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INVESTMENT MANAGERS

Shareholder Advocacy: The Other Half of Responsible Investing

Much of the focus of responsible investing approaches centers on what investors own, or don't own, in their portfolios. Choosing not to own shares of companies that are engaged in activities that an investor believes are counter to their values can send a message to those companies that may help bring about change. An early example of this was the divestment movement that helped pressure South Africa to end apartheid.

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There is, however, another effective way to influence corporate behavior in companies in which investors own shares via annual proxy votes. With a relatively small sized holding in a company, shareholders can file or co-file shareholder resolutions that ask companies to review or change current practices or policies that are of concern. Generally these resolutions are non-binding, but if enough shareholders vote in favor of these resolutions, companies will usually recognize the need to address these issues to satisfy their shareholders.

These resolutions are generally focused on environmental, social and governance (ESG) issues. Environmentally oriented resolutions might address issues such as energy use and climate impact, pollution, food toxicity and harmful chemicals in consumer products. Social issues can include human rights, impacts on communities, equitable pay, and workplace diversity. Within the governance area topics such as executive compensation, board organization and diversity, shareholder rights to elect board members and political spending are among the topics for which resolutions are filed.

Successfully influencing the behavior of large corporations definitely requires collective action. Getting resolutions on ballots is a somewhat involved process, but that is just the first step. Once they get on ballots, a significant number of shareholders need to vote in favor of resolutions in order for companies to pay attention and consider changes. Fortunately there are a number of organizations that have established networks of investors that help coordinate and facilitate the filing of resolutions and advocate for other shareholders to vote in favor of specific resolutions. Managed Portfolio Advisors (MPA) and Active Index Advisors (AIA) belong to and work with a number of these organizations including the Ceres Investor Network, the Interfaith Center for Corporate Responsibility and As You Sow.

How can I use the shares I own to influence corporate behavior?

This can actually be quite easy, and MPA and AIA can help. As a first step clients can consider proxy ballot resolutions and vote for those that they think are appropriate. Many clients delegate their proxy voting to us as their investment manager, which makes that even easier, as we have a team that evaluates resolutions and then votes the proxies.

Clients that want to be even more involved in the process can use shares that they own in companies to file or co-file resolutions. Co-filing a resolution can be quite easy if done in conjunction with other organizations advocating for a particular issue. MPA and AIA can identify companies and issues for which organizations and investors are considering resolutions that might align with a client's concerns. If a client wants to use their shares to co-file on a resolution, we can help facilitate that with a minimal amount of documentation. These issues are usually identified in the late summer and early fall.

How does the process work?

In the late summer / early fall, shareholder advocacy organizations and investor networks identify companies and issues for which ballot resolutions might be appropriate. At that point, or possibly before, a dialogue is initiated with the company. In some cases the company may agree with the point raised and may proactively take action. If not, then the filing process may begin.

Proposed resolutions are filed with the company. The company has the opportunity to challenge the resolution, and if they do, the Securities and Exchange Commission will determine whether the resolution is valid and needs to be included on the upcoming proxy ballot.

If the resolution is added to the ballot, then shareholder advocacy organizations and investor networks begin to get the message out about important resolutions to help educate and inform shareholders. Dialogue may continue with the company, and if they agree to take action to address the issue, the resolution may be withdrawn.

Annual meetings and proxy voting for most companies happen in the late spring and early summer. At these meetings someone will present the issue regarding the resolution and all shareholders have the opportunity to vote for the resolution.

Resolutions that receive 20%–40% or more votes in favor send a clear message to company management that a significant portion of their shareholder base is concerned about that issue. This level of approval might not be achieved in the first year a resolution is on the ballot. Resolutions that receive 3% in the first year, 6% in the second year and 10% in subsequent years can be resubmitted the following year. Support for the issue may build over time as more shareholders learn about it.

Will I be harming my portfolio's performance by asking companies to consider these issues and change their practices?

It is a common misperception that focusing on environmental, social and governance issues can harm the financial performance of companies and investment portfolios. In fact, there are numerous studies that have shown that companies and portfolios with stronger ESG characteristics tend to exhibit results that are either in line with or better than the broader universe. This is especially true of the governance area where companies with better corporate governance tend to have better financial performance, higher stock returns and lower cost of capital than companies with weaker governance.

ESG issues are often referred to as "non-financial" considerations, but in our view this doesn't accurately reflect the impact these issues can have on a company's financial results. An apparel manufacturer that doesn't take adequate steps to ensure there are not human rights violations occurring in its supply chain can suffer significant damage to their brand and a decrease in sales if news comes out that child labor is being used by one of their suppliers. A company with poor environmental practices might be exposed to costly judgments from lawsuits. Companies with poor governance can suffer reputational damage that can impact consumers' trust and loyalty. The connection to company financial performance, which is a key driver of stock returns, is pretty direct in many of these cases.

AIA46-0419
2052471.2.1
Expiration 4/30/2020