Engaging with Neuberger Berman




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Key Takeaways

Neuberger Berman takes a Portfolio Manager-driven approach to voting, engagement and ESG integration across asset classes

NB Votes, Neuberger Berman's proxy voting disclosure initiative, will expand this year with the goal of improving transparency and communication on voting decisions

Key focus areas for the 2021 proxy season include diversity disclosure such as EEO-1 reporting, political spending disclosure and pandemic-related executive compensation decisions

Neuberger Berman's climate risk analysis is centered on SASB and TCFD-aligned reporting and focused on company actions to reduce emissions and mitigate physical risk from climate change

Approach to Stewardship and Engagement

James Hamilton: What are the core pillars of Neuberger Berman's approach to stewardship and how has that evolved in recent years?

Caitlin McSherry: At Neuberger Berman, stewardship is not a separate function but an integral part of the investment process. Rather than having a distinct team dedicated to stewardship efforts such as proxy voting and engagement, we have embedded those responsibilities within our investment teams as it provides the most direct mechanism to integrate ESG into our investment processes. We have a robust approach to stewardship and individuals who are competent and able to engage on these matters across all asset classes.

Jonathan Bailey: Historically, our firm has given autonomy to Portfolio Managers (PMs). That means PMs have responsibility for driving engagement with the companies in which they invest, leveraging Caitlin and other centralized resources. It has also meant that we've been willing to use the full range of tools at our disposal as an asset manager - from running proxy campaigns, to exiting a position, to letter writing, to behind the scenes dialogue. Ultimately, we think it is an important part of our culture that PMs are accountable for stewardship responsibilities because it is a core part of our approach to investment management and has been for decades.

Sheena VanLeuven: Can you tell us about your roles and how you work together?

Jonathan: As Head of ESG Investing, I lead the ESG and impact investing effort for the firm across all asset classes. This incorporates a number of different aspects, one of which is our stewardship efforts, but also the development of new investment strategies, whether engagement or impact-oriented. My role involves working with our investment professionals on developing proprietary ESG analysis frameworks embedded in our equity, credit and private market processes. It also includes working with clients, including institutions like pension funds and insurers, as well as intermediaries and individuals, who see stewardship as a core part of the way that they customize the mandates we have with them.

Caitlin: I oversee our firm's investment stewardship activities, comprising our engagement efforts with companies and proxy voting activities. A core part of my role is working hand-in-hand with our investment teams on those topics rather than taking sole ownership of them. It is very much a bottom up approach, even to the development of our proxy voting guidelines themselves, which reflect the views of the investment teams.

Jonathan and I also represent the firm on external collaborations and industry groups such as the Sustainability Accounting Standards Board ("SASB"), where Jonathan and Joe Amato (President and CIO of Equities) serve on the Investor Advisory Group ("IAG") and where we are members of the APAC Working Group. In addition, several members of our investment team sit on the SASB Standards Advisory Groups, helping to identify the financially material issues for a given industry that inform the SASB standards. We are also a member of the Climate Action 100+ where we engage with high-emitting companies alongside other investors to ensure companies are taking appropriate steps to manage climate change-related risks and opportunities.

James: What are some ways that companies can be most effective, or, conversely, approaches they should try to avoid, when engaging with Neuberger Berman?

Caitlin: One effective practice we are seeing companies really improve upon is recognizing the depth that investors want to go into during our engagement. That involves agreeing upon the key topics that both parties want to focus on ahead of a call. That lets me get the right people in the room from our team and the same goes for the company, which leads to a more robust dialogue.

We do not find it helpful when companies are overly focused on a proxy advisor's recommendation and why they are wrong. In proxy season, it is more helpful when companies come to us to focus on proposals that warrant further discussion and engage on the substance of those proposals because that will inform our ultimate vote decision.

Jonathan: I echo that. Taking a step back, we often have multiple PMs that own the same stock across funds and strategies. Our analysts play an important role ensuring effective communication among PM teams and helping to prioritize the questions and concerns we might want to raise in an engagement. Different teams will often have slightly different priorities because they are representing clients in their particular strategies. That healthy debate helps us to uncover additional insights about a company and focus our dialogue on the most material issues.

What can be unhelpful is for a company to come into an engagement discussion without appreciating the dynamics that we have as an organization - it is not one house view. Most of our conversations are grounded in the fundamentals of the business and what companies are doing to create value for investors. We want to build that relationship over time so that when difficult situations arise, we are able to engage in a constructive fashion.

James: When do you want to have independent directors attend engagement meetings?

Jonathan: It depends on the circumstance. We have found that in some situations it is helpful to understand the views of independent directors and get a feel for the board. I can think of instances where engaging with directors during difficult periods has strengthened our confidence in the direction the company was taking. It is certainly welcome, but it does not need to happen every time.

Proxy Voting

James: Can you tell us about the Governance and Proxy Committee and its role in proxy voting decisions?

Jonathan: The Governance and Proxy Committee is comprised of the Equities CIO, Head of Global Equity Research, Head of ESG Investing and senior PMs. This group oversees the firm's proxy voting activities, including our custom voting policy and voting procedures, and plays an important role in ensuring that we are bringing a range of perspectives to proxy voting and related decisions. The Committee meets regularly during proxy season to debate select votes, discuss publication of NB Votes disclosures, determine our level of involvement in a contested situation and decide on any necessary escalation steps with portfolio companies.

James: Given this approach, is an active decision made on all individual votes?

Caitlin: Our custom voting policy has been developed with the PMs and analysts and is refreshed at least annually to make sure we're approaching new and dynamic topics in the best interests of our clients. As both management and shareholder proposals have become increasingly complex, our policy encourages nuanced decision-making that allows for different interpretations for different companies and situations. That is when the Committee comes into play, to facilitate those debates that help us arrive at a vote decision.

Jonathan: This is another example of how our heritage of independent thinking from PMs has driven our current practice. We have always wanted to have a starting point of principles that make sense while recognizing that rules can't apply to every situation and scenario. Compensation is a great example – you can put a return on capital metric in a compensation plan, but what happens if you need to invest in transforming your business, as many companies did through COVID? The judgment needs to be there. The Committee is a way for our analysts and PMs to bring the research they have done around a vote and make sure that is discussed and debated.

NB Votes

James: You referenced the NB Votes disclosure initiative a moment ago. That effort began last year as NB25+ and has been expanded and renamed for this year. What should companies know about this initiative in its new formulation?

Caitlin: NB25+ was launched prior to the 2020 proxy season and enabled us to share our broad analysis and insights on our vote intentions. We published short summaries of our vote decisions and reasoning in advance of select shareholder meetings, with a focus on companies where our clients have significant economic exposure. In late 2020, we renamed it NB Votes in recognition that we planned to expand the scope of the program for the 2021 proxy season. We have oriented the disclosure to encompass a broad range of proposals across our nine key governance and engagement principles (strategy, incentives, board independence, shareholder representation, capital deployment, transparency and communications, risk management, environmental issues and social issues) with an eye toward disclosing both votes in support of and against management.

When we decide to feature a company in NB Votes, it is the product of significant internal discussion. Each company is made aware that they will be featured and the reasons for our vote decision. Looking back on the first year, we have been pleased with the responsiveness from companies, even when we have been taking action against management, because it has opened the door for deeper conversations on key topics of importance to us. Improved communication and transparency is very much seen as a positive by both parties.

Jonathan: One of the reasons we did NB Votes is to provide more detailed perspective and nuance. For example, if there are two identical proposals at two companies where the topic being proposed is material in both cases, we want to be transparent about the level of analysis and judgment that goes into our voting decisions.

There is good academic research that shows shareholder proposals filed on a particular topic at one company lead to improvements in practices and disclosure by other companies in the same sector. NB Votes applies the same principle to communicating our expectations on those topics. Our hope is that other companies look at an NB Votes disclosure and will either feel they are already performing at a great level or there is space to improve. Our view is that shareholder proposals are not necessary in every case to drive change.

Shareholder Proposals

Sheena: How have your expectations shifted on topics like diversity and inclusion or climate risk and how might that come through in the way you vote on related proposals this proxy season?

Caitlin: Our philosophy is that we expect companies to put forth disclosure on their key material topics. While we do not have a red-line approach to any given proposal, if a company receives a proposal that we deem relevant and there is limited disclosure or understanding of how it is managing an issue, that is certainly a factor we put into our vote decision. In general, we always consider proposals in a company-specific context, which is why it is so valuable to bring in the expertise of the PM/Analyst who covers the company to contextualize the ask and assess if it is in the company's best interests.

Sheena: Over the past few years you have supported more proposals asking for enhanced diversity disclosure. What is driving that and can you share your thoughts on the EEO-1 data shareholder proposals up for a vote this spring?

Caitlin: We engage heavily with companies on diversity. Our voting record is a reflection of the progression of our conversations and expectations on the topic. Looking back a few years, there was a really strong focus on diversity at the board level, zeroed in on gender diversity in particular. Fast forward to today, our focus is much broader than the board – we are interested in the full workforce and the diversity of race, ethnicity, age and various other demographics represented.

This segues into EEO-1 – companies have been hesitant to disclose this information and instead are giving workforce percentages at an aggregate level. This does not give investors the information we feel we need to have a comprehensive understanding of what is going on from a human capital management perspective. We view EEO-1 data as a helpful starting point, but also completely understand that companies may not view their own workforces through EEO-1 categories. In these cases, we encourage companies to consider putting out their EEO-1 disclosure and build upon it from there by bringing in additional narrative and disclosure on their unique approach or other elements they want to highlight.

We have already seen a few companies do this nicely. I liken it to how some companies approach SASB in that a particular company may not perfectly fit into one sub-industry group and, in response, they take one standard as their floor and build upon it to reflect their business model and strategic objectives. That is a relevant approach from a diversity perspective as well.

Sheena: Political spending and lobbying have come to the forefront in the past few months. Has your thinking about shareholder proposals on this topic changed because of the events of this past January?

Caitlin: We have been focused on political spending and lobbying for some time. We tend to support many of these proposals in the spirit of encouraging more disclosure and more oversight. Coming out of events this past January, we have seen a number of companies make announcements that they are suspending their PACs or initiating reviews of overall political spending practices. We are going to be engaging to understand the scope of those efforts and what long-term changes may result. We find the CPA-Zicklin index particularly helpful in evaluating proposals on the topic. It is a very useful guidepost for assessing appropriate disclosure on practices, both in relation to the market and industry peers, and a helpful reference point when analyzing a proposal at a given company.

<u>Executive Compensation</u>

James: Given the disparate economic and social impacts of the pandemic, are you taking a different approach to evaluating executive compensation this proxy season?

Caitlin: We are not changing our approach to executive compensation this year, but there will be a broader set of inputs that we bring into our analysis as compared to a more typical year. With so many companies adjusting their plans mid-year or making significant changes moving forward in response to the current environment, we expect to be engaging quite heavily to understand the scope of changes and if they were warranted, justified and appropriate for the strategy on a go-forward basis. We want to understand to what degree companies and industries have been impacted, what capital allocation decisions were made and how the workforce was impacted. These traditionally have not played as prominent a role in our compensation analysis but they will be part of discussions this year.

Activism

Sheena: Can you talk about the process and steps you take to evaluate a contested situation and what would cause NB to go public with its view on a particular company?

Jonathan: I would say first, we never buy a stock with the purpose of activism, it is not our approach. We think of a range of tools and escalation options, including more direct engagement where necessary. Ultimately, if we feel nominating an alternative set of directors or other actions will be helpful to our clients, we are willing to take those steps. But we never buy a stock because we think we can achieve a short-term benefit from taking an activist approach. If you look at examples where we have nominated directors and been more public, those are always positions where we have had a long holding period and a relationship with the management team.

Second, it is important that our approach to activism is grounded in the view and the consensus built internally by the PM who owns the stock on behalf of his or her clients. If we have decided to take an activist approach, it usually means that in our view, multiple meetings over months and years have not resulted in sufficient action from the management team and board. During that period of steady escalation, our Governance and Proxy Committee will be involved reviewing the PM's views as to what appropriate next steps might be, in conjunction with Caitlin along with members of the legal and compliance team.

In the vast majority of cases, private engagement is successful and we think not having to go public is great. But, sometimes we are not able to achieve our objective that way. Knowing we have the option and ability to take additional steps if needed is important in showing the seriousness with which we do engage. When that happens, we will go through the Governance and Proxy Committee to make those decisions collectively and lay out a plan for how we might take action.

ESG

Sheena: What does ESG integration in the investment process look like at Neuberger Berman?

Jonathan: We think it is really important that the process of ESG integration is aligned with the investment objective of the strategy. It sounds obvious, but we do not randomly throw ESG data into a process because we think it is good PR or to have a response for when clients ask what we are doing on ESG. We do it because we think it helps our strategies to deliver. We are going to use different tools, data sets and assessments in each market and strategy, but the commonality is that there is always a combination of human judgment, data from corporate disclosure, data science and third party data providers to provide us with real time insights and business model-specific understanding.

Sheena: So when you are assessing what is material, are you looking at that through a SASB lens? How can a company understand what your perspective is on what might be material for them?

Jonathan: We were the first investment manager to say that we would use the SASB framework to evaluate materiality. SASB is intended to be a lens through which companies can understand how we might look at a topic. In cases where a company's business operations are not fully captured within a single industry, or our analysts have identified an additional metric as material for a company, we will communicate our views to the company during engagement.

Sheena: You have your own internal ESG ratings system – the NB ESG Quotient. What should companies know about that scoring system and can you provide any insight into how qualitative and quantitative disclosures factor into the score?

Jonathan: The NB ESG Quotient brings different data points together so when we are looking at a company to include in a portfolio or to prioritize engagement objectives, we are able to draw upon insights that we see as a potential source of risk or opportunity and incorporate those considerations into the investment process. It is based on ESG factors that are financially material in each industry. For instance, factors such as privacy, data security and intellectual property are relevant in technology but may be less relevant in packaging, where raw material use, recycling and safety may be more important. This is an internal rating, but we will discuss with companies the issues that we are focused on and the topics within the score upon which we think they can improve.

Sheena: Related to this topic, companies often focus on their MSCI or Sustainalytics scores. Is that something you use yourselves?

Jonathan: Our clients often use those ESG ratings services, but they are not part of our investment decision-making process. We encourage companies to be aware of those ratings but more importantly to be aware of the data that they could be disclosing that would help ratings agencies and investors have a fuller understanding of their practices. For example, on diversity, equity and inclusion I think investors have been pretty clear about the type of disclosure that would help us form a fuller picture of company practices but many companies have not followed that. We view that as the type of opportunity where companies can improve their practices and disclosure.

Sheena: How do you assess company progress on addressing climate risk and specifically around net-zero emissions reductions goals?

Caitlin: We expect companies to provide robust reporting on their management of ESG-related risks and opportunities, including climate risk. We are supportive of the work of the Task Force on Climate-related Financial Disclosures ("TCFD") and SASB. Companies can look to those frameworks as a reference of leading best practices. We expect directors to be familiar with those recommendations and be able to discuss how they relate to the risk assessment for their business.

We are seeing that many companies are comfortable setting long-term targets on GHG emissions goals. What we are also noticing is that there is a gap between when the target is set and the long-term target date, with minimal disclosure on interim targets. Often times, these targets are so far out that the management team setting them is unlikely to be in place when that date comes. We are trying to assess the interim steps to achieve those targets and the pathways to get there.

Jonathan: Part of our climate assessment is looking at physical risk, which we highlighted last season through our votes on climate risk. Physical risk is often overlooked amidst the focus on the transition and commitment to net zero. Disclosure is generally poor for those businesses that have large physical assets where climate change may have an impact on the communities in which they operate or where they have assets that are hard to fully insure from physical climate risk. That needs to improve if we are going to deal with the fact that even under a 1.5 or 2-degree scenario there will still be more instances of extreme weather. We need to understand how companies are managing that risk, which is clearly material.

Sheena: How would superior or poor ESG practices or performance potentially affect buy/sell decisions?

Jonathan: For all ESG integrated strategies, each portfolio management team determines how best to achieve its ESG integration objective and lays out how ESG analysis is conducted to potentially increase return or mitigate risk, how ESG issues are analyzed and measured at the security level, and how they influence portfolio construction. We believe that the most effective way to integrate ESG factors into an investment process over the long term is for investment teams themselves to research ESG factors and consider them alongside other inputs into the investment process. For this reason, ESG research is included in the work of our research analysts rather than employing a separate ESG research team. The investment teams can then choose how best to apply all the tools of active management, whether that is to engage or ultimately to sell a security when it no longer offers an attractive risk-adjusted potential return.

The Year Ahead

Sheena: How has the pandemic impacted how you have engaged this past year and your expectations for proxy disclosure and engagement this coming year?

Caitlin: I have been very impressed at the level that companies made themselves available to engage over the past year, despite all the challenges and uncertainty they have faced. Thinking about Neuberger's own practices across public equity teams, in 2020 our PMs and analysts held over 2,200 meetings with company management teams representing over 70% of public equity AUM. It really underscored to me the importance that active engagement plays in our investment process, particularly in challenging times when companies are making important decisions or grappling with strategic objectives and shifting the direction of a given strategy.

As I think about what is ahead, certain issues have been brought to the forefront and I do not expect them to fall by the wayside once the uncertainty settles. The pandemic has shown how topics like human capital, the health and safety of employees, community engagement, pay equity and overall diversity and inclusion efforts are critical elements of achieving strategic objectives. The next step is both improving the practices around these topics and providing investors needed context through disclosure and communications.

About PJT Camberview

PJT Camberview, the corporate governance and shareholder engagement practices group of PJT Partners LP ("PJT Partners"), is a leading provider of investor-led advice to public companies on engagement and shareholder relations, activism and contested situations, sustainability and complex corporate governance matters. PJT Camberview helps its clients succeed by providing unique insight into investors' perspectives on long-term value creation, interpreting the evolving governance landscape and creating proactive strategies to stay ahead of investor challenges.