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THE 2020 AGM SEASON IN BRAZIL

Taking stock of the shareholder sentiment and looking forward to 2021

AGMs 2021: RAISING EXPECTATIONS ON DIRECTORS MAY INCREASE AGAINST VOTES THIS SEASON

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The against votes on resolutions concerning remuneration and election of directors at the last AGM seasons should come as no surprise to companies. This attitude follows an increasing and unequivocal institutional investors' demand for better ESG practices that became more evident after the global financial crisis and grew steadily since then.

In the beginning, institutional investors were vocal but more and more they became expressing their requisites on actions. As an example, BlackRock, the largest asset management firm, registered a **32%** increase globally in the proportion of directors they voted against from 2018 to 2020. They have voted against over 1,200 directors[1] on a range of governance and sustainability-related issues and opposed the (re)election of 5,100 directors globally. The concerns driving the against votes were:

- lack of director independence,
- lack of board diversity,
- director over-commitment and
- executive compensation misalignment with long-term performance.

Not only there is no reason to expect that investors will reduce their against votes on this coming AGM season as it should be expected a more rigorous behavior. BlackRock statement is clear: "Our expectations of boards and management are higher than ever before." And this could not be different. Following the COVID-19 pandemic and the protests around racial equity issues related to diversity in the board room, investors' concerns were elevated and so the attention to the "S" of Social in ESG.

As an indicator of the attention of investors on such topics, Vanguard – the second largest asset management firm - and BlackRock will begin tracking gender, ethnic, and racial diversity on the companies they invest this year. Vanguard informed that they may vote against directors at companies where progress on diversity falls short starting in 2021. BlackRock will follow the same path but it will start voting against companies failing to increase the progress on diversity starting in 2022. This year, it will start to demand from companies that they release their overall ethnic and racial data. Hermes EOS will recommend voting against resolutions at companies in 2021 that they judge to be making insufficient on diversity and inclusion.

Additionally, BlackRock announced that they will raise their expectations regionally on board and workforce ethnic and gender diversity and director independence and capacity to serve. For Vanguard, the second largest asset management firm good governance starts with a company's board of directors: they understand that if a company's board is capable, diverse, and experienced, good results are more likely to follow. State Street sent a letter to board chairs of public companies in August last year setting forth its heightened expectations regarding board and workplace diversity

But companies should be aware of far beyond the composition of their boards. Investors are looking for progress on the main issues they care about. Besides voting against 55 companies' boards on climate-related issues, BlackRock put 191 companies "on watch" meaning that there is a risk of votes against directors in 2021 unless the companies demonstrate significant progress on the management and reporting of climate-relate risk.

1. Includes withholding support and abstentions

PROXY-STATEMENT: IMPORTANT TOOL TO PRESENT THE BOARD NARRATIVE

And here lies a big opportunity to companies. Most of Brazilian companies have been using consistently the Proxy Statement (PE) as a compliance exercise to attend regulation. Rather it should be considered as a major means to communicate with companies' shareholders. And because of the strategic importance of the PE, board directors should be strongly involved in the narrative building. And this is not happening in the majority of the companies, where the PE is totally developed by management with very low involvement of the board, if any. In particular, in the board election item of the AGM the PE should not only bring the CVs and short bio. Investors would like to understand about the process of board evaluation and nomination of directors and would expect a narrative that describes why each of the directors proposed to election meet the competences and skills required by the strategic goals. This is a board narrative and not the management one, so board directors should take a protagonist role in designing the message to shareholders. International investors have recognized recent and few efforts in the Brazilian market of improving the PE.

Companies should face the 2021 AGM's challenges as an opportunity. The institutional investors demands throughout the years have incentivized companies to be more resilient and successful. Take only one of them as an example - board and workforce diversity. A BCG study found the following evidence:

- Fortune 500 companies with at least three female directors obtained more than **53%** of ROE.
- When **30%** of leadership roles are filled by women, Net Profit Margin increases above **6%**.
- In companies with above-average diversity in the leadership teams, EBIT is more than **9%** higher and innovation increases in more than **19%**.

Your board has still time to not only obtain good results at the next AGM as to create a path of value creation for the many years to come.