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Proxy Voting Guidelines for External Managers

Topic: **Corporate Sustainability**
Subtopic: **Board Oversight of Environmental, Social, And Governance (ESG) Issues and Risk**
Approved: **March 1, 2021**

Description:

Resolutions on this topic ask companies to report on board oversight of ESG issues, challenges, and risk associated with their business, including board assessments of progress, policies, and trends toward reducing any related material risk.

Topic background:

As fiduciaries to investors and stewards for long-term corporate value, corporate boards have a responsibility to oversee material risk as part of their responsibility to protect investor interests. A decision in the Delaware Supreme Court, *Marchand* v. *Barnhill*, No. 533, 2018 (Del. June 19, 2019), confirmed that directors may be liable for failure to ensure that reasonable board-level monitoring and reporting systems exist for material risk. Increasingly, shareholders view board oversight of ESG issues, challenges, and material risk as part of a board's responsibility to oversee long-term financial and sustainability risk. For example, State Street Global Advisors developed guidance on how boards of companies in their portfolios can improve oversight of climate change-related risk. The large institutional investors CalPERS and CalSTRS amended their corporate governance principles to call for climate competence on such boards.

The particular ESG issues, challenges, and material risk relevant to any company vary depending on the company's industry and geography, as well as other factors. However, certain common ESG factors cut across many industries and geographies, and, in our view, should therefore be considered by most company boards. These include, but are not limited to, the issues posed by:

- Climate change.
- Diversity, equity, and inclusion.
- Employee and customer health, safety, and wellbeing, including:
    - the board's assessment of any progress, policies, and trends toward reducing the presence of unsafe working conditions for employees or unsafe products for sale to customers.
- Board composition along multiple dimensions of diversity and inclusion.

Some of these long-term issues, such as board composition and executive compensation, routinely attract the board's attention. Oversight on others varies from company to company. Boards with a prudent, robust sustainability oversight stance follow a variety of models, including board committees dedicated to sustainability, as at Prudential Financial and Ford

Motor Company, or the inclusion of climate change experts on their boards, as at Apple and Exxon.

In the past, board oversight of ESG issues, challenges, and material risk was hampered by a lack of understanding of and familiarity with such issues at the board level. The emergence of organizations such as the United Nations-supported Principles for Responsible Investment (PRI) and the Sustainability Accounting Standards Board (SASB), both of which Harvard Management Company supports, has addressed that challenge. SASB, for example, has established sector-specific standards and metrics for identifying material ESG risk and supporting decision-making. Businesses use SASB standards to better identify and manage ESG/sustainability information that is consistent and financially material, thereby enabling better corporate decision-making and long-term risk management. The emergence of such standards can also support board oversight of ESG issues, challenges, and material risk.

Considerations for voting:

- We generally recommend supporting well-constructed proposals encouraging boards to carefully address and report upon oversight of ESG issues, challenges, and risk within the broader context of their oversight responsibility for material financial risk. We recommend that such reports clearly articulate how boards structure their oversight of ESG issues and how companies define such issues, with regard to both material risk and broader corporate responsibility in society and civic life.
- We generally recommend supporting proposals designed to encourage improvement in board oversight of ESG issues, challenges, and material risk and, by extension, improvement in mitigating material risk and other impacts from ESG-related developments.
- As a signatory to the PRI, and as a supporter of the Task Force on Climate-related Financial Disclosures (TCFD), which identifies corporate governance as essential context within which to understand a company's financial results, Harvard fully recognizes the value of oversight, a core mechanism that preserves a company's bottom line, for addressing ESG risk. As part of its institutional response to these risks, the University maintains and updates a set of sustainability goals. Similarly, Harvard Management Company incorporates assessment of ESG factors – both risk factors and opportunity sets – in its investment processes.
- We generally do not support proposals on board oversight that specify in excessive detail the means by which a board will exercise its oversight function – for example, through requiring the establishment of specific committees or the appointment of board members with overly specific topic area expertise.

Illustrative examples of votes:

1. Vote <u>in support</u> of resolutions that request a company to ensure effective board oversight of the company's ESG policies and programs addressing the risks posed by climate change and/or report to shareholders (at reasonable cost, omitting proprietary and confidential information) on steps taken or planned.

2. Vote <u>in support</u> of resolutions that ask a company to report on the process and effectiveness of board oversight of ESG issues, challenges, and material risk associated with the company's operations.
3. Vote <u>in support</u> of resolutions that incorporate expectations that company reporting on board oversight of ESG issues, challenges, and material risk include a clear articulation of how the company defines these factors as well as expectations for plans and metrics to encourage improvement in managing them.
4. Vote <u>against</u> resolutions that prescribe particular pathways to mitigate specific risk or that are not related to the company's long-term financial sustainability.

Harvard offers broader general guidance on its recommended approach to considering shareholder resolutions in "Overview of Harvard University's Proxy Voting Guidelines for External Managers" (follow link to download full text). When determining votes on resolutions, we consider each resolution in light of this general guidance as well as in light of a resolution's specific request and contextual information about the relevant company and its approach to the issue.