Institutional Investors & Shareholder Activism in the USA

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FIVE KEY TAKEAWAYS

1

Almost all US institutional investors expect shareholder activism to become even more important in the future

Over nine-in-ten (91%) institutional investors expect shareholder activism to become more important over the next three years. Within this overwhelming majority, 32% of investors expect it to become much more important, while the remainder expect it to become slightly more important. Eight-in-ten (81%) investors say shareholder activism has become more important in the last three years, so these results show that investors feel the importance of shareholder activism is growing.

2

US institutional investors believe that they can be most influential on the E in ESG

US institutional investors see environmental protection and renewable energy as the issues they can be most influential on, followed by clean technology, energy and climate, innovation and infrastructure and delivering social and environmental benefits. These are mainly issues related to the 'E' in ESG, or 'green' issues. This suggests that as more institutional investors see the risks around climate change as increasingly important, so investors see these issues as ones where they can be influential.

3

US institutional investors know there's little point in engaging on certain issues

US institutional investors are least likely to believe that they can exert influence on the so-called "sin stocks", such as tobacco, gambling and alcohol. They are also least likely to engage with companies on these issues. This is because investors have a simple choice of investing in these activities or not, as they cannot, for example, make tobacco less harmful by engaging with tobacco companies. In the same vein, investors are more likely to engage on issues such as human rights and health and wellbeing, where companies are more likely to listen and improve their practices. There is also more engagement on environmental and climate issues, a reflection of their importance to investors and the potential for companies to change policy on them.

4

A range of actors are seen as responsible for changing companies

Asked how responsible several actors are for bringing change to companies they invest in, investors see asset managers as being the most responsible overall (both partial and complete responsibility), followed by other institutional investors and then their own organisations. However, they also see industry consultants, NGOs and pressure groups and the government as also bearing responsibility.

5

Covid-19 has increased scrutiny of companies by US institutional investors

The biggest impact of Covid-19 for investors is that nearly 70% of US institutional investors agree that there has been more scrutiny on how businesses are handling Covid-19. The pandemic has produced winners and losers among companies, as they have scrambled to adapt. Some companies and sectors have thrived, while others have suffered, so investors have had to work hard to keep track of how their investee companies are performing in 2020.

150 institutional investors from the United States were surveyed in November and December 2020 on their views on shareholder activism.

BACKGROUND

The various forms of shareholder activism and engagement

For institutional investors in the United States, shareholder activism and shareholder engagement are important aspects of owning shares in public companies. By engaging with companies they own shares in, investors can try to influence company policy to better reflect their investment beliefs and activism can be used to push for change at companies, when investors disagree with a company's board over strategy or other business matters.

Shareholder activism can be split between economic activism and 14a-8 activism. Economic activism, as the term suggests, has the primary purpose of gaining a short-term economic reward. It is usually carried out by hedge funds and other professional investors who take a position in a target company and push for changes, which they believe will unlock shareholder value and earn them a good return on their investment. The most well-known activist funds are led by the likes of Paul Singer at Elliott Management Corporation, Daniel Loeb at Third Point Management, Carl Icahn at Icahn Enterprises, or Edward Bramson. These investors typically take positions in companies they believe need corporate changes, such as mergers, acquisitions, or a break-up, to become more profitable. They can be aggressive corporate change agents, scrutinising their targets for sloppy decision-making or wasteful excess and making use of the media to put pressure on their opponents.

Recent examples of high-profile shareholder activism campaigns include Bramson's campaign against Barclays, Carl Icahn urging Hewlett Packard and Xerox to merge, or Elliott and another activist fund, Starboard, calling on Ebay to sell non-core assets. However, the global pandemic temporarily paused activist campaigns in 2020, as businesses concentrated on fighting for survival and activists decided to hold back until normality returned. The pandemic-induced crisis has also led to a temporary acceptance of 'poison pills', designed to halt hostile shareholder takeovers when company shares fell in price, due to the pandemic. But once the crisis abates, activist investors are expected to renew their campaigning.

Shareholder activism has increased in recent years

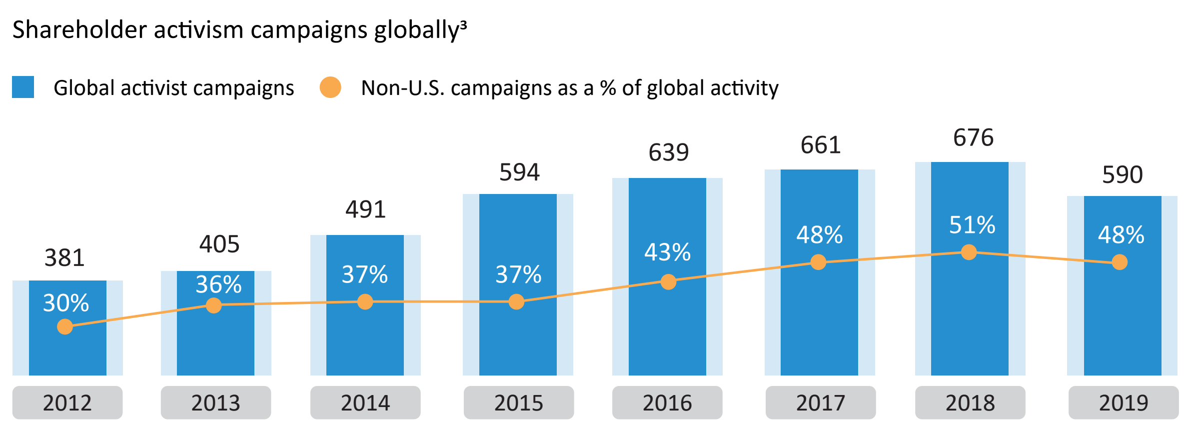

Chart source: JP Morgan 2019 Proxy Season Review. Data sources: SharkRepellent, Activist Insight and Activist Monitor as of June 30, 2019. Represents the following campaign types: board control and representation, enhance corporate governance, maximize shareholder value, remove director(s), remove officer(s) and vote/activism against a merger. * U.S., Europe, Asia and Australia

According to JP Morgan's review of the 2019 proxy season, shareholder activism campaigns globally dipped to 590 in 2019, down slightly from 676 in 2018. As shown above, the proportion of non-US campaigns has increased, but the US still accounts for around half of all activist campaigns. Other data, from Lazard[1], showed that the number of investors

[1] Lazard's Shareholder Advisory Group, 2019 Review of Shareholder Activism https://www.lazard.com/media/451141/lazards-2019-review-of-shareholder-activism-vf.pdf

launching activist campaigns continues to grow, including a number of traditional long-only fund managers, such as T Rowe Price, Fidelity, Baillie Gifford, Neuberger Berman, M&G Investments and Wellington.

Asset managers and other institutional investors can play an important role in activist campaigns, as activists pushing for change depend on institutional investors to support their efforts. Activist campaigns often seek board seats and these can be given before a proxy vote occurs as companies realize they need to listen to activists. Otherwise, activist investors want companies to meet their demands and this can result in proxy fights, when matters are voted on at shareholder meetings.

In contrast to economic activism, 14a-8 activism is the practice of shareholders putting forward proposals under Exchange Act Rule 14a-8, under which a company includes a shareholder proposal in its proxy materials for investors to vote on. This form of activism can be used by institutional investors and other groups to promote their views on a range of issues, often including those under the environmental, social or governance (ESG) umbrella. The growth of ESG investing has added to the range of shareholder concerns. Another trend supporting 14a-8 activism is the growth of "stakeholder capitalism", where companies are seen as having commitments to customers, employees, supplier and communities, as well as shareholders. This widens the scope for investors and others to call for companies to act on a wide range of social and environmental issues. As well as engaging with companies in order to influence how they operate, investors can also exercise their rights as shareholders by proxy voting. Having a 'say on pay', or executive remuneration, and other governance issues is now seen as a bread and butter part of shareholder activism and engagement, although it can get feisty, depending on the issue under debate.

Alongside these forms of activism, investors can also engage with companies they invest by engaging with them through private and public communication, or dialogue. Engagement, also known as stewardship, is important for institutional investors as part of their role as shareholders in companies, as they are frequently long-term investors and engagements aims to produce robust long-term returns. Very large institutional investors are sometimes called 'universal owners' because they have investment portfolios that are heavily exposed to global markets. It is therefore in their interest to see all companies raise their game on issues that investors see as important for their long-term success. Large US public pension funds fall in this category and many play an active role, engaging with companies they invest in and collaborating with other investors.

Recent regulatory and other developments

In the last year or so there have been significant developments that could potentially broaden and intensify how shareholders engage with companies, such as the Black Lives Matter movement and its focus on diversity and racial injustice. This is in addition to the general growth of interest in ESG investing, which has become an investment megatrend for a variety of reasons, from growing concern over climate change to the attitudes of the millennial demographic group on investing in line with their values. Against this, recently there has been distinct regulatory push-back on shareholder rights and in favor of businesses, with recent proposals from the Securities and Exchange Commission (SEC) and the Department of Labor.

On the regulatory side, the SEC voted to amend Rule 14a-8 in order to increase the ownership threshold to submit a shareholder proposal from holding at least $2,000 or 1% of a company's securities to three alternative higher thresholds ($2,000 of the company's securities for at least three years; or, $15,000 of the company's securities for at least two years; or, $25,000 of the company's securities for at least one year). The SEC said the threshold had not been updated for over 20 years and that the final amendments will apply to meetings held after January 1, 2023, following a transition period. However, the increased thresholds have been criticised by a range of organizations, who say that shareholder proposals are an important tool for investors to raise issues and raising the threshold would reduce the voice of smaller shareholders. Whatever the rights and wrongs of the rule change, the debate it generated showed the rising importance of 14a-8 activism. As well as its proposals on Rule 14a-8, the SEC has recently approved new restrictions on proxy voting advisors, which are used by many investors to help them with information on voting and the exercise of proxy voting rights. The new rules could be seen as an attempt to clip the wings of proxy voting advisors by reducing investor reliance on them.

Separately, the Department of Labor (DoL) introduced a ruling to stop trustees of ERISA (Employee Retirement Income Security Act) plans, such as defined contribution 401k pension funds, from investing in 'non-pecuniary' vehicles which sacrifice returns or take on additional risk. This means that ERISA plan fiduciaries should only take ESG issues into account when they are pecuniary, with a material impact on risk and return. While this new ruling does not apply to institutional investors, it could influence them. The DoL's stance toward ESG investing attracted criticism, as some commentators pointed out that many now believe that ESG investing no longer means giving up returns or taking on more risk. This view was shown early in 2020 by the world's largest fund manager, BlackRock, in its annual letter to CEOs. It stated: "Our investment conviction is that sustainability and climate-integrated portfolios can provide better risk-adjusted returns".

Proxy voting in 2020

According to the Glass Lewis 2020 Proxy Season Review for United States, the biggest story was the impact of the global Covid-19 pandemic. It meant that the Securities and Exchange Commission (SEC) gave companies an extra 45 days to file any disclosures due between March 1 and April 30 2020 and the SEC also gave more flexibility over how meetings were conducted. Other authorities, such as the New York Stock Exchange and the Nasdaq exchange relaxed some of their rules as a result of the pandemic.

Virtual-only meetings became common in 2020, with over 1,600 companies holding them. Proxy voting advisors, such as Glass Lewis, had to take account of the pandemic in their voting recommendations, for example in the use of poison pills. Here, Glass Lewis said it would consider the pandemic and the related economic crisis to justify the use of a poison pill if its duration was limited to one year or less, and if a company had a sound rationale for the adoption of the pill as a result of the pandemic. As most items for shareholder voting at 2020 AGMs were submitted early in 2020, issues raised by Black Lives Matter and the pandemic were not on shareholder proposals. But, according to Glass Lewis, ESG issues such as climate change are rising in prominence.

What impact will the US election result have on shareholder activism?

Despite Donald Trump's protestations to the contrary and initial refusal to concede, Joe Biden has been declared the president-elect following the US election in 2020 and this could have significant implications for shareholder activism.

Firstly, the regulatory push-back to shareholder activism and ESG investing is likely to weaken when Trump leaves office, as his administration generally opposed anything it perceived as hindering big business in general and sectors such as oil and gas and mining, regardless of any detriment to the environment they caused. But Biden has campaigned on the USA rejoining the Paris agreement on climate change and a transition from fossil fuels to renewable energy. In addition, US rules on ESG investing and corporate disclosure could move closer to those in Europe under Biden, which could boost US institutional investment according to ESG principles, as could the development of international standards on ESG investing with the support of the USA.

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Headquarters

AUSTRALIA
CoreData Pty Limited
Suite 7, Level 9, 66 Hunter St
Sydney, NSW, 2000
T: +61 2 9376 9600
E: coredata@coredata.com.au

UK
CoreData Research Ltd
6 Foster Lane, London ECV 6HH
United Kingdom
T: +44 (0)207 600 5555
E: info_uk@coredataresearch.com

US
CoreData Research LLC
15 Court Square, #450
Boston, MA 02108
T: +1 (857) 239 8398
E: info_us@coredataresearch.com

PHILIPPINES
CoreData Research Services Inc.
Unit E-1608 Philippine Stock Exchange Centre,
Exchange Rd, Ortigas, Pasig City, 1605
T: +63 2 667 3996
E: info_ph@coredataresearch.com

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