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Many governance experts believe the main driver is the movement toward passive investment

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In corporate governance, change is more often evolutionary than revolutionary. But this year institutional investors are helping to create a foundational shift that is catapulting environmental and social (E&S) issues into the mainstream.

While major investors such as BlackRock and State Street Global Advisors (SSGA) have historically preferred to wield influence through constructive engagement with their portfolio companies, this year they have made clear that they will also back up their sustainability policies with their vote if such efforts prove ineffective. With sustainability increasingly becoming a bottom-line concern, 2017 may have all of the ingredients needed for a revolution that drives E&S issues to the forefront of investor engagement agendas.

To understand the market momentum behind E&S topics, it's best to step back and briefly examine how these issues became part of institutional investors' engagement priorities. While governance has long been a focus for most institutional investors as a driver of long-term value, sustainability has traditionally been championed as an engagement topic by a smaller subset of investors, largely in the socially responsible investing space.

Those investor efforts have included divestment campaigns from businesses operating in apartheid South Africa during the 1980s; the push for sexual orientation non-discrimination policies in the 1990s; and more recent efforts to promote the publication of sustainability reports.

Today, sustainability has gone mainstream and many governance experts believe the main driver is the movement toward passive investment vehicles. The world's largest governance-focused investors now control more than one third of many companies' shareholder registers, a percentage that has significantly increased over the last 20 years.

With that consolidation of assets has come increased pressure on and scrutiny of asset managers from regulators and investor clients to analyze, engage and vote on the sustainability practices of public companies. New initiatives, many of which have broad investor support, have helped to shape this sustainability framework. For example:

- The more than 1,600 investor signatories to the UN Principles for Responsible Investment (PRI) are experiencing increased pressure to demonstrate their own progress toward integrating ESG – environmental, social and governance – factors into investment processes and ownership practices as the PRI strengthens accountability mechanisms and asset owners prioritize ESG factors in asset manager selection. The world's three largest asset managers – BlackRock,

Vanguard and SSGA – and almost every other major institutional investor are signatories to the PRI
- A significant number of large investors are participating in the development of the Sustainability Accounting Standards Board guidelines for US-listed companies. These guidelines are designed to help public companies identify and disclose material ESG information to investors through SEC filings
- Shareholders who believe that regulators may not require, or may even roll back, disclosure of E&S risks are continuing to pursue sustainability initiatives through private ordering.

Taken together, these factors have contributed to higher shareholder support for E&S resolutions and have likely spurred an increase in the number of proposals filed this year. In the US in 2016, eight E&S-related shareholder proposals received majority support; votes on climate change at several extractive industry annual meetings did not pass but received exceptionally high support; and a gender pay equity proposal received near majority support.

In February, **As You Sow** reported a 15 percent increase in the number of proposals on environmental and social topics from 2016 to 2017, and many companies have already settled with proponents on a range of E&S resolutions.

These trends dovetail with changes in the marketplace that have elevated the importance of shareholder engagement. As governance-focused institutional investors have accumulated assets, they've also expanded their corporate governance teams to respond to demand for greater engagement, including adding personnel to specifically tackle E&S issues.

In addition, these investors have taken public stances outlining their policies and expectations on sustainability. For example:

- Last year, Vanguard highlighted its focus on environmental, climate change and supply chain risk in engagement discussions
- In January 2017, SSGA devoted its entire annual letter to board members to the importance of incorporating ESG metrics into long-term business strategy, in addition to a separate letter sent in early March addressing gender diversity in the boardroom
- In mid-March, BlackRock cited board diversity and climate competency, along with human capital management and disclosure of climate risks, as being among its 2017 to 2018 engagement priorities.

However, the signal development this year is that investors are increasingly backing up their stated priorities with both calls to action and votes. Within the past three months, both BlackRock and SSGA have publicly indicated that while engagement remains their primary conduit to understanding the long-term strategies of their portfolio companies, they will now consider voting against nominating/governance committees if they perceive a lack of progress on integrating sustainability into long-term business strategy.

The message to boards is clear: investors want robust oversight of sustainability risk. For 2017 and beyond, shareholders will connect words with actions for those who fail to heed this call.