the idea behind this advance proxy voting initiative first come to fruition?

Jonathan: Well, George, as with all great ideas at Neuberger Berman, it came from our portfolio managers. We were getting to the end of the 2019 season and we were looking at how we had cast votes that had an impact and were important to our clients and to the portfolios that we managed on their behalf. And we were thinking, "Well, why aren't we talking about this more? Why aren't we explaining the rationale more clearly?" and most importantly, "Why do our clients and many of the companies that were voting at only find out the way that we vote when we file with the regulators in various different forms in the autumn of each year?" So we thought, "Well, let's get out there in front of the meetings, let's provide transparency and let's improve the quality of debate and discourse around these important votes that we cast on behalf of clients."

George: To give our listeners some background, could you tell us a bit more about the advance disclosure process?

Jonathan: Yes, absolutely. So what we've decided to do was to try and focus on votes that we thought would make a difference and would provide some sort of insight. So of course we're voting thousands of meetings each year and many of those votes, you know, are relatively routine, right? We want to generally support directors to be reelected and many executive compensation plans are well-structured. So we wanted to focus it on a set of votes that might have a clear message to sell other companies and other market participants about what we think of as being best practice. So we decided to prioritize 25.

And as you said, George, we ended up actually disclosing 29 – but to prioritize 25 votes which we thought had some significance. And those were votes where we have a large economic exposure across the firm. So our proxy and governance committee with input from portfolio managers and analysts went through our largest positions and identified those votes that we thought would be significant.

About half of the votes we were looking to disclose would be in favor of management, and half in opposition to management, trying to draw out the fact that this isn't about antagonist, it's not about pointing out failures. It's about drawing attention to best practices either that could be areas of improvement or areas of weakness. And we would then engage with the companies. You know, so we're not putting out the votes without having had a significant engagement with a company around the topic. And of course as we went through that engagement process for each of the votes, sometimes we would find that dialogue was able to achieve improvement or a change in direction without us needing to go public with our voting intentions. So not everything that we went through the process of engagement ended up being in the NB25+ advance vote disclosure initiative, but ultimately 29 key votes did and across those 29 I think we can draw some interesting examples of the types of outcomes that are important for clients.

George: What are some of the types of issues that we would want to weigh in on?

Jonathan: So we try to make sure that we addressed each of our nine key governance principles. So that's everything from risk management to transparency and accounting and audit, to appropriate board competency and of course environmental and social issues. So we did have a broad range of topics and that includes everything from environmental leadership and response to the COVID crisis, as well as topics like gender pay equality.

George: So if we could get into some details I'd love to hear some examples of the companies that we looked at as part of the initiative, perhaps what their stances were and what we did on our end to disclose positive behavior or highlight items that we believe needed to be addressed.

Jonathan: Yeah, let's start with gender pay equality. So let me contrast two companies, Cigna and Adobe. So Adobe is obviously software and cloud-based technology company who relies on incredible engineering talent to be able to innovate solutions for businesses and consumers around the world. We decided to oppose a shareholder proposal at Adobe on gender pay equality. And the reason for that was because we felt that they already had world leading practices in regard to that topic. In fact, they are a company that not only provides very detailed reporting, but they've actually achieved gender pay equality in key parts of the business which is something that is ultimately the objective of much of the disclosure initiatives and proposals that we see at companies. So we wanted to make sure that we were drawing attention to that leadership rather than just saying, "Uh, we're going to support a proposal on this topic because we believe in the principle of it."

Now, in contrast Cigna in the healthcare space, a company that does take the topic of gender pay equality very seriously, doesn't quite have the same level of quality of disclosure and has not achieved gender pay equality in practice. So we wanted to draw attention to some of the specific things that we felt that they could improve on, for example, providing more detail of the sampling that they use to actually evaluate pay levels at different tiers of their organization between men and women or to provide more transparency about the consultants' and the third parties' independence when they go through that process. So we weren't saying that this was a management team that didn't care about this issue, but we felt that the quality and the specificity of the disclosure could be improved and hence we supported a shareholder proposal at that company.

George: Terrific. And, how about an example of environmental practices amongst oil and gas companies?

Jonathan: Yeah. This is obviously an area that's particularly highly visible, right? The oil and gas sector is bifurcating at the moment between companies that are embracing the Paris Climate Agreement and the transition over the coming decades towards a net zero scope one, two and three footprint of their emissions and those that are moving a bit more slowly. And we wanted to draw attention to the difference between different companies on that respect. So for example we said at Royal Dutch Shell, a company that has already made commitments to a net zero goal for scope one, two and three by 2050 and interim targets along the way that it wasn't appropriate at this time to support shareholder proposals that were pushing for further disclosure, right? We really felt that they were class leading, and that the management team should be applauded for the steps that they have taken. In contrast, at ExxonMobil and Chevron we felt that there was still insufficient action by those companies on climate change. And in particular we notice that there was an opportunity to take a position on physical climate risk, in relation to assets that they either directly or in joint ventures control in the Gulf Coast region. A physical climate risk is clearly a very important aspect to this. So it's not just about changing the business model to adapt to changing regulation and consumer demands, but also actually making sure that the resilience of the assets is as strong as possible. So we wanted to vote in favor of shareholder proposals pushing for greater disclosure at Exxon and Chevron on that topic and we voted against the proposal at Royal Dutch Shell to make that clear distinction between the level of leadership that we feel those respective companies have taken on climate change.

George: And finally perhaps could you talk about the current challenge that companies are facing with regards to COVID-19, as well as the global struggle for racial equality? Have those elements also impacted our voting?

Jonathan: Absolutely. I think this is a great example of why voting is only one small part of a robust investment process because the huge challenges the world faces and particular communities are suffering with at the moment with COVID-19, and the actions that companies are taking – you know, these are not things that we are necessarily getting to vote on today, but we're having conversations with management teams about their response all the time. And so engagement is the first and most important step to looking at that challenge. However, we did want to signal through the NB25+ initiative our support for management teams that we felt were navigating these challenging months with particular strength of leadership.

And so we publically disclosed that we would be voting in favor of the CEO's reelection to the board at Thermo Fisher Scientific in part because of the adept way that that company responded to the pandemic, working with the National Institute of Health in developing molecular tests, using the polymerase chain reaction kits, development of PPE for frontline workers and of course playing a critical role in development of vaccines and treatments not just in the U.S. but also with Chinese government and regulators in Europe.

So really navigating this in an apolitical and effective manner to help protect communities around the world. And so that's a vote in favor of the leadership that we were proud to make. On the other topic that many of us have been focused on in recent months, which is of course discrimination and racial inequality, we had cast a vote earlier in the season at the hospitality chain Marriott not because we felt that there was significant challenges around discrimination happening, but because we felt that as a company in a sector that historically has not had the same levels of diversity at all levels of the organizational types of roles and jobs, that they could do more to provide reporting and disclosure about pay disparities between different ethnic and racial groups. And so, we supported a shareholder proposal on that topic at Marriott and we look forwards to the company providing greater disclosure in the months ahead, of course acknowledging the challenging environment for any company in that sector at this time given the COVID situation that we just discussed.

George: What did you find to be some of the key components that lead to the success of this initiative?

Jonathan: I think the first thing that was important in the success of the initiative was that it was grounded in the work of our research analysts and portfolio managers. So this is not some sort of top down, you know, "Here's 10 topics that we want to hit and that's what we're going to go for." This was grounded in an understanding of the business models, the progress of each company and where they were in their own strategic cycle. And that meant that when we were talking to management teams and engaging with them on these issues, they understood that we were bringing that judgment to bear, and that I think made a real difference to the quality of dialogue that we were having ahead of the votes.

Secondly, of course, you know, we ultimately found in a number of cases that we wanted to come out publically on these votes because we didn't find management's response convincing enough. And even though many of the other shareholders through their own independent analysis may not have always agreed with us on those votes, uh, by coming out publically and by laying out our rationale we've had many of those companies come back to us to want to engage in the months ahead, uh, of next year's season in order to take practical steps, because they know that we've thought about it robustly and they know that we've taken this issue seriously.

So I think, I think actually, you know, that willingness to come back and engage and improve, uh, as a result of the disclosure is being critical. And then thirdly I think the key third element of the success of the initiative is just frankly that it has picked up coverage, right? I think it's been well received by the industry and I think it's drawn attention to the fact that voting is ultimately a value for clients, right? It's an important part of the investment process and it's elevated the seriousness with which we should all be taking, uh, this important duty that we have on behalf of clients.

George: To wrap up, no good initiative is ever complete. So what do you have in store for the next proxy voting season?

Jonathan: So for-for next season of course many of the issues related to the response to COVID-19, the economic challenges the world is going through, uh, those will be coming through and be, and be more prominent. You know, many senior executives have participated in reductions in compensation or adjustment in targets for incentive pay as a result of the current challenges. So we'll be looking very carefully at that. We'll be looking at capital allocation decisions during this period and of course actions that companies have taken to protect workers, communities, suppliers and others. So I think the response to COVID-19 and the leadership that we've seen from corporate management teams will be an important part of the focus of-of this initiative as we expand it into 2021.

George: Well, Jonathan, I think that's all for this episode. Thank you so much for your leadership in this key, important area. We're looking forward to seeing what comes in next proxy voting season and beyond.

Jonathan: Thank you, George.

George: And to our listeners, you can subscribe to this show via Apple Podcast, Google Podcast or Spotify or visit our website www.nb.com/disruptiveforces for previous episodes, as well as more information about our firm and offerings.