ESG Voting Policy Overlay

2023 Report



A holistic approach to active ownership that supports voting alignment to robust ESG principles, ESG research, engagement efforts and shared investor concern.

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Executive Summary

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Proxy season has become an important space for examining the investment case for sustainability and evaluating company-specific sustainability concerns. Themes, voting trends and company responses are closely watched from year to year.

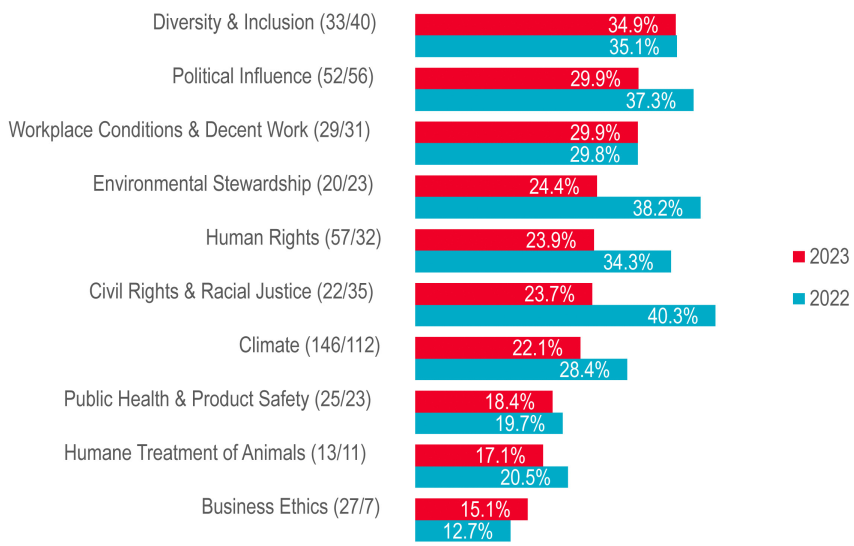
Until 2022, overall support for shareholder proposals on social and environmental issues had been steadily growing. In 2022, average support inched down, but majority-supported resolutions on sustainability themes increased. In 2023, however, support dropped sharply on both counts, even as the number of shareholder-sponsored measures on proxy ballots increased significantly.

Seventy percent of all shareholder-sponsored resolutions on which we offered voting recommendations in 2023 were on the ballots of US companies. Furthermore, vote results disclosure in many markets outside the US is not consistent. Reported global voting trends are therefore strongly skewed towards voting trends in the US.

In 2023, average shareholder support across 424 sustainability-focused shareholder resolutions voted globally fell to 24% - from 32% support across 370 resolutions in 2022. Whereas average support for shareholder proposals voted outside the US remained almost unchanged from 2022 to 2023, at 20%, average support for US company shareholder proposals dropped nearly 10 percentage points, from 36% to 26%, not counting so-called ‘anti-ESG’ resolutions.

Exhibit 1 shows that voting support varies significantly across sustainability themes.

Exhibit 1: Average Support Across 10 Broad Sustainability Themes (2023/2022)*



*The number of resolutions on which we offered a vote recommendation is shown in parentheses (2023/2022). Governance resolutions are not compared as fewer governance resolutions were covered in our voting recommendations in 2022. All reported vote results are adjusted to exclude the influence of insiders with significant voting control.

Interesting insights emerge from our comparison of voting on broad environmental and social themes.

- Whereas support for environmental and social resolutions fell across nearly all themes, support for **human capital themes**, including **diversity and inclusion** and **decent work**, remained almost unchanged from 2022 to 2023. Support for **business ethics-linked** themes increased with an increase in the number of **tax-related** resolutions in 2023, from three to eight, with 20% average support.
- The strongest supported theme in 2023 was **diversity and inclusion**, comprised of resolutions requesting disclosures around gender and racial pay gaps and the effectiveness of efforts to improve workplace, senior management and board diversity, with five resolutions in this category supported by a majority of non-insider shareholders.
- Support also remained unchanged across the broad category of resolutions addressing **workers' rights and working conditions** – such as freedom of association, paid sick leave, and prevention of workplace harassment – at 30%. Within this category, the theme of freedom of expression earned the highest support – 37% across eight resolutions.
- The steepest decline in support was for resolutions requesting independent audits of the **racial equity and civil rights** impacts of companies' policies, practices, products, and services. Compared with 35 resolutions voted in 2022, support dropped more than 16 percentage points across 22 resolutions voted in 2023. All except two resolutions in this category were voted at US companies.
- Resolutions addressing various themes within the broad category of **environmental stewardship** also saw a steep decline – from 38% to 24% on average, across 23 and 20 resolutions, respectively. Half of resolutions in this category (10) addressed efforts to reduce single-use plastic packaging and were supported by 29% of shareholders, on average.
- Average support for **human rights-related** topics dropped by 10 percentage points, while the number of resolutions coming to vote jumped from 32 to 57. At least 12 resolutions in this category addressed the risks of state-level policies restricting **reproductive rights** at US companies, either from a data protection or worker impact perspective. In 2023, nearly half of resolutions in this category (21) asked for **due diligence on human rights impacts**, including across companies' supply chains.

The number of environmental and social resolutions supported by a majority of shares voted dropped from 70 in 2022 to just 16 in 2023.

Majority Supported Sustainability-Focused Shareholder Resolutions in 2023

COMPANY	TITLE	MANAGEMENT'S VOTE RECOMMENDATION	SUSTAINALYTICS' VOTE RECOMMENDATION	REPORTED SUPPORT	INDEPENDENT SHAREHOLDER SUPPORT
Cenovus Energy	Report on Lobbying Alignment with Net Zero Goal	For	For	99.5%	99.5%
Coterra Energy	Report Methane Emission Measure Reliability	Against	For	74.4%	74.4%
Dollar General	Commission Worker Safety & Well-being Audit	Against	For	67.7%	67.7%
Expeditors Intl	Report on Diversity, Equity and Inclusion Efforts	Against	For	57.3%	57.3%

Majority Supported Sustainability-Focused Shareholder Resolutions in 2023 cont.

COMPANY	TITLE	MANAGEMENT'S VOTE RECOMMENDATION	SUSTAINALYTICS' VOTE RECOMMENDATION	REPORTED SUPPORT	INDEPENDENT SHAREHOLDER SUPPORT
FLSmidth & Co.	Report on Human Rights	For	For	100.0%	100.0%
McDonald's	Report on Lobbying Activities	Against	For	50.3%	50.3%
Meta Platforms	Publish Third-Party Human Rights Impact Assessment	Against	For	17.0%	57.6%
Meta Platforms.	Report on Child Safety and Harm Reduction	Against	For	16.3%	53.7%
New York Community Bancorp Inc.	Align Lobbying Activity with the Paris Agreement	For	For	95.0%	95.0%
NIKE	Report on Gender and Racial Pay Gaps	Against	For	29.6%	51.5%
Oracle	Report on Gender and Racial Pay Gaps	Against	For	31.6%	64.3%
Red Rock Resorts	Report on Board Diversity	Against	For	6.0%	77.8%
Starbucks	Assess Worker Rights Commitments	Against	For	52.0%	52.0%
The Kroger Co.	Report on Gender and Racial Pay Gaps	Against	For	51.9%	51.9%

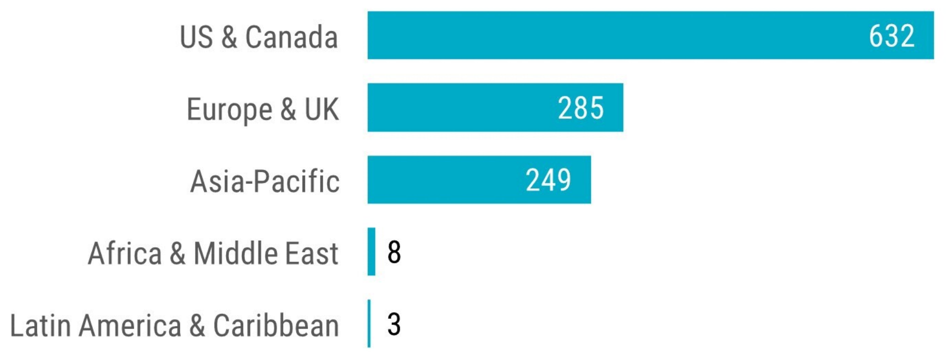
Majority Supported Sustainability-Focused Shareholder Resolutions in 2023 cont.

COMPANY	TITLE	MANAGEMENT'S VOTE RECOMMENDATION	SUSTAINALYTICS' VOTE RECOMMENDATION	REPORTED SUPPORT	INDEPENDENT SHAREHOLDER SUPPORT
Walmart	Conduct Third-Party Review of Workplace Safety	Against	For	23.9%	54.8%
Wells Fargo & Co.	Report on Workplace Harassment and Discrimination Prevention	Against	For	55.0%	55.0%

Summary of Voting: January–December

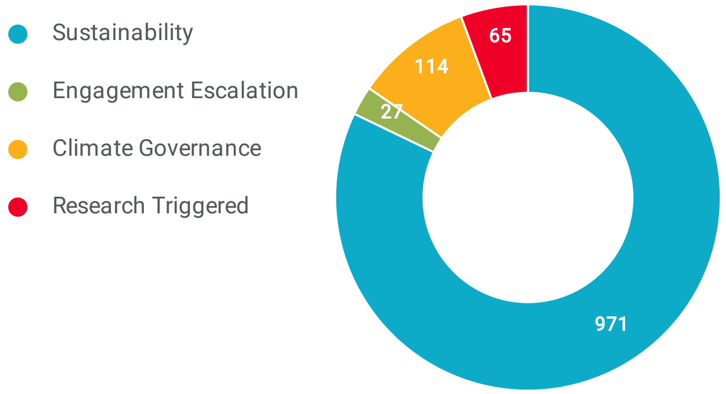
During 2023, we delivered **1,177** recommendations on resolutions voted at **724** Shareholder Meetings across **34** Markets. This represents a 20% increase in both the number of voting recommendations delivered and the number of meetings covered over that of 2022.

Regional Distribution of Voting Recommendations



The largest share of our recommendations covered North American companies' shareholder meetings. Of the 724 meetings on which we offered one or more voting recommendations in 2023, 311 (43%) were at US and Canadian companies. These accounted for just over half (54%) of all voting recommendations. Europe and the UK accounted for a quarter and Asia-Pacific accounted for 21% of the total number of voting recommendations in 2023.

Voting Insights and Recommendations

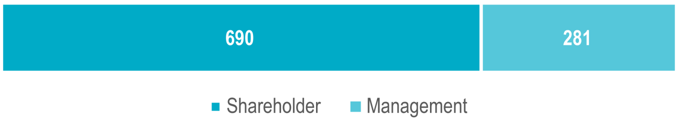


Triggers for Vote Recommendations

Vote recommendations can be triggered by four types of voting signals:

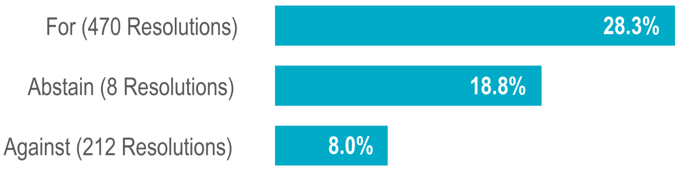
Sustainability	ESG-related resolutions
Engagement Escalation	Poor performance in engagements
Climate Governance	Misalignment between executive performance metrics and decarbonization targets
Research	Poor performance

971 Vote Recommendations were Triggered by Sustainability Resolutions



Eighty-two percent of our voting recommendations, or 971, were on sustainability-linked ballot proposals, with 690 of these being shareholder resolutions and 281 being management-sponsored sustainability resolutions. Of the shareholder resolutions, we recommended votes in support of 68%, which earned an average 28% support from shareholders, and against 30%, which earned only 8% shareholder support, on average. We recommended abstentions in eight cases where the resolution appeared supportable but was put forward by a proponent with an anti-ESG agenda.

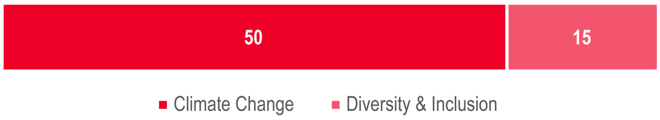
Recommendations and Average Support on Shareholder Sustainability Resolutions in 2023



During 2023, 33 management-sponsored resolutions sought shareholder approval for companies' climate transition plans, strategic climate initiatives or transition plan progress reports – collectively referred to as 'say-on-climate.' In eight cases we recommended a vote against approval. For example, we recommended that shareholders vote against the approval of an energy company's climate transition strategy at its November AGM as it had not disclosed or set targets to reduce its scope 3 greenhouse gas emissions.

Eight shareholder resolutions requested that shareholders have the right to vote on and approve companies' climate plans. Seven of these were voted at Canadian financial institutions, and were posed as advisory resolutions, asking boards to adopt an annual say on environmental and climate action plans. The other was voted at a French utility company, requesting an amendment to the company's articles of incorporation to give shareholders a triennial consultative vote on the company's climate strategy as well as a vote on any significant changes to the strategy. The resolutions averaged 20% shareholder support. We recommended votes in support of these resolutions as we believe companies should have a defendable climate transition plan and that a regular shareholder advisory vote is an important way of ensuring accountability for progress on such plans vote.

65 Vote Recommendations were Triggered by Research Signals



Throughout 2023, sixty-five voting recommendations were triggered by research signals, of which 15 were triggered by poor performance on diversity and inclusion and 50 were triggered by poor management of climate risk.

114 Vote Recommendations were Triggered by Climate Governance

In 2023 we expanded the scope of our climate governance voting signal to include consideration of climate-linked incentive pay arrangements at large mining companies and electric utilities with significant thermal coal generating capacity. In total, we evaluated the incentive-linked pay practices at 163 companies and offered 114 recommendations against pay arrangements. Our recommendations take into account how companies address their scope 3 emissions within their climate strategy as well as how targets are reflected in the overall structure of senior executives' remuneration plans. We review companies' proxy statements and compensation reports as well as their climate action plans and any climate reporting the company provides in standalone or ESG disclosures.

27 Vote Recommendations were Triggered by Engagement Escalation

During the reporting period, our engagements addressed a number of topics across the environmental, social, and governance pillars.

2024 Proxy Season Outlook

Looking ahead to 2024, here are some sustainability themes we believe will shape ballots and votes in coming months.

1 – Biodiversity and Circular Economy: Investors are mobilizing to protect nature loss.

Agreement on a Global Biodiversity Framework at COP 15 at the end of 2022 formalized a set of global goals for preserving nature. Early in 2023, the World Economic Forum estimated that over half of the world's GDP could be at risk from nature loss, with some sectors even more vulnerable to value erosion. Investor initiatives that followed. The release of the Taskforce on Nature-Related Financial Disclosures (TNFD) reporting guidance, and the launch of the Nature Action 100 collaborative engagement programme create a framework within which investors can evaluate financial risk and take action to address nature-related risks. The EU's new regulation on Deforestation-free products, the anticipated Corporate Sustainability Due Diligence Directive and the prospect of a global, legally binding UN treaty to end plastic pollution in place by the end of 2024 will further impose on boards the need to strengthen oversight of the environmental impacts across companies' value chains.

In 2023, 20 resolutions addressing environmental themes like plastic waste, deforestation, water stewardship and pesticide use came to vote, averaging 24% support. As investors become increasingly aware of the direct and systemic impacts of biodiversity loss and nature-related risks on investment value, engagements will become more specialized and visible, and support for well-targeted environmental resolutions will likely increase in 2024.

2 – Human Capital: Human capital management will continue to attract strong support in 2024.

In 2023, widespread strike action across various sectors highlighted the importance of human capital to investors. As living costs eroded living standards, workers mobilized for better pay, working conditions and job security. In some cases, labor disputes led to supply chain disruptions, compounding disruptions caused by extreme weather and political conflict.

Not surprisingly, human capital management was a priority issue for investors in 2023 and will very likely continue to be so in 2024. Across the 57 human capital resolutions voted in 2023, average support was 33%. Twenty-nine resolutions addressed decent work themes like workplace safety, freedom of association, living wage and harassment prevention. Eighteen addressed diversity and pay equity themes. Across the broad category, nine human capital-related resolutions were supported by a majority of shares voted. Two resolutions voted late in 2023, asking companies for better racial and gender pay gap reporting, earned majority support from non-insider shareholders – 51% at Nike and 64% at Oracle's annual shareholder meeting.

However, following the US Supreme Court's rulings against affirmative action in college admissions, the politicized backlash against workplace diversity and inclusion programmes intensified in 2023. Threats of legal action against workplace diversity programmes (see: SFFA Letter to Fortune 100 CEOs) may have a dampening effect on companies' formal DEI efforts in 2024. Notwithstanding, investor commitment holds firm: In September 2023, the 'Investor-as-Owner' subcommittee of the SEC's Investor Advisory Committee proposed new human capital management disclosures, including diversity disclosures, that would allow investors to better evaluate the effectiveness of companies' efforts to access and develop new sources of talent.

3 – Artificial Intelligence: Responsibility for Responsible AI falls on boards.

While 2023 proved to be a watershed year for AI, with widespread availability of Generative AI Chatbots and new tools for leveraging large language models, investor concern over the use and governance of emerging digital technologies has been gathering pace over the past several years.

Since at least 2019, shareholders have filed proxy proposals raising concerns around the development and licensing of facial recognition technologies, the collection and storage of biometric data, online platform content generation, algorithmically targeted advertisements and the weaponization of AI technologies.

With the growing sophistication of cyber-security threats enabled by new technologies, board-level cyber expertise has become essential for most large companies. In July 2023, the SEC adopted new rules requiring companies to provide greater transparency around cyber-security incidents and better reporting on cyber security oversight, including how boards oversee cybersecurity risk.

AI amplifies cybersecurity risk and raises a host of new risks. Investors are concerned that the race to develop and adopt AI-driven technologies has outpaced the development of sound frameworks for limiting negative impacts on stakeholders.

Two resolutions voted in 2023 offer a glimpse of more to come. A resolution voted at Canadian IT consulting firm, CGI Inc, asked the board to "…review the mandate of the Corporate Governance Committee in order to include an ethical component concerning the use of artificial intelligence." The resolution earned 13% support from shareholders. Later in the year, a resolution voted at Microsoft's AGM asked the board to "…assess the risks to the Company's operations and finances as well as risks to public welfare presented by the company's role in facilitating misinformation and disinformation disseminated or generated via artificial intelligence", earning 21% support. At least eight other shareholder proposals that came to vote in 2023 referenced AI in their supporting statements.

We believe that there will be far more focus on responsible AI and oversight of AI risks in the coming proxy season, requesting clarity on how boards are overseeing frameworks for the responsible deployment of AI across workplaces and in products.

4 – Due diligence and Corporate Governance: After a big year for sustainability disclosure in 2023, implementation of new rules in 2024 will focus investor attention on value chain impacts.

Significant milestones in sustainability disclosure were achieved in 2023: the passing into law of the EU Corporate Sustainability Reporting Standards (CSRD) and finalization of 12 companion Sustainability Reporting Standards (ESRS), the finalization and launch of the International Sustainability Standards Board's (ISSB) IFRS S1 and S2, and California's enactment of two broad-based climate-related reporting laws.

As some of the largest companies begin work on mandatory sustainability reporting, 2024 will see increased focus on sustainability due diligence, further extending boards' oversight and responsibilities around sustainable business practices. In 2023, the OECD updated its guidelines on Responsible Business Conduct, expanding due diligence requirements for Multinational Enterprises regarding the development and use of technology and storage of data, as well as for downstream product stewardship. Several European countries (Germany, The Netherlands, France, Norway, Belgium and Switzerland) have already enacted supply chain due diligence laws that require companies to take stock of, and protect, human rights, labor rights and the environment, as well as take mitigating and remedial actions for negative value chain impacts. These build on the human rights due diligence requirements in laws banning forced and slave labor in supply chains passed in the UK, Australia, the US and Canada.

The widely anticipated European Corporate Sustainability Due Diligence Directive (CSDDD), which is progressing towards final adoption in 2024, is already spurring companies across the globe to take stock of their upstream and downstream impacts. Like the CSRD, the CSDDD extends the EU's impact-focused sustainability agenda to non-EU companies doing business in the EU. Accountability and shared liability for supply chain impacts will encourage companies to invest in supply chain monitoring and to take more proactive and collaborative approaches to engaging with their supply chains beyond their own borders.

5 – Climate Transition Planning: Companies are under growing pressure to articulate and implement credible plans for aligning their business models to national and global 'net-zero' goals.

With 2023 officially called the hottest year on record, climate planning at every level takes on a new urgency. More governments and municipalities around the world are adopting strategies and laws committing economies to achieve emissions reductions aligned with the Paris Climate Agreement. On February 6 the EU announced its aim to achieve a 90% reduction in emissions from 1990 levels across its 27 member states by 2040, building on an earlier commitment to reduce emissions by 55% by 2030.

For investors, climate transition plans are a valuable source of information about the resilience and impact of investee companies within their portfolios. Frameworks are emerging to help investors assess companies' climate transition plans. The CDP and the French Government Agency for Ecological Transition's (ADEME) developed a framework for Assessing Low-Carbon Transition (ACT). The Climate Action 100+ Net Zero Company Benchmark tool evaluates various aspects of companies' climate plans and actions, as does the Transition Pathway Initiative tool.

Regulatory pressure is also building: The UK Government's Transition Plan Taskforce Disclosure Framework, launched in October 2023, provides detailed guidance for complying with mandatory transition plan reporting. California Senate Bill 261, passed in October 2023, requires biennial financial risk reporting, applying a broader definition of material financial risk and including a strategy for mitigating and adapting to reported risks. Both apply to 2025 with first reports required in 2026. Under the CSRD, companies will have to provide annual reporting on their transition plans – from 2024 for the first tranche of companies. The EU's anticipated CSDDD would require companies to adopt and implement a net-zero aligned climate change transition plan.

Not surprisingly, significantly more climate-related shareholder resolutions asked for, or referenced, climate transition plans in 2023, compared with 2022 – mostly at companies outside the US. In 2024 we anticipate that shareholders will build on these requests, asking companies to produce net zero aligned plans, enhance climate transition planning, and provide more detail around specific aspects of plans, such as, capital expenditure alignment, alignment of lobbying and policy influence activities, and how banks and insurers intend to align their financing activities with their sectoral emissions reduction targets.

At the intersection of shareholders' climate and human capital risk concerns, the 2024 proxy season could see more, and stronger support for, requests for just transition reporting, building on the 25% average support received by seven resolutions in 2023, asking companies to report on "social impact on workers and communities from closure or energy transition of the Company's facilities, and alternatives that can be developed to help mitigate the social impact of such closures or energy transitions."

Product Enhancements for 2024

Starting in February 2024, the ESG Voting Policy Overlay Service is generating Meeting Commentaries for actively engaged companies covered by Morningstar Sustainalytics Engagement 360. Meeting Commentaries are narrative, high-level meeting explainers generated ahead of an engagement company's annual shareholder meeting. They provide a summary of the themes and issues on which the company is being engaged; an overview of the ballot measures to be voted at the company's upcoming shareholder meeting; and a review of important governance arrangements at the company relevant to voting items. Corresponding meeting alerts will be sent to clients via the channels through which voting recommendations are sent.

About Morningstar Sustainalytics and Contacts

Morningstar Sustainalytics is a leading ESG data, research, and ratings firm that supports investors around the world with the development and implementation of responsible investment strategies. For more than 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Morningstar Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG information and assessments into their investment processes. The firm also works with hundreds of companies and their financial intermediaries to help them consider material sustainability factors in policies, practices, and capital projects. Morningstar Sustainalytics has analysts around the world with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit www.sustainalytics.com.

Do you have any questions regarding our Stewardship Services? Contact us today to connect with our team of experts.

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