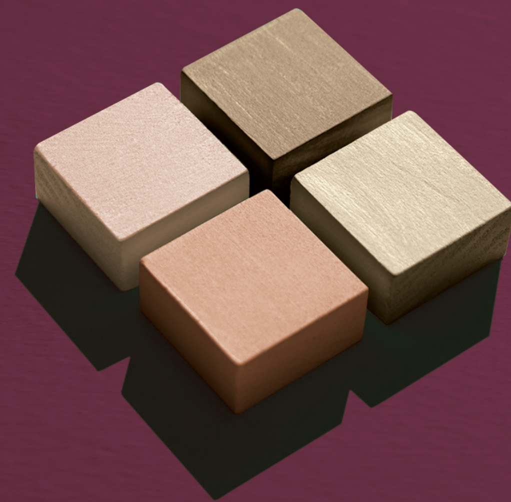
Vanguard Investment Stewardship Policy Insights

Our perspective on Say on Climate proposals



May 2022

Executive summary

- At this time, Vanguard does not proactively encourage companies to hold a “Say on Climate” vote given the lack of established standards or widely accepted market norms that govern these votes.
- When a company chooses to hold a “Say on Climate” vote, Vanguard expects the board to provide clear disclosure of the rationale for the vote, to articulate the oversight mechanisms and implications of the vote, and to produce robust reporting in line with the Task Force on Climate-related Financial Disclosures (TCFD) framework.
- Vanguard does not seek to direct company strategy. We view “Say on Climate” votes as a signal on the coherence and comprehensiveness of the reporting and disclosures a company provides to explain its climate plan to the market, rather than an endorsement of, or an expression of lack of confidence in, the plan itself.

Vanguard’s Investment Stewardship team is responsible for engagement with portfolio companies and proxy voting at the direction of the boards of our internally managed global equity funds, including Vanguard index funds. Investment stewardship activities, including proxy voting, for Vanguard’s externally managed active funds are supported by those funds’ external advisors. See the back page for additional context.

Developments in Say on Climate votes

Last year we outlined our approach to evaluating Say on Climate proposals that encouraged companies to disclose climate transition plans.

We have since observed a significant increase in management-proposed climate plans that are put to an advisory shareholder vote, primarily among European and Australian companies. The specific forms and governance mechanisms of these votes remain heterogeneous, as some companies mirror the framework of "Say on Pay" (a vote on the plan every three years, and an annual vote on a progress report) while others opt for "test and learn" or "one and done" approaches. The various choices boards make amid the lack of consensus or convergence of frameworks and standards on these votes creates some confusion and complexities that investors and other stakeholders are working to navigate.

Beyond the confusion about the nature and mechanics of Say on Climate votes, there are no established standards or widely accepted norms for what a robust climate plan entails, given the evolving nature of these votes and the accelerating pace of the energy transition. For example, TCFD is a robust framework for assessing climate-related risks, but it does not provide a framework for a company to create a climate transition plan. Most management-submitted Say on Climate resolutions to date have drawn high levels of support, which may indicate appreciation for general progress and enhanced disclosures on the topic. At the same time, we are concerned that these high levels of support might unintentionally mask some of the disclosure and risk management gaps that have been identified in climate transition plans and reports. Clearly, intensive dialogue and ongoing constructive engagement between boards and shareholders are fundamental to close these gaps and are often more meaningful than the binary choice that a vote offers.

Like other stakeholders, Vanguard remains cautious about the value of a Say on Climate vote. We recognize the possible benefits in terms of strengthening shareholder engagement but are concerned about the potential implications and unintended consequences for governance and accountability.

We do not proactively encourage companies to hold such a vote, and we emphasize the need for boards to explain why a Say on Climate vote might be an appropriate choice for their organizations. We do, however, recognize the value that a Say on Climate vote could serve for a company where climate-related risks are material, when the vote is structured clearly and appropriately as an advisory vote on a company's reporting on its climate plan. A vote could add perspective to ongoing engagement with shareholders and other stakeholders about a company's climate-related disclosure as it evolves over time. Through our ongoing engagement with relevant stakeholders, we will continue to advocate for the development of clear and consistent best practices for companies that choose to offer a Say on Climate vote.

Grounding in long-term risk governance

Climate change represents a fundamental risk to investors' long-term investment success and has the potential to materially affect companies across many sectors. Our case-by-case approach to evaluating climate-related proposals is grounded in our duty to safeguard and grow our clients' assets. Vanguard expects boards to effectively oversee material climate-related risks, implement strategies to manage and mitigate risks and seize opportunities, and disclose those risks using widely recognized investor-oriented reporting frameworks. We also expect regular reporting, aligned with the TCFD framework, on progress to meet goals and demonstrate responsiveness to shareholder feedback. Advisory votes might help companies judge investors' perspectives on a topic, but these votes should not be used to delegate strategic oversight responsibilities to shareholders, nor should they be used in place of meaningful disclosures to the market and communications with shareholders.

There are situations when we may challenge a board on the relevance of a Say on Climate vote. For example, we question what additional costs and benefits such a vote brings at companies in sectors where climate-change-related risks are comparatively low. We are also concerned that some companies may be using the vote in opportunistic ways to demonstrate that they have shareholder support for plans that are incomplete or have remained static. In other cases, companies may be adopting a Say on Climate vote under pressure or as a defense tactic, without undergoing the significant engagement and dialogue with shareholders and stakeholders that are necessary to enhance mutual understanding and alignment.

We are also concerned when a proposal has not been adequately framed to explicitly clarify the advisory nature of the vote. Seeking approval of a company's climate strategy could infringe on the fundamental corporate governance premise that shareholders elect a board to oversee management's formulation and execution of a company's strategy and management's implementation of appropriate risk management frameworks. Indeed, Vanguard's proxy voting policies indicate that we may vote against directors at companies where we have identified material gaps in climate risk monitoring and management.

How Vanguard approaches Say on Climate votes

A core principle of Vanguard's stewardship program is that we do not seek to direct a company's strategy—including on climate-change plans. Instead, we look to its board to articulate how the strategy is expected to generate shareholder value. We are therefore concerned when a board puts forward a resolution that is framed as a vote on the company's strategy, as it could indicate an abdication of the board's responsibilities and diminish its accountability.

At the same time, we recognize that by enabling shareholders to vote on climate disclosures, companies can gather important feedback on how their climate strategies are considered or perceived in the context of the goals of the Paris Agreement and shareholder expectations.

We urge companies' boards to clearly articulate what shareholders are being asked to vote on, and we encourage boards to frame a potential Say on Climate vote as an advisory vote on disclosures. We intend and interpret our vote on a Say on Climate proposal as being a signal on the coherence and comprehensiveness of the reporting and disclosures that a company makes available to explain its plan to the market—rather than an endorsement of strategy or lack of confidence in the plan itself.

How we assess disclosures that explain climate plans

The Vanguard funds are long-term investors that seek to constructively support companies in value creation, including through the transition to a low-carbon economy. Our support relies on our ability to understand and contextualize companies' decisions and strategies. Although robust governance and effective disclosure are not a guarantee of a credible transition plan, they are key components that will enable investors to make informed decisions.

In assessing plans, we use our expertise, engagement activities, and third-party resources to apply a case-by-case, principles-based approach grounded on our three key pillars: climate risk oversight, mitigation, and effective disclosures. For companies with material climate risks, considerations include clear board-level oversight and accountability, a well-articulated strategic approach to climate, credible emission-reduction targets aligned to the goals of the Paris Agreement, and the quality of disclosures.

We seek to confirm and understand the coherence and consistency of a company's plans and disclosures with the company's commitments and actions, and evaluate whether a company's efforts are reasonable, sufficient, and appropriate to address the expectations of investors and other relevant stakeholders, including factoring in potential changes in regulations or market dynamics. We look for a coherent value proposition for shareholders, consistent with prudent risk management and mitigation; alignment with the Paris Agreement goals and related country-level targets and international agreements; and mitigation of reputational and legal risks.

We may question boards' decisions to seek shareholder approval on unclear or incomplete disclosures that fail to meet some basic market expectations. We may decide to oppose or withhold support for a plan based on individual elements of disclosure (or lack of them) and/or a combination of concerns that indicate inconsistency and incoherence of approach.

Conclusion

Companies do not need a Say on Climate vote to develop and execute a robust climate plan. We recognize that advisory votes may support ongoing progress and market engagement, while acknowledging the challenges with an emerging and fast-evolving tool.

As Vanguard's investment stewardship activities do not seek to direct companies' strategies, it is imperative that accountability for climate-related risk strategy and oversight firmly remains in the board domain. It is also fundamental that companies produce clear and comprehensive disclosures to show evolution of approaches over time, to allow the market to understand and price risk appropriately.

When boards choose to adopt a Say on Climate vote, we expect them to provide clear disclosure of the rationale for the vote, to articulate the oversight mechanisms and implications of these votes, and to produce robust reporting in line with the TCFD framework.

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