INTERVIEW WITH ROBERT WALKER

Robert Walker is Managing Director and Global Co-Head of Asset Stewardship at State Street Global Advisors (SSGA), one of the largest institutional investors in the world and a significant minority shareholder in GCC public companies. SSGA also manages capital on behalf of clients such as sovereign wealth funds in the Gulf region. SSGA's 12-person stewardship team has a global influence on governance standards and expectations, including in times of disruption.

Robert spoke with Hawkamah advisory board co-chair **Stephen Davis** *about how SSGA acts to strengthen portfolio companies as they face crisis.*

Q: Let's start by getting some background under our belt. What is the current size of SSGA's assets under management and how does the stewardship team operate?

It's about USD 3.15 trillion, of which USD 9.6 billion is in the MENA/GCC region.

My team, the stewardship team, owns the right to vote at SGGA and that creates a lot of simplicity in terms of how we conduct ourselves from the engagement and voting point of view. It's much easier to have a clear line between the two. So if we come out saying that we are going to do something on climate or on diversity or on executive remuneration, I don't have to go to the portfolio manager and ask, "Is it OK if I vote against that?"

But what we have been doing is bringing the different investment teams together to better understand their views and educate them on our stewardship policies. For example, our Active Quant Equity team have developed their own model for how they look at ESG. What I have been doing is saying, "Look, you have a number that tells you the ESG characteristics of a company, but I have a different perspective because I speak to the chairman of that company. The insights I get from that meeting may clarify your position, but for those companies you hold that rank relatively poorly on ESG metrics, our Stewardship program which is focused on engagement and voting can add value to your investment process.

Further, SSGA developed the "R-Factor"—an ESG analytics system—as a foundation upon which different investment teams can base their ESG research. And what we are starting to see through the R-Factor is the way in which we can really engage with companies on ESG issues in a consistent way and then give companies the opportunity to improve their ESG disclosure and create a momentum effect.

Q: It's important to note that your stewardship team has ownership of the voting, whereas in other shops each fund manager may vote differently. Many people in the market fail to appreciate that there are very different models of stewardship.

The benefit of our model is that we have very experienced people who have been doing this for a long time. Every year we select three industry sectors to examine and we explore ESG insights and communicate them to investors and clients. Then we have the thematic approach where we focus on global ESG issues which we think are impacting businesses on a five-year time scale – for e.g. climate change, gender diversity and culture. And because we are voting all holdings through a single channel, clients who give us assets to manage understand that they are essentially signing up to our stewardship policies.

This means that when we speak to companies, we have got that weight behind us. I can tell you that when I joined State Street three years ago, I was quite surprised by the amount of stewardship work that we do. The reality is that in Europe last year we engaged with most of the largest oil and gas companies that we hold. I and my team met with every single chair of those companies. We talked to them about climate change, we pushed them. Companies know that when we come to meet with them, we are prepared. Engagement is at the core of what we do. We have to understand the ESG characteristics of the portfolio companies that we own.

Q: Let's talk now about when disruption affects companies in which you invest. How does SSGA apply stewardship at companies facing the pandemic or, more generally, existential crisis, particularly in MENA or the GCC region?

I don't think there is a regional bias here. When COVID-19 hit, the first thing we did was to consider how we want to support our portfolio companies. So we put out guidance to boards, telling them that we are here to support you in the short to medium term and assuring them that we realize for now that you need to put a priority on your employees and wider stakeholders.

We have done 150 COVID-related engagements with companies in the last six months. And they all are saying the same thing: we have had to focus more on our employees—but we haven't necessarily got the metrics to measure that. I mean, how do you best define materiality of human capital? So there's a definite data challenge there. That's why SASB [Sustainability Accounting Standards Board] is re-focusing its attention on human capital.

On top of that, we have got the racial diversity element coming in as well. And we all know and see the evidence that companies that are more diverse, in gender and racial perspectives, outperform.

If you look at the GCC, we see markets beginning to wake up to the gender portion of that. Every single one of the long-term economic development plans of GCC states–Saudi Arabia, UAE– will have a sentence somewhere saying we need to increase the penetration of women in the economy. So that is clear. It's because they all realize that their future economic success is linked to more women coming into workforce. McKinsey did a study showing that if the GCC increased the penetration of women in the economy to 50%, you would create more than 800 billion in new GDP. And if you look at Saudi Arabia, it has more women graduating

from university than men. If they don't create opportunities for them, they are going to leave. Not immediately, but they are well-educated, they can leave. Even when I was in the Middle East two years ago speaking to sovereign funds, they were all talking about this.

I remember visiting a sovereign wealth fund to discuss climate change and I can tell you that of the 30 people in the room 90% were women. These were future leaders of the fund, and they were asking questions and they were plugged in. So I think change is happening, and this is driven by the economic rationale, which again feeds into our program – which is value, not values.

Everything we do from the stewardship perspective is rooted in economic value. Because our job, my job, is to push companies to improve their ESG characteristics to create long-term value for our clients. In order to do that, I need to be able to demonstrate that by focusing on issues such as diversity, board accountability, or corporate governance, for example we are going to reduce risk across the portfolio.

Q: Is it right to infer, then, that SSGA believes that a company would be wise to ensure diversity in crisis decision making?

Yes. I think there is clear evidence now and we proved this in the US with the "Fearless Girl" campaign where we identified this issue. Why do we have all these US companies that do not have a woman on the board? We didn't just go to companies and say, "Women are 50% of the population, why is there this gap?" We actually got the academic evidence, the broker research, to show that companies that have women on boards have a better return on equity than those that do not.

We started pushing companies to respond. We wrote guidance to help companies understand the issue. We then said, "Look, we will work with you on this issue but if you don't engage with us and sell us a plan on how you will address the issue, we will vote against management." And over the last two years, I think we identified 1,463 companies that didn't have one woman on the board and 54% of these companies have now added a woman to their boards.

Of course, we look at a range of issues such as the quality of governance, which includes diversity, as well as environmental and social factors. At the beginning of this year we wrote to companies in our main indices, but not yet to MENA companies.

We probably need to give MENA companies a bit more time. One of the reasons we wanted to understand the state of play in gender diversity in the GCC in 2018 was because Saudi Arabia was joining the MSCI and FTSE emerging market indices in 2019. And because of that we would have more exposure to those companies. But we recognized that we just can't stomp into these places and say, "You need to add more women to your boards immediately or otherwise we will vote against". We have to give them time and we did that in the US. We engaged with US companies for a little while before saying that we will vote against.

I expect we will update our GCC paper next year and then we might look up whether or not it's the right time to implement our voting policy for MENA. It's difficult and there may be a data challenge there, but this is certainly something that is on our radar.

Q: Might you expect the pandemic to accelerate SSGA's engagement on ESG?

The pandemic has highlighted the significance of traditional social issues such as labor practices and employee health and safety. And I think it is fair to say that the identification of Human Capital Management metrics is now a persistent challenge for companies.

That's why our R-Factor model is so powerful. It helps us identify companies doing the right thing on environmental and social factors. And we want to work with companies that aren't doing that. And if they don't want to change or offer plans to change, then we can say, "We see it as a risk that you are not doing it, we think other companies in the sector are doing it and thereby benefiting from lower risk profile. Therefore, if you're not listening to us, we are going to use our vote."

Q: Whom do you typically want to engage with: Management or the board of directors?

We typically speak to the board. We also have companies that approach us, because of their R-Factor score or because we voted against them on an issue. But mainly it is the board of directors. Interestingly, our fundamentals teams mainly talks to management. There are situations where the fundamentals team organizes a meeting with a company, where they meet with the CEO—and the stewardship team joins these meetings. And when we, the stewardship team, organize a meeting with the same company, we meet with the chair—and the fundamentals team joins in.

Q: Is there something from the pandemic that you have learned as an investor in respect to stewardship? Questions you might ask which you might not have asked before?

I think the biggest thing to come out of the pandemic is the ability of our stewardship program to be flexible. We set out our priorities in the beginning of the year: the sectors we will look at and our themes. Then COVID came, and all of a sudden these long-term ESG issues are relevant. But they are not as relevant as this company needs urgent capital. And yes, we are going to have to vote on a shareholder resolution or think about compensation – not this year, but next year – as a lot of companies will be coming and saying to us, "Our CEO is a good guy, we are going to have think about how we pay him because last year COVID happened and he is not going to meet his targets but we don't want him to go."

So the pandemic has definitely focused our attention on the liquidity of the business, its capital position and, especially, the rise of social issues. We might say to companies, "You haven't been thinking about your employees, but now their well-being should be one of your business priorities – they are working from home and what are the implications for productivity? Every company now acknowledges that no one is going to return to the office five days a week. There will probably need to be a balance of two or three days. So the rise of social issues is here to stay and I think that we can expect companies to disclose more information on human capital and how they are managing their employees. But also the wider benefits you are providing to your employees, because people are not just working for salaries anymore and, if they are increasingly working from home, they are looking at wider benefits. So there is a potential competitive advantage for companies if they can demonstrate their appeal. But again, there is a data challenge and we are looking to SASB and other frameworks to help provide the KPIs to measure that.

Q: Do you expect that SSGA will be changing its perspectives on executive remuneration at portfolio companies in the context of the pandemic?

I don't think it has changed our perspectives, but I think it's more that we are we are being upfront. We put out some guidance recently on COVID-19 and compensation where we are telling companies what we expect from them. What we don't want to see is companies laying off employees because of COVID but then on the other hand handing executives the same bonuses and awards.

All companies are going through some pain, with some sectors being more exposed to COVID. Of course, some companies will need to change their performance metrics given the new reality we live in. But I think that's got to be measured and companies need to think about the reputation risk of thinking that it is business as usual when some of their employees have been furloughed or laid off.

So we are certainly being more flexible. But that flexibility is not a signal to companies that they can do whatever they want. It is more that we want to support our portfolio companies, and we will do that, but we are supporting them where they are doing things that are appropriate and sensible, and aligned with the experiences of the wider workforce.

Q: Would you say there has been a shift in what you are expecting from companies in terms of risk management for a crisis? In terms of stewardship, what will you be asking of companies?

In the COVID guidance that we put out in March 2020, we were quite clear that we wanted companies to be more upfront with us on how COVID has changed the risk profile of the business – whether it's the supply chain, their employees, their need for capital in some cases. And we have seen a lot of companies that have been talking about de-centralizing their supply chain after years of trying to centralize it, which led to a lot of problems with COVID. So we are asking companies to engage with us on that. Many companies have responded and, where appropriate, we have supported them.

The issue even comes up around leadership succession. We have seen some senior executives getting COVID, and in some stark cases, dying. Have companies thought about that enough? What happens if a few senior executives get COVID and are out – can we cope with that?

Q: So you are trying to figure out, in a way, what risk management for an existential crisis might work best?

The problem is that – a little bit like with corporate governance – you are fighting the last crisis. Whenever there is a new governance code, usually this is to prevent what happened previously from happening again. It's very hard to be forward looking. But of course you want companies, as much as possible, to put in place processes that allow them to react.

I know people have talked about the possibility of pandemics, but it was still something that was not foreseen. We will learn lessons from it, we will engage companies and build those lessons into our engagement. We will need to support our portfolio companies in the short to medium terms, but also to remind them that we have not forgotten about other issues such climate change and board accountability. We are still talking to companies about those issues, but we are recognizing that companies need to focus on safeguarding the business.

Q: In terms of engagement with MENA or GCC companies, you did an intensive consultation or engagement with them in 2018. Are expecting to do another one in 2021?

Yes, we will update it next year in order to see what has changed. In 2018, we did our own research and put together a report. In 2021, what we want to do is to repeat that exercise and maybe also survey some of our key partners in the GCC to see what their expectations are.

We put out a report last year on how sovereign funds are approaching ESG and one of the things that came out of it was how important governance of portfolio companies is for these funds. When they are thinking about ESG, the most important factor for them was corporate governance. I presume this is because most countries have governance codes, stock exchanges are now thinking about this, and governance is measurable in the sense that when something goes wrong, you can see it in the share price fairly quickly. We have Wirecard as a recent example of this and we are now asking ourselves questions again such as how relevant is an audit to the financial health of a business and does it actually do what it says it's going to do.

We run our own corporate governance screens. For instance, a few years ago we created our own high-level European governance screen which was essentially based on all the European markets and allowing us to create a set of high-level principles and then codifying that.

We ended up with a really nice view on what European governance looks like. So when we are talking with a French company, we can tell them that their governance might be good for a French company, but not as good against European

companies. I expected companies to be quite negative on this. But what was really interesting is that companies were very positive in their response. This was because we were essentially saying to them, "Here's the playbook, here's what we think that matters" and this allowed companies to say, "We are actually better than many other companies". And that may mean that they will get less pressure from investors, because they are meeting expectations.

Q: Drilling down on the point that regions move at a different pace, would SSGA's stewardship approach to GCC companies have a different character from your approach to North American or European companies?

Yes, it would have to, because we have to understand the characteristics of the market. We have to look at where can we push on meaningful matters. I think diversity is one, because there has been a shift in momentum. And then we have to look at the characteristics of the market, and not just go in and vote against everything. We are taking companies with us on a journey, and we want to be voting in a meaningful way.

Q: If a GCC company has SSGA on its shareholder register, or wants to have SSGA on its register, whom would they would contact to understand more about State Street's stewardship expectations? Is there an open door?

Yes, our asset stewardship webpage has all our voting policies, our engagement policies, our sector approach, R-Factor, and now, more recently, our first annual climate review. It is all there. And of course, interested parties can reach out to me or our stewardship team to have a conversation.

One of the things I realized when I joined State Street was that I needed to spend more time with our institutional clients. It is not enough to vote and engage and write a stewardship report. I need to go out and explain to them what we have done on their behalf and why this matters to them and to hear what they have to say. I can tell you that climate change and diversity are at the top of the agenda for all of clients.

The level of interest in ESG now is significant but this is where it comes back to data. I think companies want to disclose more ESG KPIs to help investors understand what they are doing in that space. But a limiting factor is confusion about what they should disclose. Last year we were getting to a tipping point toward consensus where we had SASB and TCFD [Taskforce on Climate-related Financial Disclosures] poised to become global frameworks. This year, I feel we may have taken a step back. Now we have the big auditors coming up with their own ESG frameworks and other frameworks are coming in too. The whole point of SASB and TCFD was materiality – what are the critical KPIs for each sector? If I as an investor understand those KPIs, then I can engage with a company on how they are mitigating risk. If now we are saying, yes, there is SASB but there are also lots of other frameworks, then as an investor, I don't know how useful that is. And for a company getting bombarded daily by requests for data, I don't know how useful that is. We need some kind of standardization of ESG frameworks, a bit like the financial reporting rules, which enable comparison between companies.

Q: You have brought us back full circle. Do I understand correctly that in your view a strong performance by a company on ESG metrics brings you comfort that it can navigate disruption better?

Yes, I think that is a reasonable assumption. But maybe because I'm a corporate governance person, I might lean more towards governance and say that governance scores give me more comfort. This is because if the governance score is good, then the environmental and social factors will get taken care of. But yes, SSGA's view is that companies that are thinking about ESG and linking it to their long-term strategy should do well over the longer term.