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BlackRock Publishes 2021 Stewardship Expectations – Takeaways for U.S. Public Companies

Last week, BlackRock Investment Stewardship published its 2021 Stewardship Expectations. The Stewardship Expectations update BIS' Global Principles and market-specific voting guidelines. For 2021, BIS has made several changes to its policies on ESG factors. In this Alert, we describe key commentary from the Stewardship Expectations that companies should take into account as part of their management of ESG factors, as well as in their ESG disclosures.

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The Global Principles set out BIS' stewardship philosophy and views on corporate governance and sustainable business practices intended to support long-term value creation by companies. BIS' market-level voting guidelines provide detail on how it implements the Global Principles, taking into account local market standards and norms.

Climate Risk

Investor expectations concerning the management and disclosure of climate risk continue to increase. As noted by Larry Fink in his last annual CEO letter, BlackRock views climate change as a defining factor in companies' long-term prospects, equating climate risk with investment risk.

- BIS is broadening the universe of focus companies – from 440 to more than 1,000 – that it believes have significant physical and/or transition climate-related risk in their business. A broad range of sectors are included in this universe, consisting of communication services, consumer discretionary, consumer staples, energy, financials, health care, industrials, information technology, materials, real estate and utilities.
- Companies in the expanded focus universe are expected to disclose a business plan aligned with the goal of limiting global warming to well below 2°C, consistent with achieving net zero global greenhouse gas emissions by 2050.

As noted in the Stewardship Expectations, this is not a new request by BIS. It is consistent with the recommendations of the Task Force on Climate-related Financial Disclosures. BIS has been engaging with companies on the TCFD recommendations for several years and previously has requested that companies disclose climate-related risks in line with the TCFD's recommendations.

- BIS will step up its engagement efforts with the focus companies and consider accelerated voting actions if the substance of companies' climate-related commitments and disclosures does not meet its expectations.

In its 2020 engagement priorities published in March, BIS indicated it expects companies with which it already has engaged on TCFD-aligned reporting to disclose sufficient detail across the four pillars of the TCFD framework and provide a timeframe within which they will report fully in line with the eleven recommendations of the framework. In its 2020 engagement priorities, BIS further indicated it will hold members of the relevant committee, or the most senior non-executive director, accountable for inadequate disclosures and the business practices underlying them.

Diversity, Equity and Inclusion

Leading institutional investors such as BlackRock have been calling for increased diversity for several years. Events in 2020 have further sharpened the focus by investors on racial equity and social justice.

Workforce

- BIS is asking companies to disclose the diversity of their workforce, including demographics such as race, gender and ethnicity, through the disclosure of EEO-1 data.

Many other large institutional investors also are making this request. Disclosure of EEO-1 data is likely to become the prevailing disclosure practice within the next few years.

- BIS also is requesting that companies disclose the actions they are taking to advance diversity, equity and inclusion and support an engaged workforce.
- The Stewardship Expectations indicate that BIS will raise its expectations that companies take action to advance equity of opportunity within their workforce.

Board

- Consistent with BIS' 2021 proxy voting guidelines for U.S. securities, the Stewardship Expectations indicate that BIS expects U.S. boards to have, in addition to other aspects of diversity, at least two women directors.
- BIS is asking U.S. companies to disclose, among other things, data on the race and ethnicity of their board members.
- BIS intends to increase voting action against boards not exhibiting diversity in 2022.

Key Stakeholder Interests

BIS notes in its 2021 proxy voting guidelines for U.S. securities that, to deliver value for shareholders, companies should also consider their stakeholders. The 2021 proxy voting guidelines go on to note that, while stakeholder groups may vary across industries, they are likely to include employees, business partners (such as suppliers and distributors), clients and consumers, governments and regulators and the communities in which companies operate.

- BIS is asking companies to report on how they have determined their key stakeholders and considered their interests in business decision-making.
- Companies should effectively address adverse impacts that could arise from their business practices and mitigate material risks with appropriate due diligence processes and board oversight.
- Beginning in 2021, BIS will prioritize a focus universe of approximately 150 companies whose business practices may have resulted in adverse impacts or reflect insufficient management of social sustainability risks. For these companies, BIS will emphasize company disclosures and what they reveal about underlying business practices and long-term plans.

SASB Disclosure

- The Stewardship Expectations note that BIS will raise its expectations that companies make relevant SASB-aligned disclosures.

BlackRock has been a strong advocate for SASB-aligned reporting. In his January letter to CEOs, Larry Fink called on companies to put out disclosure in line with industry-specific SASB standards. Underscoring BIS' focus on SASB reporting, its 2019/2020 Investment Stewardship Annual Report indicates SASB was an area of focus in 540 engagements. Consistent with the Stewardship Expectations, BIS noted in its most recent Global Quarterly Stewardship Report that it will continue to request that companies publish SASB-aligned disclosures.

Corporate Political Activities

- BIS will seek confirmation from companies, through engagement or disclosure, that their corporate political activities are consistent with their public statements on material and strategic policy issues. In that regard, BIS expects companies to monitor the positions taken by trade associations in which they are active members for consistency on major policy positions and will expect companies to provide an explanation if there are inconsistencies. The Stewardship Expectations note that, for many carbon-intensive companies, the credibility of companies' commitments to manage climate and other sustainability risks may be undermined by their involvement in or affiliations with efforts that seek contradictory public policy aims.

Director Tenure

- BIS will look more closely at average director tenure, as it seeks a balance between the knowledge and experience of seasoned directors and the fresh perspective of newer directors.

Voting on E&S Shareholder Proposals

The Stewardship Expectations note that BIS' approach to shareholder proposals is evolving. According to the Stewardship Expectations, voting on shareholder proposals will play an increasingly important role in BIS' stewardship efforts around sustainability. Since July 1, 2020, BIS has supported globally eight of nine environmental proposals and three of 13 social proposals.

The Stewardship Expectations note the following (with some overlap in the statements made):

- If a company does not provide adequate public disclosures for BIS to assess how material risks are addressed, it will conclude that those issues are not appropriately managed and mitigated.
- BIS will support proposals that address material environmental risks that a company could be managing to greater effect. As noted in the Stewardship Expectations, environmental risk is broader than just climate risk.
- BIS also will support proposals on social topics where it believes there is a material risk to the company that has not yet been addressed or disclosed. However, BIS observes that, while many environmentally-focused shareholder proposals increasingly address material business risk, proposals on social issues are not always as targeted and some request disclosures that the company already is substantively providing.
- If BIS agrees the issue and intended outcome of a proposal are consistent with long-term value creation, it expects the board and management to meet the spirit of the request. If its analysis and engagement indicate a need for improvement in a company's approach to an issue, it will support shareholder proposals that are reasonable and not unduly constraining to management.

- BIS may support a proposal if management is on track, but it believes that voting in favor might accelerate their progress. Given the perceived need for urgent action on many business-relevant sustainability issues, BIS will be more likely to support a shareholder proposal without waiting to assess the effectiveness of engagement.

BIS' 2021 Engagement Priorities and Commentary

- Early in 2021, BIS will release its engagement priorities and supporting key performance indicators for the year.
- BIS will provide a more holistic commentary on its perspectives on companies' impacts on natural capital (described as the environment beyond climate) and their impacts on people, including customers, employees, suppliers and communities. Among other things, the commentary will include BIS' expectations on promoting biodiversity and counteracting deforestation and also will address how BIS expects affected companies to manage the scarce water and energy resources on which they depend to avoid negative impacts that could impair their ability to operate.

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