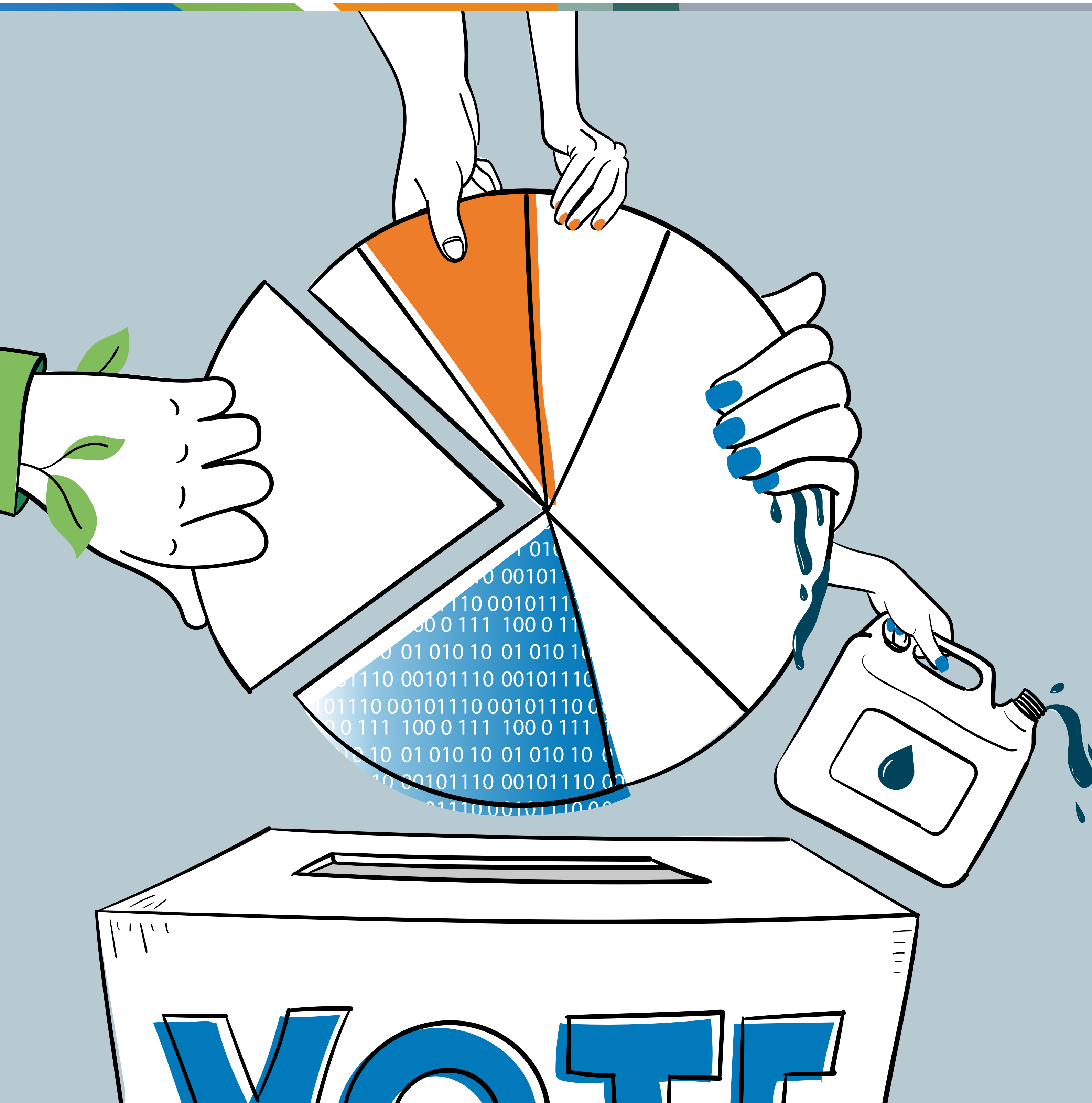
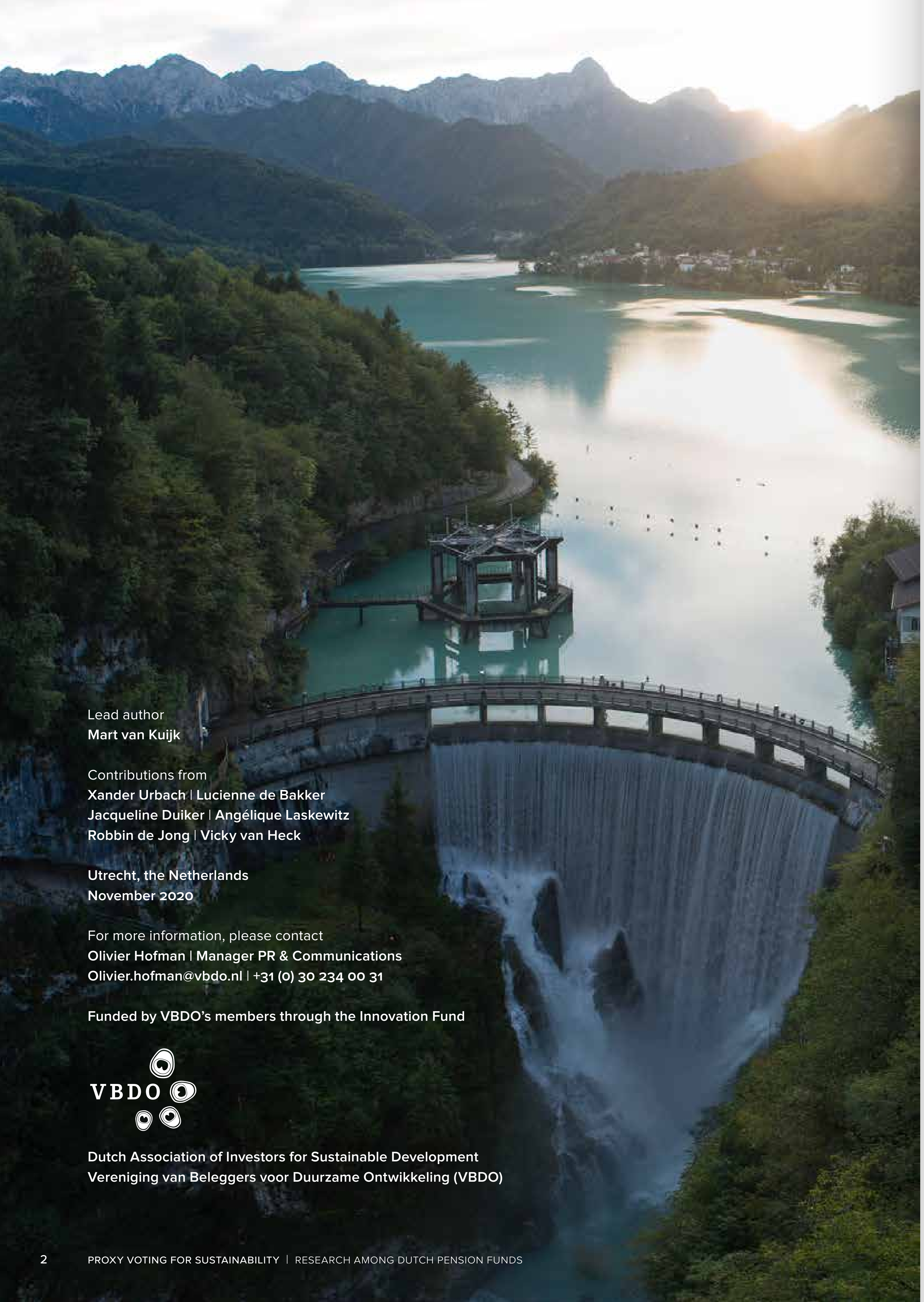
Proxy Voting for Sustainability

research among Dutch pension funds





Lead author
Mart van Kuijk

Contributions from
Xander Urbach | Lucienne de Bakker
Jacqueline Duiker | Angélique Laskewitz
Robbin de Jong | Vicky van Heck

Utrecht, the Netherlands
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For more information, please contact
Olivier Hofman | Manager PR & Communications
Olivier.hofman@vbdo.nl | +31 (0) 30 234 00 31

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Dutch Association of Investors for Sustainable Development
Vereniging van Beleggers voor Duurzame Ontwikkeling (VBDO)

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Preface

VBDO is pleased to present this report on Proxy Voting for Sustainability. It has been made possible thanks to our members, through the VBDO Innovation Fund. While we address the topic of proxy voting in our VBDO Responsible Investment Benchmark, we felt that it was time to both dive deeper into the topic and to get a broader perspective. In this report, VBDO investigates how Dutch Pension Funds take environmental and social (E&S) topics into account when expressing their shareholder rights and if (and how) they use proxy voting for sustainability-related issues.

The year 2020 will enter history books as the year our societies and economies were faced with a health, social and financial crisis. 2020 also marks VBDO's 25th year of existence, a silver jubilee. We remain committed to the fulfilment of our mission: making the capital market more sustainable. As well as acknowledging the crisis that society is facing, we must not forget that there is much to be positive about. 2020 has seen the largest inflow of capital towards sustainable investments in history. In addition, shareholders filed the highest number of climate-related resolutions and these received the greatest support from shareholders ever reported. We hope these events help to highlight the need for a sustainable recovery and a more just and green economy.

Active ownership, with voting in tandem with engagement, is one of the most important tools an investor has when it comes to steering corporate strategies. Ultimately, this will assist the transition to a more sustainable economy and it will support society to take swift action in making a sustainable recovery from the pandemic. We are pleased to find that a large number of the pension funds are reporting the integration of environmental and social criteria in their voting processes, e.g. through implementing a responsible investment policy. However, it must be noted that these self-reported results do not fully align with those of our own Benchmark on Responsible Investment by Pension Funds in the Netherlands 2020. We are aware that the formulation of a robust RI policy and the effective implementation thereof still poses many challenges.

This study aims to support pension funds to overcome those challenges and offers guidance to implement policies and use voting as an effective tool for active ownership. We trust that this study also offers valuable insights for other players in the investment community, in particular those in the proxy voting chain.

I would like to thank our members for their continued support of our mission and these types of thematic reports. I would especially like to thank the participating pension funds and their asset managers for their cooperation, input and valuable contributions.

Angélique Laskewitz
Executive Director
VBDO

Main findings

PROXY VOTING FOR SUSTAINABILITY IS NOT USED TO ITS FULL POTENTIAL BY DUTCH PENSION FUNDS

Proxy voting and divestment are the most important 'sticks' that pension funds have to exercise their shareholder rights and execute their active ownership responsibilities. In the past couple of years, voting has received a lot of attention due to several climate resolutions filed at the world's largest Oil & Gas companies (e.g. by Follow This), but perhaps more interestingly it has also received attention due to the voting behaviour of the largest asset owners and their asset managers. This is the first time that VBDO has conducted research among Dutch Pension Funds on proxy voting for sustainability. The following findings are based on self-reported results by 34 Dutch Pension Funds and are concluded by seven recommendations. See Chapter 4 for a more detailed explanation of the findings and recommendations.

Different requirements for embedding E&S in voting policy | Almost all (94%) pension funds indicated that E&S requirements are included in their proxy voting policy. However, in this year's VBDO Benchmark on Responsible Investment by Dutch Pension Funds it was found that only 47% of the pension funds have integrated environmental and social requirements in their voting policy. This could indicate that VBDO's minimum requirements for E&S integration in voting are higher than those of the pension funds. We feel that it is crucial to close this gap in the years to come.

Unutilised potential for implementing the voting instrument | When we take a closer look at the implementation of the voting policy, we can conclude that a large share of the pension funds (63%) report that they use voting as an escalation tool for failing engagement efforts on environmental and social topics. This also means that 40% do not utilise the effective combination of voting alongside engagement.

Unaware of deviations in voting | We found that not all pension funds are aware of deviations in votes in relation to their voting policy, even though this information is critical if the voting policy is to be effectively implemented. Only 44% of the funds monitor if votes are cast in accordance with their voting guidelines.

Accountability on voting is gaining traction | Accountability is an important aspect of voting and is increasingly being integrated in legislation. In addition, more advanced services by asset managers and. service providers are entering the market. Almost all pension funds report on their voting records, either in an aggregated form (93%) or for each resolution (63%).

The results indicate that while E&S voting is considered by pension funds as an important tool to exercise their active ownership, it is not used to its full potential and there is still much unfulfilled potential, e.g. in setting effective E&S requirements in voting policies, implementing the policy effectively and ensuring more transparency and accuracy in the proxy voting chain. We recommend that pension funds start raising the bar on sustainability in their voting behaviour and initiate discussions on case-by-case voting decisions in the board and with their asset manager or voting advisor. Also, pension funds should participate in consultations on voting policies and start to review asset managers and service providers' performance on E&S topics. We suggest that pension funds use engagement in tandem with voting and optimise these active ownership instruments, for example by joining forces with other investors on important voting decisions.

Recommendations

1 Raise the bar | Not all pension funds in the Netherlands have yet effectively integrated E&S requirements into their voting policies. Therefore, it is important that all pension funds formulate a baseline, be more ambitious and periodically heighten the baseline to further increase the integration of material environmental and social topics.

2 Integration of E&S requirements in voting on routine items | Pension funds should create stronger links between E&S performance and routine voting, i.e. for or against management proposals. These should be formalised in their own voting policy, and emphasised in internal discussions related to voting decisions and in consultations on voting policies with advisors and providers. We recommend that pension funds push for better qualification and flagging of ESG items in the AGM agenda's by proxy voting service providers. It is important to improve the feedback loop with the proxy voting service provider (and asset manager) and make sure that environmental and social requirements (E&S) are also applied when votes are being cast relating to companies that aren't being engaged with.

3 Active participation in external consultation of asset managers and proxy voting service providers | Active engagement with asset managers and proxy advisors during external consultation rounds is crucial to raise the bar on environmental and social risks. The yearly review of the voting policy of these organisations is key to putting important ESG risks on the agenda. Pension funds and other institutional investors need to actively participate in these dialogues, express their concerns and integrate their clients' beliefs.

4 Continue to assess and monitor proxy voting advice and services | Several criteria should be evaluated when selecting or continuing the relationship with a manager or provider. These include the organisation's voting policy, historical engagement outcomes, capacity, governance mechanisms, engagement processes, capacity for reporting and digital systems. More specifically related to sustainability, the depth and scope of the research that the organisation conducts on ESG topics should be evaluated and the pension fund should consider how the organisation deals with salient issues and controversies, as well as considering policy deviations and engagement objectives and pathways.

5 Optimise relationship with engagement | A clear relationship between voting and engagement supports the mission and overall responsible investment strategy of the asset owner. Submitting E&S shareholder resolutions, voting against the re-election of directors who are responsible for the topic of engagement or voting against the board of directors are escalation strategies that are not optimally used. We recommend pension funds use their shareholder rights and start to utilise these active ownership tools strategically.

6 Increase transparency on voting | ***Actual voting*** | More transparency from pension funds and their advisors and service providers, can lead to a different voting behaviour across the line. Potentially, voting activities not aligned with collaborative investor groups, corporate dialogues and investor mandates could be called into question by the public. | ***Voting accuracy*** | An assessment by the pension fund in part or in full of the accuracy of votes by the asset manager or voting service provider is essential for the effective implementation of a pension fund's voting policy, and could prevent reputation damage in future AGM seasons due to increasing scrutiny from stakeholders. | ***Voting rationale*** | We recommend pension funds ask their advisors and service providers to commit to a 'comply or explain' approach for supporting independent ESG resolutions. This means that the service provider would need to provide a published rationale for not supporting such a resolution.

7 Join forces | Collaborate more intensively with other similar shareholders on voting. Collectively, it makes more sense to vote for or against an important ballot item. While pension funds should keep making their own informed decision on votes, it is important to note that shared voting and discussing the rationale for specific votes with other asset owners can have beneficial outcomes and accelerate corporate action.

1. Introduction

Since 2004, shareholders have voted on more than 400 resolutions asking companies to report on the business risks of climate change and disclose strategies for addressing these risks[1]. Activist investors started by filing resolutions at AGMs. These ranged from calls for greater transparency and climate-related disclosure to demands for companies to set ambitious emissions reduction targets. This year (2020), we have again observed an increase in the amount of climate change-related resolutions filed at Oil & Gas companies. Even more promisingly, we have also seen an increase in the support shown by mainstream asset managers and large fund families.

Voting and engagement are two of the main ways that an investor demonstrates an active ownership approach, and are important tools for shareholders who wish to have an impact on the real economy. There are now many relevant shareholder initiatives, such as Climate Action 100+, IGCC and the UN Net-Zero Asset Owner Alliance. and an increasing number of asset owners and asset managers are becoming active signatories. While climate change is one of the most widely identified ESG risks that investors exercise their shareholder rights and exert influence on, an abundance of other topics have also entered engagement and voting arenas. The majority of all interactions between investors and their investees still relate to governance, but an increasing amount of asset owners, their clients, asset managers and proxy voting service providers now also identify environmental and social topics (e.g. living wage and biodiversity) as material risks to be considered in investment decisions.

VBDO observes that a great amount of progress has been made in the visibility of E&S related topics in ballots, but that not everyone is convinced of the result. Engagement has gained popularity and is widely implemented in Responsible Investment (RI) processes, but actions after failed engagement varies greatly between pension funds. How can these RI instruments, information and results be more interlinked? This study tries to provide insight in the 'who', 'what' and 'how' of proxy voting for sustainability. It takes a closer look at pension funds' voting policies and behaviour and whether this active ownership tool is utilised to its full potential. Other important questions that are addressed in this study include the way that pension funds interact with their asset manager and proxy voting service provider, the relationship with engagement and the accountability of pension funds. This report is structured as follows:

Chapter 2 | offers background information on the topic of voting;
Chapter 3 | presents the results;
Chapter 4 | concludes the report and offers practical recommendations on how to approach this topic as a pension fund.

This study is based on the results of the voluntary questionnaire that is part of VBDO's yearly Benchmark on Responsible Investment by Dutch Pension Funds. Together with the use of a literature review, expert interviews and case studies, the results have enabled us to gain a broad perspective on proxy voting for sustainability. The questionnaire was sent to the 50 largest Dutch pension funds. The questionnaire used for this research is available upon request.

More information about VBDO's activities can be found in Appendix II.

2. Proxy voting

Each publicly listed company is required to hold AGMs with shareholders. At this meeting, shareholders are invited to file or ask questions to the board and vote on company issues (i.e. resolutions). Voting on important matters is a key way for shareholders to exert influence over their investee companies and is crucial in helping to determine that companies are governed in the way that shareholders deem most appropriate.

Generally, asset owners hold large amounts of shares of a large variety of companies in their public equity portfolio. This can mean that voting at each AGM becomes a time and resource intensive practice. For this reason, it's common for asset owners to 'outsource' their voting duty. This is called 'proxy voting' and means that a third-party casts votes on behalf of the shareholder, without the shareholder physically participating in the AGM. In most cases, this party is an asset manager or a proxy advisor. There are several ways in which an asset owner can outsource their voting duty, for example through their asset manager. In many cases, asset managers also outsource their voting responsibilities to proxy voting service providers, creating more distance between the asset owner and the companies that they own.

WHAT IS A PROXY VOTING SERVICE PROVIDER/ADVISOR?

A proxy voting service provider formulates voting recommendations based on their own analysis and research of companies and will execute votes for shareholders. Their influence is exerted in two ways:

- They provide recommendations to an asset owner or manager;
- They execute votes for their clients.

Many asset owners and asset managers outsource their voting to the same small group of proxy advisors, as there is only a select number of proxy advisors to choose from. Because of this, these organisations have a significant influence on the outcome of resolutions. There are several relationships possible between asset owners and managers and the proxy voting service providers. The most common ones are as follows:

- The pension fund has its own voting policy, which the proxy voting service provider executes. The asset manager is responsible for ensuring that the policy is correctly executed.
- The pension fund has completely outsourced the voting policy and implementation; voting decisions are made by the asset manager or engagement & voting provider.

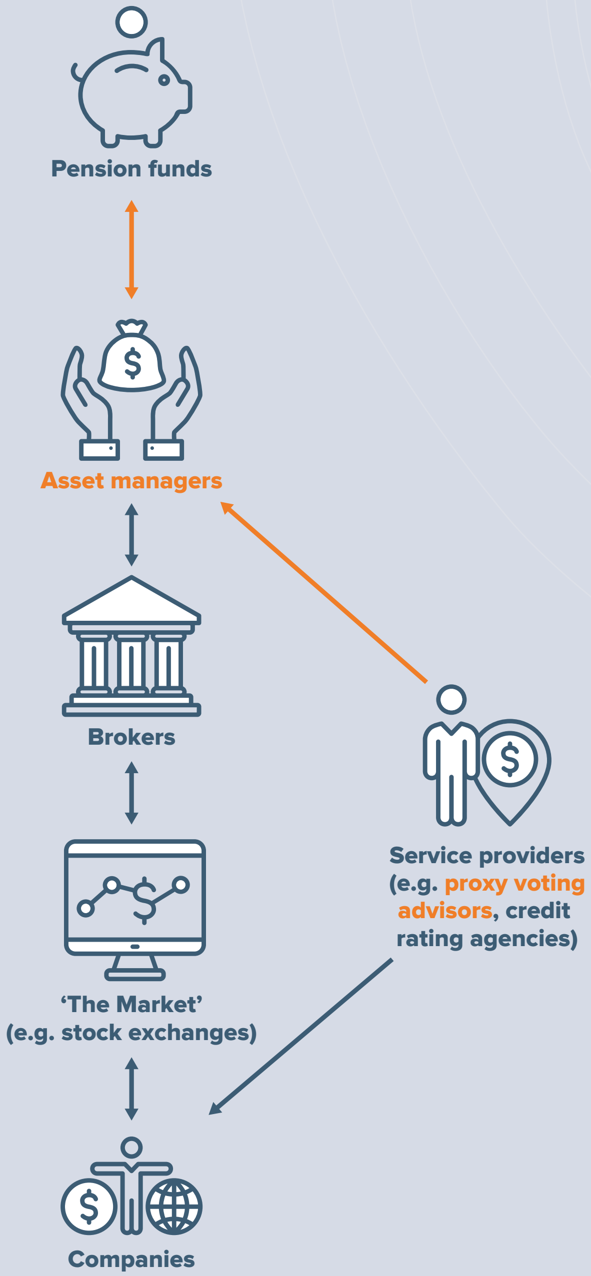
It is also possible that a pension fund does not vote. In this case there is no relationship between the fund and the asset manager or proxy voting advisor on voting related issues.

FROM ACTIVE TO PASSIVE INVESTMENTS

Proxy voting market in the U.S. and Europe

Large asset managers and proxy voting service providers have considerable influence on major decisions made at investee companies. In order to understand the balance of influence, it is crucial to look at how this market is divided. Since the financial crisis of 2008, a substantial shift in assets under management (AuM) from active to passive funds has occurred. This shift has resulted in a high concentration of assets managed by Blackrock, State Street and Vanguard (the 'Big 3'). Research indicates that AuM at these three fund families have grown from 10% to nearly 40% of total mutual fund holdings in the past 15 years[2]. Shareholder voting is now dominated by institutional investors – such as mutual funds, index funds, pensions and hedge funds – which own 70% of the outstanding shares of publicly traded corporations in the United States[3]. Blackrock, Vanguard and State Street in turn manage large parts of these funds. Individual (or 'retail') investors own the other 30%[2]. The main reason for the increased influence of the Big 3 is the growth of passive investment.

Figure 1 | **Relationship between asset owner, manager and proxy advisors (Source: ShareAction, 2020, Another Link in the Chain: Uncovering the Role of Proxy Advisors)**



Financial services firm Morningstar created a graph depicting the growth of passive equity funds compared to active equity funds (as can be seen in figure 2). The graph indicates how passive equity funds in the U.S. have caught up to active, taking off from 2008 onward. The European Fund and Asset Management Association (EFAMA) wrote in their annual report that asset managers in five countries in Europe manage more than 76% of the total AuM in Europe[4]. Passive investors characteristically simply follow the benchmark; therefore they rarely divest from companies. This leaves engagement and voting as the only responsible investment instruments available. Large U.S. asset managers, in particular, tend to have a conservative voting policy that only recently includes environmental and social requirements for companies. Therefore, it is important that pension funds formulate their own ES(G) voting policy and signal what topics are material to their participants (and for other asset owners to their clients).

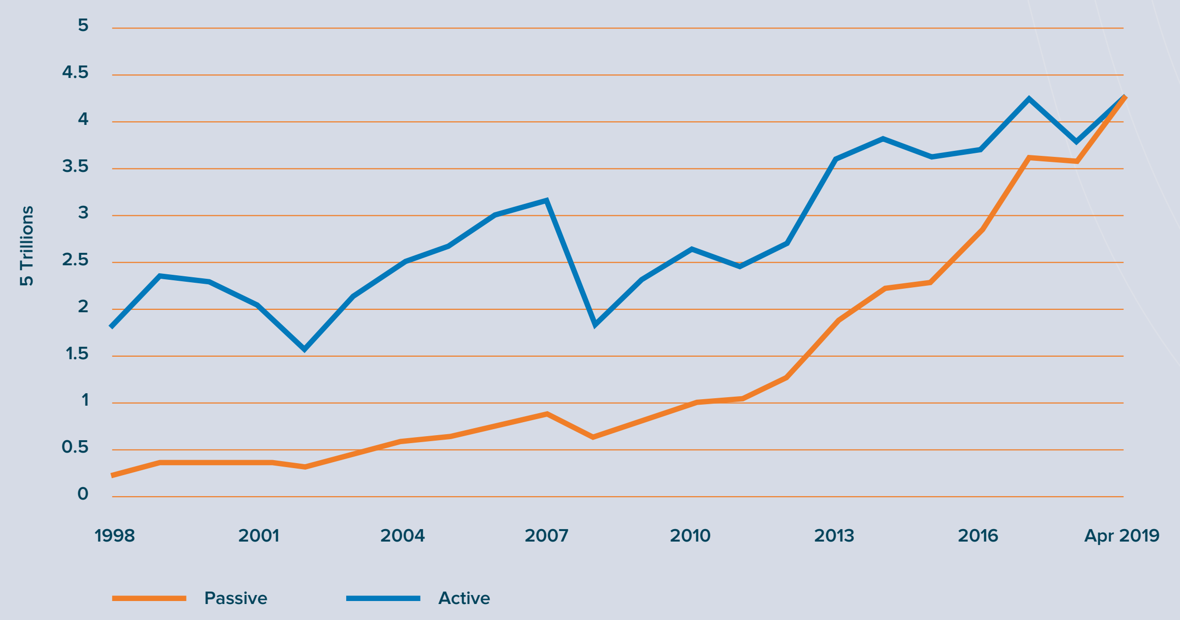
ROLE OF PROXY SERVICE PROVIDER IN VOTING

Proxy voting service providers give advice to asset managers and funds on how to vote during AGMs and resolutions. In many cases, decisions are based on the policies provided by the asset managers or funds, but sometimes they are also based on the voting policy of the proxy voting service provider itself. Various studies examine the influence of these firms and the asset managers, addressing such questions as: what happens if the asset managers and proxy advisors have differing stances on a resolution?

Influence of proxy voting service providers

The proxy voting service market is currently dominated by two firms: Institutional Shareholder Services (ISS) and Glass Lewis. ShareAction estimated that in 2014 97% of the U.S. market share was held by ISS and Glass Lewis. More recent data (2017) found that ISS controlled 63% of the proxy service market for mutual funds in the U.S.

Figure 2 | **Active vs. passive assets in U.S. equity funds. (Source: Morningstar, 2019, A Look at the Road to Asset Parity Between Passive and Active U.S. Funds)**



($13.4 trillion assets from 134 fund families)[5] and Glass Lewis controlled 28% of the market ($6.0 trillion assets from 27 fund families). This implies that ISS and Glass Lewis jointly controlled 91% of the market. In Europe, as well as the presence of the large U.S. proxy voting service providers, there are also some smaller players. Unfortunately, there is currently no data on the percentage of European market share held by different proxy voting service providers.

Around 60% of listed firms in the world are covered by ISS proxy services, while Glass Lewis covers around 34%[6]. However, there is some overlap. As a result, around 65% of all listed firms are covered by either ISS or Glass Lewis, and almost a further 33% are jointly covered by both firms. Two studies have found that that 'vote for' recommendations of ISS and Glass Lewis on average receive around 97% shareholder support, whereas proposals that ISS and Glass Lewis recommend voting against receive between 88-90% shareholder support[7]. We suggest that a new study looks at this relationship, with a focus on environmental and social topics.

Blind votes increase the influence of proxy voting service providers

Another factor that determines the influence of a proxy advisor is the amount of 'blind votes'. The percentage of ISS's customers that blindly follow its recommendations grew from 12% in 2006, to 23% in 2017[8]. What's more, after a fund becomes an ISS customer its agreement with ISS increases by 22% on contentious director elections. Similarly, after a fund stops being an ISS customer, its agreement with ISS decreases by 20% on contentious director elections.

Source of influence

The influence of proxy advisors partly results from the amount of time and attention that investors can commit to evaluating companies themselves[9]. For example, in the situation of a volatile market and multiple uncertainties, investors have limited time to make informed voting decisions, so following the recommendations of proxy voting advisors becomes more attractive. On top of this, two additional factors, one economic and one regulatory, also play a role[10]. The economic factor is the demand for proxy voting services. Not all asset owners

or asset managers have the time and resources to perform extensive research or to develop proxy voting guidelines for themselves. The regulatory factor stems from the Securities and Exchange Commission (SEC) and SRD(I&II), which has required registered institutional investors to develop and disclose their proxy voting policies and votes since 2003. Investors comply with regulatory obligations by outsourcing voting to an independent third-party agency, such as a proxy voting service provider. There are several other factors pointed out by ShareAction that can influence voting in relation to proxy voting service providers[11]. These include:

- **The size of asset manager**
  Smaller asset managers are more likely to vote with proxy advisors. A reason for this could be capacity issues as smaller asset managers tend to have correspondingly small corporate governance teams.
- **The geographic location of the holding**
  Evidence indicates that European asset managers vote with the recommendations of proxy advisors approximately twice as often for overseas than for domestic holdings.
- **The complexity of the topic voted on**
  Asset managers may rely more heavily on proxy advisors' voting recommendations for proposals on complex or technical issues such as executive remuneration.

How do proxy voting firms make their recommendations?
The voting recommendations of proxy advisors are based on detailed voting policies that they develop and update annually. The exact approach that is used to develop voting policies varies, but some common features have been identified[12]:

Internal expertise | Combining qualitative judgments of internal analysts with quantitative assessments based on proprietary models that they have developed[13].
External consultation | External feedback is sought on their policies, both from their investor clients and through engagements with corporations. In this phase, asset managers and their clients, can influence the policies that proxy advisors implement. The following feedback process for ISS has been identified[14]:
- Annual feedback surveys are sent to institutional investors (and their asset managers).
- Roundtables are held with smaller groups of investors and companies to discuss the survey findings and seek additional feedback.
- A two-week consultation period is held on the updated policy.

This feedback loop shows the possibility of interaction between the advisors and those that they advise. The last step is policy changes: based on the combination of internal analysis and external feedback, the final policy updates are released in late autumn.

Sustainability and proxy voting service providers
Proxy voting to date has focused mainly on 'traditional' corporate governance topics. It is therefore unclear from the existing research what influence proxy advisors have on responsible investment practices. What we do know are the current voting guidelines that ISS uses (regular and sustainability), which can also tell us more about how they deal with responsible investment. Glass Lewis' guidelines on sustainability are not publicly available and thus cannot be compared to their regular guidelines, which they do publish.

From the comparison between ISS's regular guidelines and their sustainability guidelines, it became clear that in the latter more attention was paid to diversity and ESG themes. This should not come as a surprise as ISS's sustainability policy uses internationally recognised sustainability-related initiatives as a frame of reference. Interestingly, neither the SDGs nor the Paris Climate Agreement are mentioned. An example from the board of directors category shows that ISS advises to "vote against or withhold from directors individually, on a committee, or potentially the entire board due to material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company, including failure to adequately manage or mitigate environmental, social and governance (ESG) risks." The sustainability guidelines include a section at the end where 'other items' are listed. This includes social and environmental proposals and covers ESG shareholder proposals. ISS states that they will "generally vote in favor of social and environmental proposals that seek to promote good corporate citizenship while enhancing long-term shareholder and stakeholder value." A couple of requirements are then given to indicate what will be considered before a decision is made on the vote.

ISS is transparent about their guidelines, except for how they are conceived in more detail. In general, ISS's guidelines are not very specific and it is difficult to determine how they are used to make decisive votes on E&S resolutions or voting against routine voting items. Glass Lewis, as mentioned earlier, has only published its regular guidelines, which do not include sustainability or E&S.

VOTING FOR SUSTAINABILITY – UNTIL NOW

As mentioned briefly above, proxy advisors can vote against governance issues for environmental and social reasons. This warrants further explanation as there is a difference between E&S as a category, and governance issues that are voted against because of E&S.

E&S and governance issues
An example of E&S as a separate category can be found in the responsible investment guidelines of asset owners, asset managers and proxy voting service providers[15]. For example, Blackrock states that they "expect companies to issue reports aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the standards put forward by the Sustainability Accounting Standards Board (SASB)." Their E&S guidelines outline what Blackrock expects and require investee companies to adhere to these standards. The underlying idea behind Blackrock's E&S section is that it supports the goal of disclosing material non-financial information (or rather pre-or extra-financial information such as climate risks), as it relates to industry-specific metrics and target setting. This method focuses on risk mitigation.

The other example relates to governance topics that are influenced by E&S topics. ISS state in their guidelines that they will vote against a certain director (note that director election is a governance theme) if it "fails to adequately manage or mitigate environmental, social and governance (ESG) risks." This approach is different as it is more practical and shows a deeper layer of E&S that permeates the governance theme.

Both approaches deal with E&S issues, and both enable investors to potentially avoid climate risks at their investee companies. In both lines of reasoning, investors can vote according to the degree of climate risks impacting potential returns. However, this mitigation strategy does nothing to improve environmental or social problems in those areas, it simply avoids them.

ESG shareholder proposals
In 2019, shareholder proposals related to corporate governance accounted for most of the proposals that actually reached a vote (64.4%) and represented the majority of proposals that were passed at companies[16]. However, more E&S proposals were actually submitted by shareholders than governance-related ones. Many of these E&S proposals did not reach a vote and were withdrawn[17]. Due to engagement, investors resolve the issues with the company before the proposal comes to a vote, resulting in a high number of withdrawn proposals.

In 2019, U.S. companies experienced a continuing increase in shareholder activism and support on ESG issues. When looking at the topic of shareholder resolutions, we can see that companies' social impacts (across a range of social topics) significantly outpaced environmental ones, accounting for 64% of E&S resolutions filed. However, as a single topic, climate change emerged as the top E&S issue[17].

In Europe, the topic of climate change rarely appears as a voting item, but there are indications that things are starting to improve (albeit slowly). In 2018, only two climate change proposals appeared on the ballots of European companies. This increased to three in 2019 and five in 2020. These resolutions received very low support rates, but the trend is upwards. According to research by Harvard Law School's Forum on Corporate

Governance, the reasons for the difference in the use of shareholder proposals on the two sides of the Atlantic are both structural and cultural[18].

The first reason is that it is much harder to file a shareholder resolution in most European markets compared to the U.S. To place items on the ballot in Europe, there are legal and regulatory hurdles (including higher ownership requirements) that need to be overcome. In the U.S., the ownership requirement to file a shareholder proposal is a holding of USD 2,000, while in most European countries, shareholders need to own between 0.5 and 5% of a company in order to be able to file a proposal. The second reason is cultural. In general, European investors would rather reach a consensus on topics. Although investors and companies might not agree on a certain issue, through consensus building in the form of engagement (e.g. letter writing campaigns and collaborative action) they can avoid confrontation through a resolution or 'against' vote on a routine voting item. In Europe, filing a resolution would mark an escalation of failed engagement.

ACTIVE OWNERSHIP FOR SUSTAINABILITY

Potentially, binding resolutions can reshape the course of a company. One example of this is corporate board elections; board composition can mean the difference between a company taking a more long-term focus on shareholder returns rather than just a short-term focus. In the case of ESG, the board composition could determine whether a company takes the impact of climate change into account or not. A diverse list of items up for vote on a proxy ballot affords shareholders an opportunity to weigh in on the direction of a company. This will have an effect at company level, and also on the entire economy. Managing ESG risks can provide long-term benefits for companies and, in turn, for investors and their participants (or clients). The degree to which the proxy voting process gives voice to the concerns of investors and integrates material ESG factors will shape the resilience of the stock market.

Top Shareholder Proposals in 2020 by Percentage of Total Submitted in the US[19].

1. **Written consent (9%)**
2. **Climate change (8%)**
3. **Independent chair (7%)**
4. **Anti-discrimination & diversity (7%)**
5. **Lobbying spending (6%)**

Shareholders Rights Directive II (SRDII, 2017) and the Dutch Stewardship Code

SRD II has been established and drafted by the European Commission to make it easier for shareholders to exercise their rights. This is especially convenient across different markets or countries and encourages the use of digital technology. New technologies will make it possible to communicate between companies, their shareholders and any intermediaries that are active between those two main actors.

The Stewardship Code, drafted by corporate governance advocate Eumedion, came into effect in the Netherlands in 2019. It encourages Dutch institutional investors to engage in a constructive dialogue with Dutch listed companies, fellow shareholders and other interested stakeholders in society. The Stewardship Code emphasises the importance of shareholder involvement in the pursuit of long-term value creation of Dutch listed companies, as laid down in the existing Dutch Corporate Governance Code.

The Stewardship Code and the SRDII align on multiple aspects. For example, both include transparency requirements regarding the engagement policy and voting policy. For more detailed information on these guidelines please visit the respective webpages[20, 21].

COVID-19

During the COVID-19 crisis, which is still active at the moment of publication of this report, investors face great uncertainties. Although governments are largely responsible for managing the economic fallout, success will in part depend on the resilience of our global financial system. Therefore, it is essential for asset owners to remain vigilant in protecting their right to submit shareholder resolutions in order for them to push for more sustainable governance practices.

Active ownership – E&S voting and engagement

Voting and engagement are the two main tools used within active ownership approaches, and when combined, they can strengthen each other. In tandem with engagement, voting becomes much more than simply casting a vote. It is an important element in an ongoing mutual exchange of views. If engagement efforts appear to be unsuccessful or do not reach an investor's engagement objective, investors can consider escalation strategies, such as contacting the company's management, issuing a public statement or manifest, engaging at the AGM, changing voting decisions, filing a shareholder resolution and, as a last resort, reducing exposure or divesting (see figure 3 for an example of DWS).

Figure 3 | **Example of engagement and escalation strategy (DWS, 2020[22])**

3. Results

This chapter presents and analyses to what extent voting, and the inclusion of E&S topics, is considered in the (responsible) investment process by pension funds. These results are based on the questionnaire sent out to the 50 largest pension funds of the Netherlands, to which 34 pension funds responded (68% response rate). The data used in this study is based on self-reported answers provided by pension funds and has not been validated by VBDO. In some cases, results from the VBDO Benchmark on Responsible Investment by Pension Funds (2020) are placed next to the results of this study to provide additional context. The results are discussed per responsible investment element: governance, policy, implementation and accountability. For more information on the questions asked, please contact VBDO.

GOVERNANCE

Good governance is crucial for a successfully implemented voting policy and relies on several factors, such as sufficient knowledge at board level, insight into the preferences of participants, and providing clear guidance on responsibilities and roles to asset managers and other advisors in all phases of the voting process.

ESG voting in general

A large share of the pension funds report that ESG voting is applied for 100% or almost 100% of their investments. Of the 34 pension funds that responded, 22 conduct ESG voting on actively managed investments. The main reason for not voting on actively managed investments was due to the non-existence of these investments. A larger share of pension funds conducted ESG voting for passively managed investments. The main reason provided for not integrating ESG in voting on passively managed investments was the additional costs that are involved.

97%

of the pension funds conduct ESG voting on the majority of their investments

A substantial amount of pension funds indicated that they were not able to conduct ESG voting for all companies in the portfolio (both active and passive), because in some cases voting was too costly in terms of time or they encountered a high degree of administrative complexity. This was particularly the case for companies in the Nordic region, Mexico and other emerging markets.

Responsibilities in proxy voting

Due to the complexity of the active ownership system, with many different actors in different phases of the process, VBDO asked pension funds which actors are responsible for each phase in the voting process. VBDO divided the voting process into four categories: policy, advice, execution and reporting. In many cases, multiple actors are responsible for one phase in the proxy voting process. The pension funds in scope (or their asset managers) have designed or outsourced different parts of the (proxy) voting process in a variety of ways. Figure 4 gives an overview of the actors that are active in each phase.

Proxy voting policy

More than half (18) of the 34 pension funds are responsible for constructing their own voting policy. Almost a third of these pension funds are not solely responsible however, as they have a shared responsibility with their asset manager, fiduciary manager or proxy voting service provider. Eleven pension funds indicated that the responsibility is solely theirs. There is not a clear pattern that can be identified for the 16 pension funds that are not responsible for constructing their voting policy. In some cases, fiduciary managers (4), asset managers (5) or the proxy voting service providers (3) or a combination of those (2) are responsible for the proxy voting policy of the pension funds.

Proxy voting advice

Voting advice is, in many cases, the responsibility of the proxy voting service provider, as 29 of the 34 pension funds indicated. However, only 11 of these pension funds award sole responsibility to the proxy voting provider. In the other 18 cases, the proxy voting service provider is responsible together with the fiduciary manager (7) or the asset manager(11). Four of the funds give sole responsibility to the asset manager to deliver proxy voting advice.

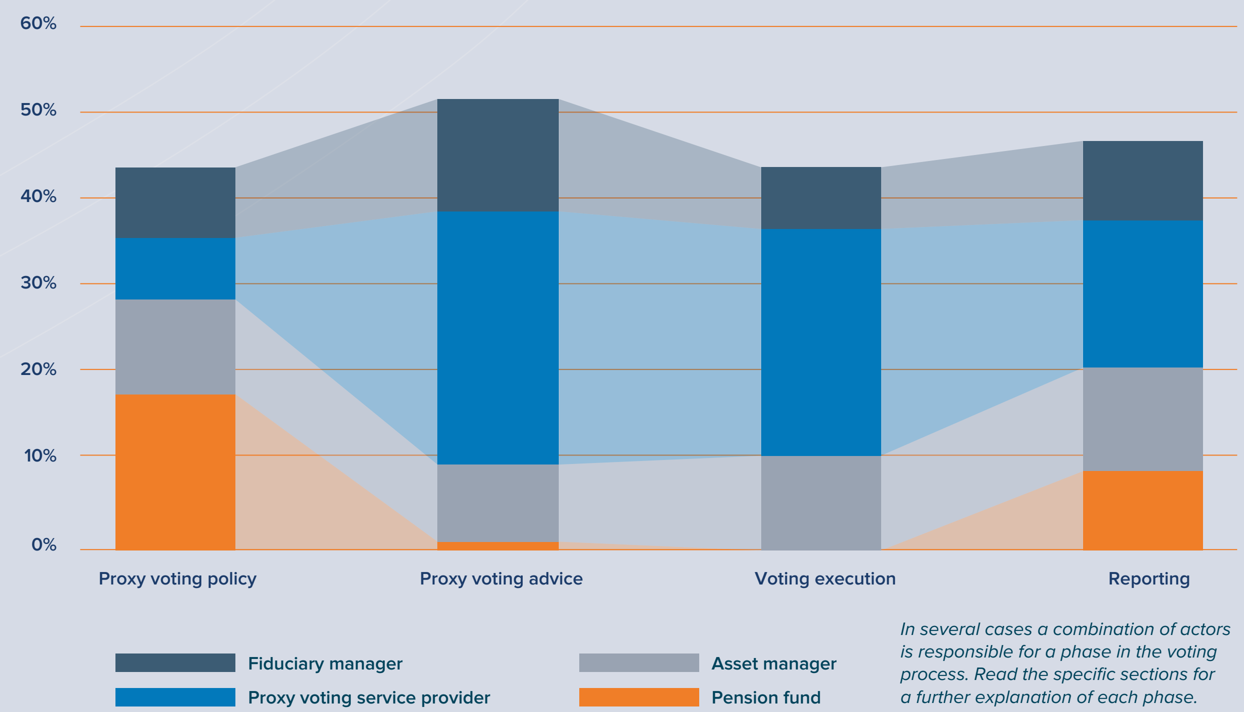
Voting execution

Voting is mainly executed by the proxy voting service provider. 76% of the pension funds stated that proxy voting service providers are responsible for the voting execution phase. For half of those cases (13), it is the sole responsibility of the proxy voting service provider and for the other half the responsibility is shared with the fiduciary manager (7) or the asset manager (6). In four cases, the asset manager alone was responsible for voting execution. In the proxy voting advice phase, more actors were identified, mostly in combination with the proxy voting service provider (see figure 4 for more information).

Reporting

It is becoming increasingly important for pension funds to publicly disclose how they have voted, both at an individual company level and per voting item. Stakeholders often want to see this information, and policies and legislature now often demand it. Responsibility for reporting can lie with a range of actors. The majority of reporting is done by proxy voting service providers (6) in combination with the fiduciary manager (8) or by asset managers (9).

Figure 4 | **Responsibilities in voting**



In several cases a combination of actors is responsible for a phase in the voting process. Read the specific sections for a further explanation of each phase.

ESG inclusion in proxy voting mandates

Our findings show that 82% of the pension funds include environmental and social criteria in the proxy voting mandate to their asset manager or service provider. The same funds also include governance criteria. This high percentage suggests that pension funds are actively including themes that are relevant (to them and their participants) in the mandate given to the asset manager or service provider. However, no assessment was conducted on the depth of the mandates. We are not clear why 9% of respondents felt that the question was 'not applicable'.

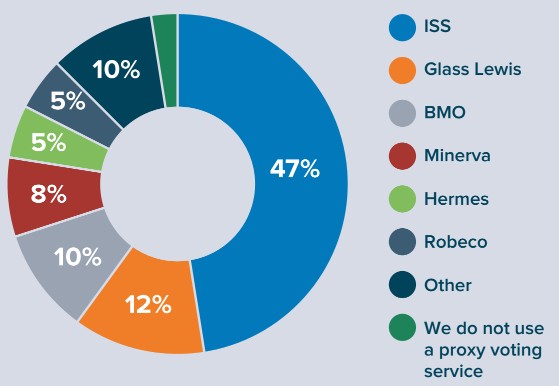
Proxy voting service provider

There are several proxy voting service providers that Dutch Pension Funds can choose from. In some instances, the service provider is chosen by the asset manager or the asset manager also provides proxy voting advisory services. ISS is the largest service provider among the pension funds in scope with almost 50% market share. Glass Lewis comes in second at 12% (see figure 5). The rest of the market is divided amongst proxy voting service departments of large asset managers and Minerva – a smaller proxy voting advisor. In most cases, these asset managers also outsource the actual proxy voting to ISS or Glass Lewis, but the advice and accuracy of the voting remains their responsibility.

VOTING POLICY

Investors with a public equity portfolio should establish a clear voting policy that reflects the values of the pension fund and its participants. This policy should formalise the ESG principles that are most important to the pension fund and create a baseline. The voting policy can be part of the RI policy or the active ownership policy or it can stand alone as a separate document. Alternatively, pension funds can simply apply the voting policy of their asset manager or proxy voting service provider. Almost three quarters (25) of the pension funds that responded to our survey indicated that they have their own voting policy. The rest (10) use the voting policy of their asset manager or service provider and one pension funds follows its own policy and that of its asset manager (see figure 6). It appears that a considerable amount of the surveyed pension funds have recently established, or are in the process of establishing, a (new) voting policy.

Figure 5 | **Voting service providers used by Dutch Pension Funds**



The majority (77%) of all pension funds reviews their voting policy every year based on specific guidelines, two pension funds review every five years and four do not periodically review their voting policy.

Regardless of how voting policies are formulated, almost all pension funds (94%) report that E&S requirements are in some way included in their policy or the policy of their asset manager/proxy voting service provider. We asked the funds to specify how they incorporate E&S requirements in voting policies (see figure 7). They were given four answers to choose from:

- The standard voting policy of our proxy voting service providers is applied.
- The E&S/ESG voting policy of our proxy voting service provider is applied.
- Our custom voting policy is applied by our proxy voting service provider.
- Our proxy voting service provider is requested to take into account additional E&S criteria.

If we take a closer look at how E&S requirements are integrated in voting policies, 64% of the pension funds report that E&S requirements apply to both routine and non-routine voting items, including shareholder resolutions (see figure 7). 81% of the pension funds state that E&S requirements apply to at least routine voting items. However, according to our Benchmark on Responsible Investment by Pension Funds in the Netherlands 2020 (which is based on analysed and weighted results), only 47% of the pension funds include E&S requirements for routine voting items in their voting policy (see figure 8). Some of this discrepancy in results could be due to the difference in the response rate, but we also believe that our definition of E&S integration (i.e. our minimum requirements) may differ from that of some pension funds. From our standpoint, there is still much that pension funds could do to optimise E&S integration and therefore increase their impact on the real economy.

Alignment of E&S requirements in responsible investment policy and proxy voting policy

According to our survey, 76% of pension funds align the E&S requirements set out in their voting policy with their general responsible investment policy. 26 of the 34 pension funds have provided us with an explanation on how they ensure this alignment.

Figure 6 | **Applicability of type of voting policy by service provider**

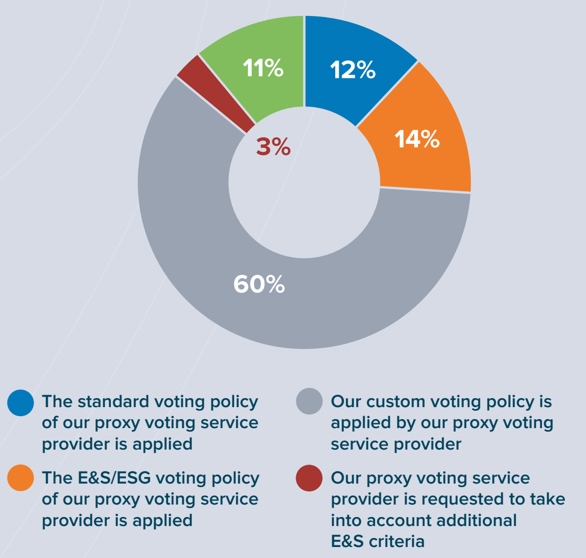


Figure 7 | **E&S requirements part of voting policy**

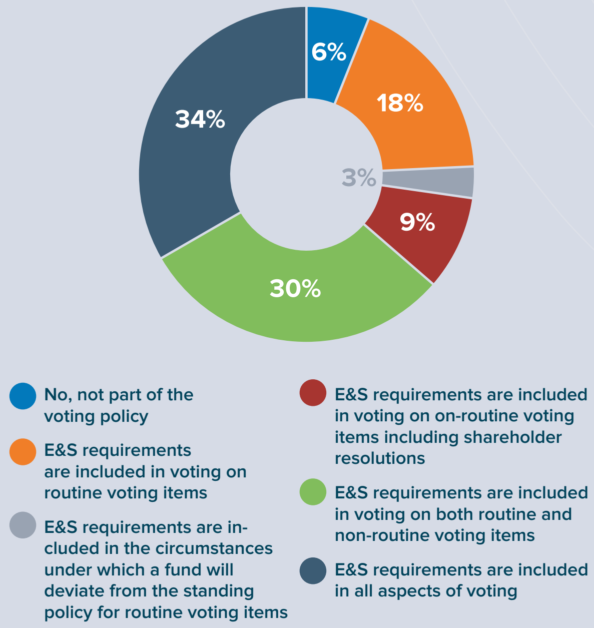
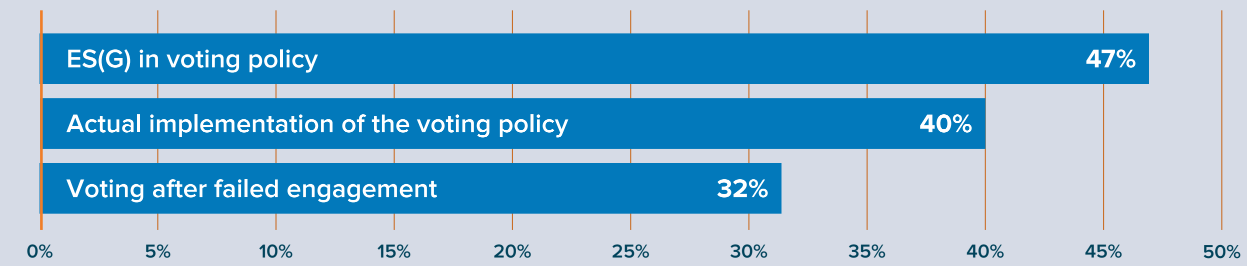


Figure 8 | **Results from 2020 VBDO Benchmark on Responsible Investment by Dutch Pension Funds**



- Seven pension funds reported that requirements are implicitly aligned through compliance with regulation, stewardship codes and initiatives, as these are the basis for both policies.
- Five pension funds have integrated the voting policy in the responsible investment policy, making E&S criteria applicable to all RI tools.
- Another eight have periodical dialogues with their asset managers to ensure that the policies align with each other. Most of these pension funds have adopted the voting policy of their asset manager.
- Six pension funds reported that the RI policy and proxy voting policy are not aligned.
- In most cases, the RI policy is more progressive on E&S criteria than the voting policy.

Asset managers consult their clients periodically with regards to engagement and voting to ensure that they are executing votes in line with the pension fund's policies. We can conclude that some pension funds are more active than others when it comes to ensuring consistency on E&S criteria in their policies, and that asset managers play a significant role in facilitating these efforts, with considerable differences.

IMPLEMENTATION

A voting policy is in essence a bottom line. Asset managers, fiduciary managers or proxy voting service providers assess a company's approach to the guidelines set out by the asset owner. These voting guidelines are applied on a case-by-case basis (in some cases automatically), by taking into consideration a large number of factors, such as specific circumstances at a company, the market, policy developments and previous engagement results.

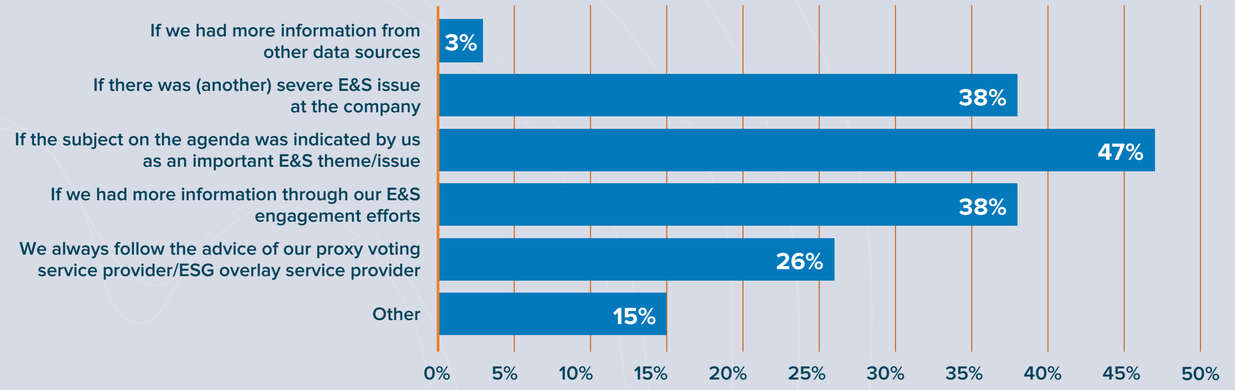
Although several actors can implement a pension fund's voting guidelines, some pension funds still take an active participation in decisions on specific agenda topics or companies. Pension funds in this study provided several reasons why they might take a closer look at routine and non-routine items on the agenda of companies.

Figure 9 shows the types of cases in which E&S criteria were a reason for a pension fund to deviate from voting advice. A quarter of the pension funds always follow the advice of their proxy voting service provider. The rest indicated that E&S criteria were a reason to deviate, especially when the criteria related to a focus theme of the fund (47%). As well as the reason for deviation, it is important to also understand how often pension funds deviate from the advice given by their proxy voting service provider. This could indicate how advanced or ambitious their policy or guidelines for E&S criteria are. Of the 33 pension funds that responded, 12 did not want to provide this type of data and 10 did not have this type of data. Of the 11 funds that did provide details, four did not deviate from the advice given by their service provider at all. The six pension funds that did deviate did so for between 0.01 and 1% of votes. Our deeper analysis finds that there is a lot of potential for pension funds to become more aware of these deviations. By having more insight into deviations, a fund can ensure that its voting policy is more effectively implemented and strengthen the integration of its investment beliefs.

Table 2: **Reason to reassess or consider more carefully voting on routine and non-routine agenda topics, based on E&S criteria**

Routine voting	Non-routine (including shareholder proposals)
Minimum standards in high impact sectors	Systematic case-by-case assessment of shareholder proposals
E&S performance or strategy deviates from norm	E&S performance or strategy deviates from norm
Controversies and media attention	Company is on engagement priority/focus list
Company is on engagement priority/focus list	Alert from shareholder groups (e.g. Eumedion, Climate Action 100+)
Alert from shareholder groups (e.g. Eumedion)	When there is significant impact to be made
Supporting the achievement of engagement objectives	Asset manager/service provider alerts pension fund if it suspects the fund will want to vote differently – case by case
Asset manager/service provider alerts pension fund if it suspects the fund will want to vote differently – case by case	

Figure 9 | **Cases E&S criteria were a reason to deviate from the proxy voting advice**



CASE | APG and Ahold Delhaize's AGM

At the shareholders' meeting of Ahold Delhaize in 2020, APG voted against the executive remuneration policy, a routine item on the agenda. APG was of the opinion that the importance of sustainability was not integrated enough in the determination of remuner-ation. APG felt that the only indicator that had to do with sustainability was not sufficient, was difficult to monitor and did not allow shareholders to properly check for performance. Similar to the year before, APG gave a strong signal to the board that E&S targets in the remuneration policy are of great importance next to financial targets. Nevertheless, the proposal was approved by the majority of shareholders.

Engagement

Engagement and voting practices are interlinked and feed into each other. A voting policy is, in most cases, the foundation of an investor's active ownership approach, outlining best practice guidelines and specific topics that are material to the asset owner or manager. Investors can strictly follow their voting policy, or instead make informed decisions based on a multitude of resources. Beyond the use of ESG research and proxy voting, the active ownership process involves engaging with investee companies before and after the AGM. Investors can start a dialogue with their investees and (as shareholders) require them to perform better on certain ESG topics. An engagement process can take several years, after which the company has hopefully improved its performance.

Figure 10 indicates the relationship between voting and engagement and how pension funds used these tools inclusively, or not. The results indicate that for the majority of pension funds (81%), voting and engagement are interrelated tools and used as such. Using voting as an escalation tool for failing E&S engagements was reported by almost two thirds (63%) of the pension funds. However, this number does not correspond with the analysed data from the annual VBDO Benchmark on Responsible Investment by Dutch Pension Funds as seen in figure 8, which shows less than one third of pension funds using voting after failed engagement. Approximately half of the pension funds also reported that (upcoming) shareholder resolutions were utilised to increase leverage in engagement dialogues, and also as a way to escalate failing engagement efforts on E&S topics.

Engagement and escalation

Engagement can deliver multiple outcomes for the investor, and also for the company. Shareholders can change their perspective on a company due to pre-AGM engagement and change their vote, or engagement can lead to a change in the view of the company's management, resulting in retraction of shareholder proposals or resolutions from the agenda. We observe that pension funds have different approaches and do not always use the full spectrum of voting as a tool for escalating failed engagement (see figure 11). As mentioned before, only a third of the pension funds use voting after failed engagement (based on the assessed results of the VBDO Benchmark on Responsible Investment by Dutch

Figure 10 | **Use of voting in relation to E&S engagement**

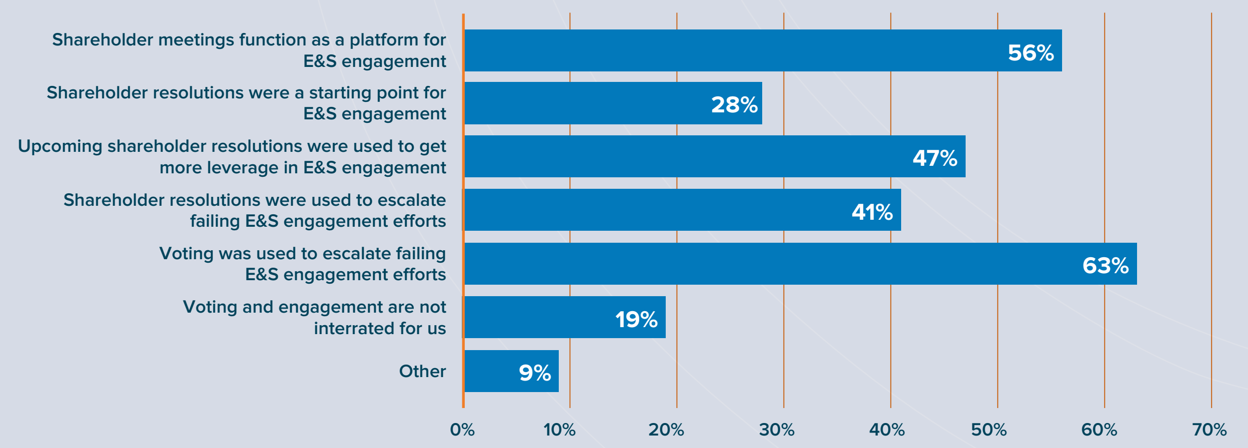
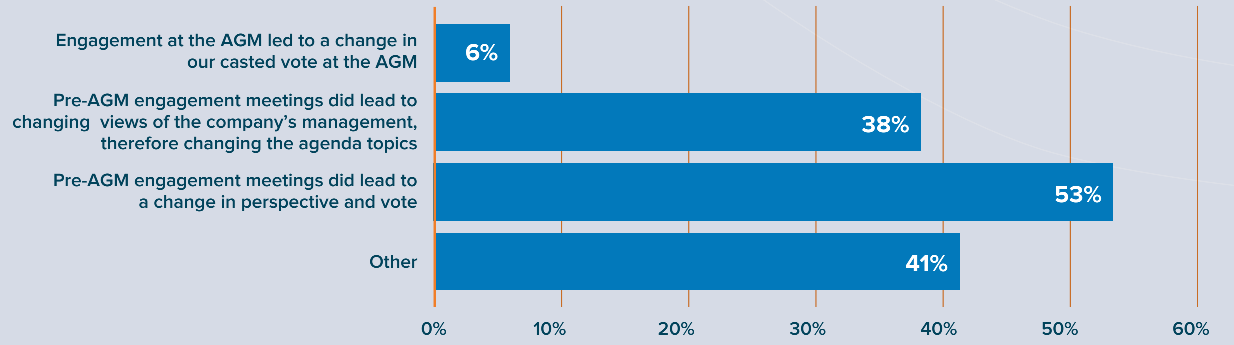


Figure 11 | **Change in casted votes as a consequence of pre-AGM and AGM engagement**



> **The carrot and the stick – Have your escalation strategies ready**
>
> **"To make a fist, instead of lifting a finger, we need bundled capital from multiple asset owners. We think that our own influence is small, but the service provider can achieve a lot with more firepower. We are being too kind and polite towards corporations. After 15 years of using engagement as an instrument, we still have engagement trajectories without an end date. Company boards will make fun of you in the board room if you don't have an escape strategy. Within the first few years, an investor has several options to guide a company towards the desired outcome, but if there is no progress after that, you should weigh-up other options. In many cases, engagement is utilised too much without a stick to back it up."**
>
> *From interview with large to medium-sized pension fund.*

Pension Funds), and this might also be the case for other uses of voting in relation to E&S engagement.

If we look at the effect of pre-AGM and AGM engagement on casted votes, we find that 41% of the pension funds reported that they did not change their vote. We can identify two groups within this 41%, one group for which voting and engagement are not interrelated and another group for which they are but who do not actually escalate and vote 'for' resolutions or against management.

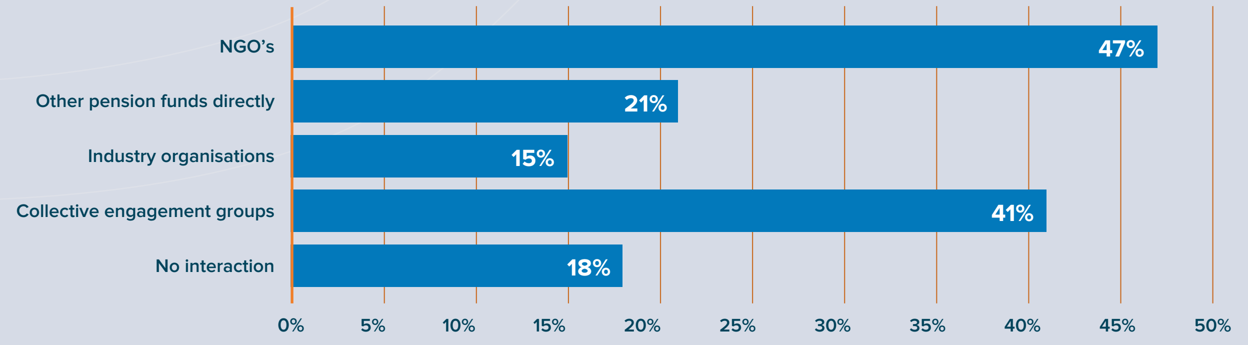
Informed and collaborative engagement and voting

Investors engage on an increasing amount of relevant ESG risks and topics (see figure 12). In order to be well-informed, gain expertise and not waste resources, investors interact with different organisations and groups so that they can discuss or align their voting decisions. The Dutch pension funds in our study reported that they have been interacting most with Eumedion, followed by Climate Action 100+ and Follow This. A smaller number of pension funds interact on voting decisions with IIGCC. Only six pension funds do not have specific interactions on voting decisions with organisations other than their asset manager, service provider or fiduciary. No reason was provided for this.

Asset Manager voting

The world's largest asset managers and fund families (mainly based in the U.S.) have the potential to hold companies accountable for their climate performance and urge them to transition towards low carbon strategies. Several asset managers (mainly European) are leading the way on this. Unfortunately, BlackRock and Vanguard persist in using their shareholder voting power to shield corporate boards from accountability. In 2020, BlackRock and Vanguard, the world's largest asset managers and among the top three shareholders in the vast majority of S&P 500 companies, continued

Figure 12 | **Discuss, align or take action on (case by case) voting decisions with other organisations**



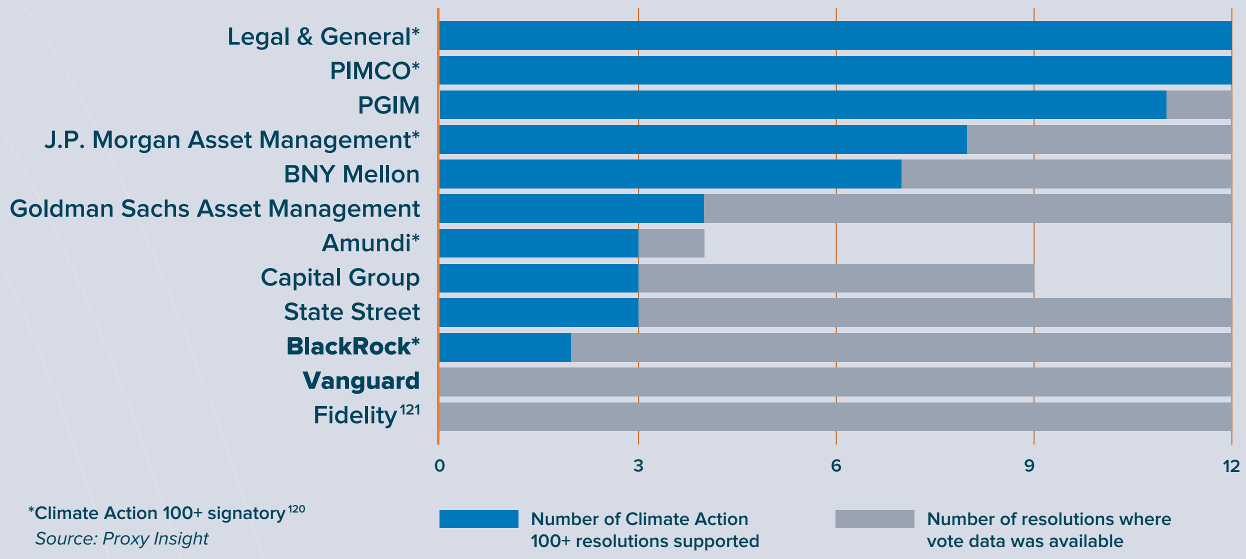
Oil & Gas resolutions – Climate Action 100+ led investors to vote differently on Shell's climate targets

In 2018, the 10 largest Dutch investors did not support the climate ambitions of Shell's management and abstained or voted for the resolution of Follow this. The resolution secured votes from 5.5% of Shell's shareholders. In 2019, Follow This signalled that Shell had made positive strides in setting targets and taking responsibility for scope 3 emissions. Although a resolution was filed, after discussions with investors that previously supported the 2018 resolution, the organisation (together with six Dutch investors) decided to 'give Shell time' to align its ambitions with the Paris Climate agreement. Simultaneously, other shareholders (including some that had supported previous Follow This resolutions) started to engage separately with Shell through Climate Action 100+.
The 2020 resolution repeated the substance of previous Follow This resolutions. Although Follow This and Climate Action 100+ share the same goal, their approach and outcomes are different. Follow This will keep on filing resolutions and find support from investors until their goal is achieved: Paris-aligned targets for all emissions. Climate Action 100+ members have active negotiations with the board of Shell (and other oil majors) and rely on statements as the result of the engagement. Climate Action 100+ does not provide voting recommendations and its members are all responsible for their own voting decisions and filing resolutions. This was the case in 2020, when co-leading investors of Climate Action 100+ arrived at different voting decisions on the shareholder proposal of Follow This.

In 2020, 14.4% of shareholders voted for the Follow This resolution, more than doubling its support compared to 2018. The shareholder proposal at Total and Equinor received 17% and 27% support respectively.

Before Shell's AGM in 2020, for the first time in history the world's largest proxy voting service provider (ISS) recommended that their asset owner clients voted differently on the Follow This resolution based on their advice resulting from their sustainability voting guidelines (FOR) and the standard advice resulting from their regular voting guidelines (AGAINST). At Equinor, both the sustainable and standard recommendations for the Follow This climate resolution were to vote for it.

Figure 13 | **Climate Action 100+ resolutions**



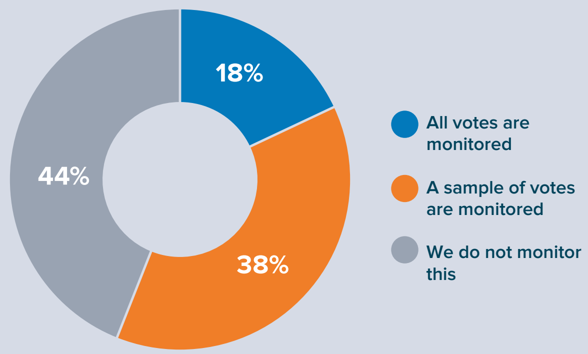
*Climate Action 100+ signatory[120]
Source: Proxy Insight

to undermine global investor efforts to promote responsible corporate climate action – despite their public commitments to hold corporate directors accountable in the 2020 proxy season (see figure 13).

ACCOUNTABILITY: ACCURACY OF VOTING AND REPORTING

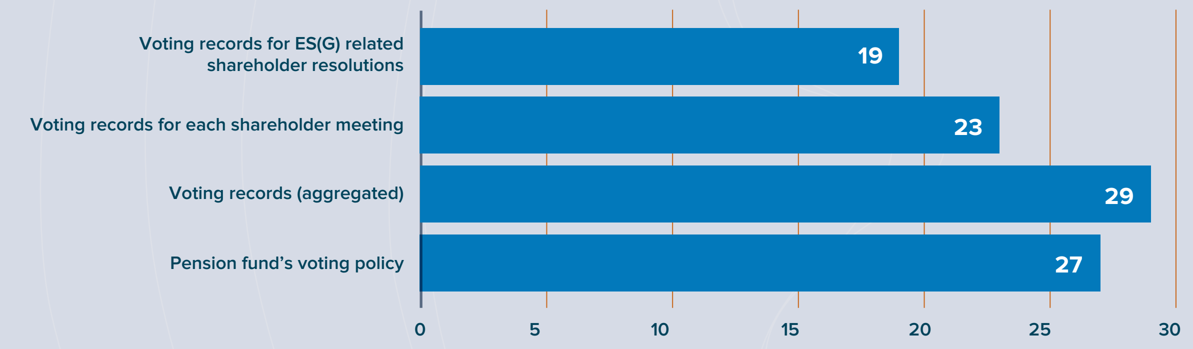
It is important that shareholders know whether their voting guidelines and recommendations are accurately implemented by their advisor or service provider.
For recommendations to be accurately implemented, the advisor or service provider needs to successfully differentiate between good and bad future outcomes and align voting with shareholder interests to maximise long-term value. 44% of pension funds in this study did not monitor if the casted votes were in line with their guidelines (see figure 14). Accuracy in voting is a potential risk for asset owners as it could undermine the investment beliefs of their participants. An important factor to guarantee accuracy is transparency, partly integrated by new legislation (SRDII and Dutch Steward-

Figure 14 | **Monitoring by pension funds if casted votes are in accordance with their voting guidelines/policies**



ship Code). This supports asset owners in holding their advisors and service providers accountable. 93% of the surveyed pension funds report on aggregated voting records; 74% publish voting records for each shareholder meeting and 61% report on E&S shareholder resolutions (see figure 15).

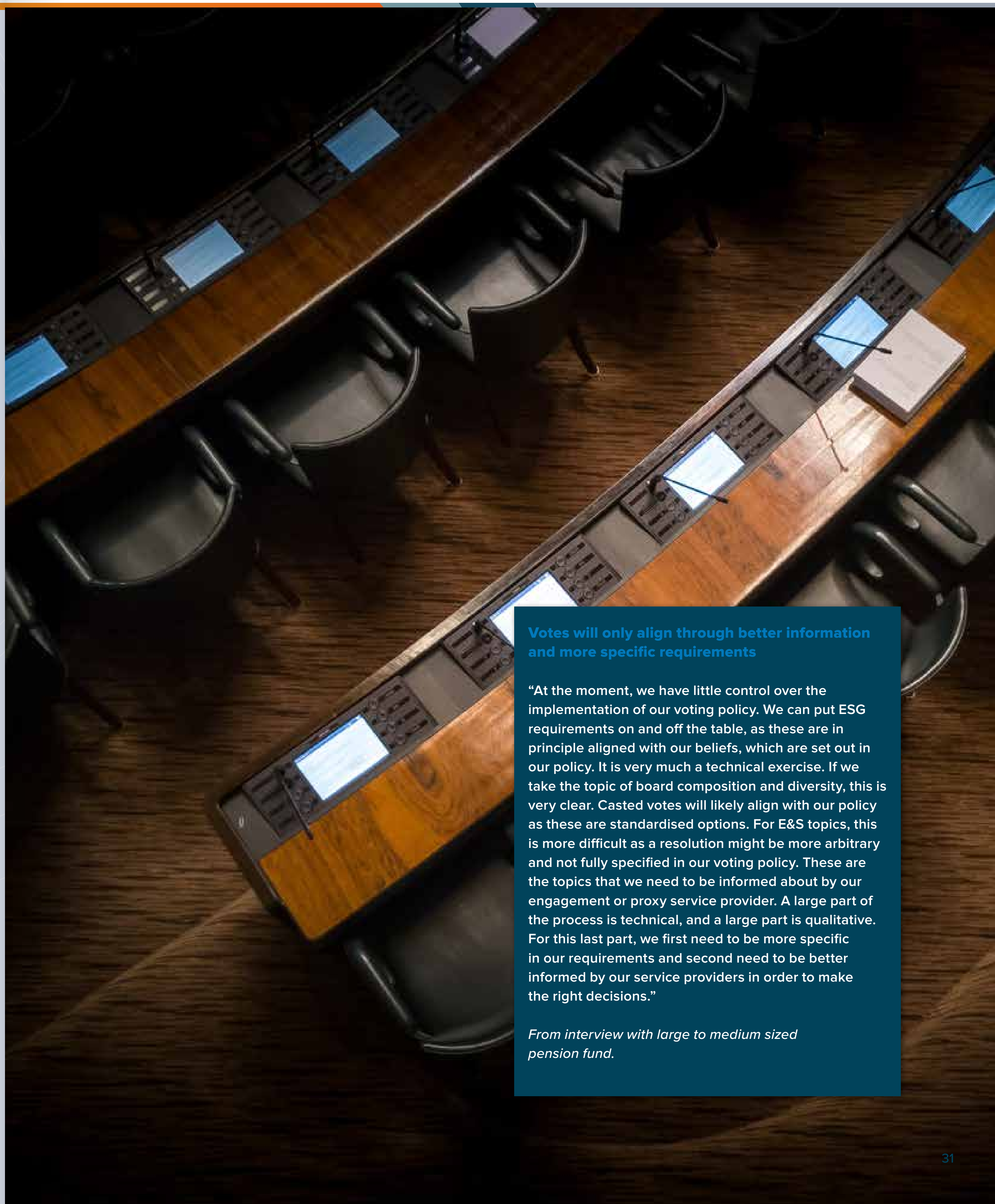
Figure 15 | **Publicly available information related to voting of pension funds**



FUTURE OF PROXY VOTING – TRENDS OBSERVED BY PENSION FUNDS

Institutional investors can actively exert influence on the companies in which they invest by voting during shareholder meetings. Many institutional investors vote at shareholder meetings, but their voting policy is in many cases limited to governance issues so E&S criteria are not actively implemented in routine and non-routine voting items. We have given recommendations in the next chapter, and also asked pension funds for the voting trends they see emerging. The trends put forward are as follows:

- **Increased attention for transparency on how asset managers/ owners vote (e.g. voting rationale, pre-disclosing voting decisions)**
- **Behaviour of world's largest asset owners and managers will change toward more sustainable behaviour**
- **Stronger links between E&S performance and routine voting for management proposals set out in voting policies of proxy voting service providers**
- **More E&S agenda items and more critical stance towards management**
- **E.U. and U.S. regulatory developments (e.g. SRDII, increasing or decreasing the shareholder rights)**



Votes will only align through better information and more specific requirements

"At the moment, we have little control over the implementation of our voting policy. We can put ESG requirements on and off the table, as these are in principle aligned with our beliefs, which are set out in our policy. It is very much a technical exercise. If we take the topic of board composition and diversity, this is very clear. Casted votes will likely align with our policy as these are standardised options. For E&S topics, this is more difficult as a resolution might be more arbitrary and not fully specified in our voting policy. These are the topics that we need to be informed about by our engagement or proxy service provider. A large part of the process is technical, and a large part is qualitative. For this last part, we first need to be more specific in our requirements and second need to be better informed by our service providers in order to make the right decisions."

From interview with large to medium sized pension fund.

4. Conclusions and recommendations

Shareholder voting is dominated by institutional investors. Therefore, it is important that these institutions give a voice to the beliefs of their participants or clients and set a clear direction. They have a fiduciary duty to include themes that are considered important by the participants or clients in the voting policy and implementation strategy. Voting, as part of an investors' active ownership approach, serves as an essential vehicle for shareholders to communicate their ESG requirements or baseline to the boards of the companies they hold shares in. There are multiple ways to exercise these shareholder rights, including using voting in tandem with engagement to escalate an issue, protest voting on a routine agenda item and voting on shareholder resolutions. In the past few years, we have observed a massive shift of capital behind some historical shareholder resolutions and ballot items related to sustainability. Dutch pension funds have an important role to play in this and should exert their influence in order to minimise (financial and climate) risks and steer change for the better in the real economy.

CONCLUSIONS

The proxy voting chain is comprised of multiple phases, in which a large variety of actors are active. The responsibilities given to asset managers and proxy service providers differ between pension funds. In some cases, pension funds follow the voting policy of the asset manager; in others they apply the policy of their proxy advisor or they formulate their own voting policy. Either way, the effectiveness of the voting processes of the asset manager and/or proxy voting service provider is crucial. However, perhaps more important are the resources available and the ambition level of the pension fund to effectively integrate its investment beliefs (i.e. ESG requirements) in voting decisions. The following conclusions are based on self-reported results by 34 Dutch Pension Funds.

Different requirements for embedding E&S in voting policy

Almost all pension funds (93%) include ESG voting in passively managed investments, compared to 79% in actively manged funds. Not surprisingly, many pension funds (82%) also indicated that E&S issues were included in the mandate given to their asset manager, and an even larger group (94%) demonstrated that these requirements are included in their proxy voting policy. These results seem promising but they do not seem to align with those of our 2020 Benchmark on Responsible Investment, which found that 47% of the pension funds had integrated E&S requirements in their voting policy. This difference is an important result of this study as it could indicate that VBDO's minimum requirements for E&S integration in voting are higher than those of the pension funds.

Unutilised potential for implementing the voting instrument

Most of the pension funds (63%) report that they use voting as an escalation tool for failing engagement efforts on E&S topics. Of all pension funds, approximately half (47%) report that upcoming or filed shareholder resolutions are used to escalate failing E&S engagements. More than half (56%) indicated that pre-AGM engagement lead to changing the views of the company's management, or changed their own perspective and eventually their vote. A large share of this engagement is executed using the collaborative efforts of asset managers or engagement and voting service providers. However, there are still a significant number of pensions funds that do not use voting as an escalation tool.

Unaware of deviations in voting

We found that not all pension funds are aware of deviations in votes in relation to their voting policy, even though this information is critical if the voting policy is to be effectively implemented. Only 44% of the funds monitor if votes are cast in accordance with their voting guidelines.

Accountability on voting is gaining traction

Accountability is an important aspect of voting and is increasingly being integrated in legislation. In addition, more advanced services by asset managers and service providers are entering the market. Almost all pension funds report on their voting records, either in an aggregated form (93%) or for each resolution (63%).

The results indicate that while E&S voting is considered by pension funds as an important tool to exercise their active ownership, it is not used to its full potential and there is still much unfulfilled potential, e.g. in setting effective E&S requirements in voting policies, implementing the policy effectively and ensuring more transparency and accuracy in the proxy voting chain.

RECOMMENDATIONS

This section recognises the main challenges that we identified for investors and other actors in the proxy voting chain and formulates concrete recommendations for integrating E&S requirements.

Recommendation 1 | *Raise the bar*

Voting rights are a powerful instrument to address the sustainability performance of the investee companies. It is therefore important that pension funds periodically review and update their voting policies with relevant E&S requirements, and also take a stance on material risks that jeopardise long-term value for their participants. Together, these actions will help to create impact in the real world and on the economy. Not all pension funds in the Netherlands have yet effectively integrated E&S requirements into their voting policies. Therefore, it is important that all pension funds formulate a baseline, be more ambitious and periodically heighten the baseline to further increase the integration of material environmental and social topics.

Recommendation 2 | *Integration of E&S requirements in voting on both routine items and non-routine items*

Pension funds should create stronger links between E&S performance and voting on both routine and non-routine ballot items, i.e. for or against management proposals and specific shareholder resolutions. These should be formalised in their own voting policy, and emphasised in internal discussions related to voting decisions and in consultations on voting policies with advisors and providers. We realise that integrating E&S into voting and making informed voting decisions on routine items is costly in time and resources. We recommend that pension funds push for better qualification and flagging of ESG items in the AGM agenda's by proxy voting service providers and improving the feedback loop to ensure that environmental and social requirements (E&S) are also applied when votes are being cast relating to companies that aren't being engaged with.

Recommendation 3 | *Active participation in external consultation of asset managers and proxy voting service providers*

Active engagement with asset managers and proxy advisors during external consultation rounds is crucial to raise the bar on environmental and social risks. After many years of low responses, ISS, the largest proxy voting service provider, saw a 37% jump in responses from institutional investors this year. The general proxy voting guidelines (and the specific ESG voting guidelines) of large asset managers and proxy voting service providers are often, but not always, used as a baseline for pension funds. This effectively means that only minimum requirements are applied. The yearly review of the voting policy of these organisations is key to putting important ESG risks on the agenda. Pension funds and other institutional investors need to actively participate in these dialogues, express their concerns and integrate their clients' beliefs.

Recommendation 4 | *Continue to assess and monitor proxy voting advice and services*

If a pension fund partially or completely outsources its voting and engagement practices and activities (i.e. active ownership) to asset managers or service providers, it is crucial that it performs proper due diligence and carefully selects, assesses and monitors these organisations and their services. Several criteria should be evaluated when selecting or continuing the relationship with a manager or provider. These include the organisation's voting policy, historical engagement outcomes, capacity, governance mechanisms, engagement processes, capacity for reporting and digital systems. More specifically related to sustainability, the depth and scope of the research that the organisation conducts on ESG topics should be evaluated and the pension fund should consider how the organisation deals with salient issues and controversies, as well as considering policy deviations and engagement objectives and pathways.

Recommendation 5 | ***Optimise relationship with engagement***
Dialogue without a clear path, consequences and consistency of messaging can be more detrimental than taking no action at all. If a dialogue does not bring the desired outcomes after a certain period of time, investors can consider different escalation strategies to trigger corporate action. A clear relationship between voting and engagement supports the mission and overall responsible investment strategy of the asset owner. Submitting E&S shareholder resolutions, voting against the re-election of directors who are responsible for the topic of engagement or voting against the board of directors are escalation strategies that are not optimally used. We recommend pension funds use their shareholder rights and start to utilise these active ownership tools strategically.

Recommendation 6 | ***Increase transparency on voting***
Some pension funds do not disclose specific voting related documents, such as their voting policy, voting results, and/or the rationale for a voting decision. We also found that a substantial number of funds do not track whether the service provider accurately votes according to the fund's voting policy. This is a potential risk as society and legislation increasingly ask for transparency on how pension funds vote. We recommend that pension funds work on three aspects:
Actual voting | Legal developments increase the need for disclosure on how investors vote. We anticipate that stakeholders will also increasingly scrutinise and assess how well pension funds' words and actions align. More transparency from pension funds and their advisors and service providers, can lead to a different voting behaviour across the line. Potentially, voting activities not aligned with collaborative investor groups, corporate dialogues and investor mandates could be called into question by the public.
Voting accuracy | An assessment by the pension fund in part or in full of the accuracy of votes by the asset manager or voting service provider is essential for the effective implementation of a pension fund's voting policy, and could prevent reputation damage in future AGM seasons due to increasing scrutiny from stakeholders.
Voting rationale | We recommend pension funds ask their advisors and service providers to commit to a 'comply or explain' approach for supporting independent ESG resolutions. This means that the service provider would need to provide a published rationale for not supporting such a resolution.

Recommendation 7 | ***Join forces***
If a shareholder votes on a proposal, it is crucial that it engages not only with a company's management but also seeks to open a dialogue with the other (activist) shareholder(s) to gain a better understanding of their views and the overall situation. In some cases, it can even be wise to collaborate more intensively with other similar shareholders on voting, as in several cases is already done through engagement initiatives. Collaborate more intensively with other similar shareholders on voting. Collectively, it makes more sense to vote for or against an important ballot item. While pension funds should keep making their own informed decision on votes, it is important to note that shared voting and discussing the rationale for specific votes with other asset owners can have beneficial outcomes and accelerate corporate action.

Abbreviations and references

ABBREVIATIONS

AGM	Annual General Meeting
CA100+	Climate Action 100+
ESG	Environmental, Social and Governance
E&S	Environmental & Social
IIGCC	The Institutional Investors Group on Climate Change
ISS	Institutional Shareholder Services
RI	Responsible Investment
SDGs	Sustainable Development Goals
SRDII	Shareholders Rights Directive II
S&P	Standard & Poors
US	United States

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Appendix I - Methodology

This thematic study aims to create an overview of how environmental and social requirements are integrated in the voting process and decisions of Dutch pension funds. This study was not included in the VBDO Benchmark on Responsible Investment by Dutch Pension Funds, but was conducted on a similar time scale and the survey was conducted using the same digital collection system. Pension funds can decide for themselves whether they want to participate in this voluntary survey or not.

The pension funds were asked questions on the following topics:

- Voting conducted on active/passively managed investments
- Voting responsibilities and mandates
- Proxy voting service provider
- E&S criteria in the pension fund's own voting policy
- Alignment of voting policy with responsible investment policy
- E&S criteria as reasons to reassess voting on non-routine and routine voting items, or to deviate from the advice given by proxy advisor
- Relationship between engagement and voting
- Alignment of case-by-case voting decisions with other actors
- Reporting on voting decisions and accountability
- Execution of a more responsible voting policy

These questions were answered by the investors, and subsequently analysed by VBDO for accuracy, but they were not assessed. For this study, 50 institutional investors were asked to fill in the questionnaire and we received 34 respondents (68%). Alongside the survey, VBDO conducted multiple interviews with pension funds, asset managers and proxy advisors to discuss the results and receive more detailed information. If you would like to receive more details about the methodology used in this research, please contact VBDO.

Appendix II - VBDO's activities

About VBDO

The Dutch Association of Investors for Sustainable Development (VBDO) is a not-for-profit multi-stakeholder organisation. Our mission is to make capital markets more sustainable. Members include pension funds, insurance companies, banks, asset managers, NGOs, consultancies, trade unions and individual investors. VBDO is the Dutch member of the international network of sustainable investment fora. VBDO's activities target both the financial sector (investors) and the real economy (investees) and can be summarised as follows:

Engagement

Since VBDO was founded more than 20 years ago, our core activity has been engagement with 40+ Dutch companies listed on the stock market. VBDO visits the annual shareholders' meetings of these companies, asking specific questions and voting on environmental, social and governance (ESG) themes. The aim of this engagement is to promote sustainable practices and to track progress towards the companies becoming fully sustainable, thereby providing more opportunities for sustainable investments.

Thought leadership

VBDO initiates knowledge building and sharing of ESG-related issues. Recent examples of this include a masterclass on the investment risks and opportunities in the protein value chain, a round table on the physical risks of climate change and how investors can become more climate-resilient, and round tables about implementing human rights in business and investor practices. In addition, VBDO regularly conducts capacity building exercises with regards to responsible investment, both for investors and NGOs.

Benchmarks

Benchmarks are an effective instrument to drive sustainability improvements by harnessing the competitive forces of the market. They create a race to the top by providing comparative insights and identifying frontrunners, thus stimulating sector-wide learning and sharing of good practices. VBDO has extensive experience in developing and conducting benchmarking studies.

VBDO has conducted annual benchmarking exercises for a number of years. These include Responsible Investment by Dutch Pension Funds (since 2007), and Responsible Investment by Dutch Insurance Companies (since 2012). Benchmarking has proven to be an effective tool in raising awareness about responsible investment and stimulating the sustainability performance of pension funds and insurance companies.

VBDO is one of the founding partners of the Corporate Human Rights Benchmark. This benchmark ranks the world's 500 largest companies based on their human rights performance, and makes the information publicly available, in order to drive improvements. VBDO's Tax Transparency Benchmark ranks 64 listed multinationals on the transparency of their responsible tax policy and its implementation.

For more information about VBDO, please visit our website: www.vbdo.nl/en

Colofon

Vereniging van Beleggers voor Duurzame Ontwikkeling (VBDO)
Pieterstraat 11, 3512 JT Utrecht
+31 (0) 30 234 00 31 | info@vbdo.nl