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BlackRock, Vanguard and State Street Update Corporate Governance and ESG Policies and Priorities for 2022

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BlackRock, Vanguard and State Street Global Advisors ("State Street") recently issued their voting policy updates for 2022, as well as guidance about their 2022 priorities for their portfolio companies. On January 18, 2022, BlackRock's CEO issued his annual "Letter to CEOs" (available here), following closely on the heels of State Street's CEO, who issued his annual letter to public company directors (available here) on January 12.

These pronouncements from the "Big Three" asset managers reflect a number of common themes, including an emphasis on climate and the transition to a Net Zero economy, diversity at the board level and throughout the workforce, and effective human capital management. Links to the BlackRock and Vanguard voting policies for 2022 are below. State Street's voting policy updates span several documents that provide guidance on areas that State Street views as focal points for the coming year. Links to these documents are also below.

BlackRock Proxy Voting Guidelines for U.S. Securities (effective as of January 2022)

Vanguard Proxy Voting Policy for U.S. Companies (effective as of March 1, 2022)

State Street

Guidance on Climate-Related Disclosures;

Disclosure Expectations for Effective Climate Transition Plans;

Guidance on Diversity Disclosures and Practices;

Guidance on Managing Director Time Commitments; and

Guidance on HCM Disclosures & Practices.

1. BlackRock

2022 Letter to CEOs

In his 2022 letter titled "The Power of Capitalism," BlackRock CEO Larry Fink encourages companies to focus on their purpose and put that purpose at the foundation of their relationships with stakeholders, in order to be valued by their stakeholders and deliver long-term value for their shareholders. The letter urges companies to think about whether they are creating an environment that helps their employee-stakeholders navigate the new world of work that has emerged from the pandemic. The letter observes that most stakeholders now expect companies to play a role in moving toward a Net Zero global economy and discusses BlackRock's approach to climate and sustainability. This is a

Related People

Elizabeth A. Ising

Lori Zyskowski

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priority area for BlackRock because of its need, as a capitalist and fiduciary to its clients, to understand how companies are adjusting their business to massive changes in the economy. Mr. Fink also emphasizes that divesting from entire sectors, or simply passing carbon-intensive assets from public to private markets, will not move the world to Net Zero. BlackRock does not pursue divestment from oil and gas companies as a policy, but believes that action by "foresighted companies" in a variety of carbon-intensive industries is a critical part of the transition to a greener economy. Government participation on the policy, regulatory and disclosure fronts is also critical because, Mr. Fink notes, "businesses can't do this alone, and they cannot be the climate police."

The letter concludes with a reminder that BlackRock has built a stewardship team so it can understand companies' progress throughout the year, and not just during proxy season. BlackRock previously announced an initiative to give more of its clients the option to vote their own holdings, rather than BlackRock casting votes on their behalf. The letter notes that this option is now available to certain institutional clients, including pension funds that support 60 million people. The letter also commits to expanding that universe as BlackRock is committed to a future where every investor, including individual investors, have the option to participate in the proxy voting process.

2022 BlackRock Voting Policy Updates

30% Target on Board Diversity

BlackRock believes boards should aspire to 30% diversity, and encourages companies to have at least two directors who identify as female and at least one who identifies as being from an "underrepresented group." The definition of "underrepresented group" is broad and includes individuals who identify as racial or ethnic minorities, LGBTQ+, underrepresented based on national, Indigenous, religious or cultural identity, individuals with disabilities and veterans. Although the wording of the policy is aspirational, insufficient board diversity was a top reason BlackRock opposed the election of directors in 2021.

Board Diversity Disclosure

BlackRock updated its expectations for disclosure about board diversity. It asks that companies disclose how the diversity characteristics of the board, in aggregate, are aligned with a company's long-term strategy and business model, and whether a diverse slate of nominees is considered for all available board seats.

Votes on Compensation Committee Members

BlackRock appears to be strengthening its position on votes for compensation committee members where there is a lack of alignment between pay and performance. In that situation, BlackRock will vote "against" the say-on-pay proposal and relevant compensation committee members (rather than simply "considering" negative votes for committee members).

Sustainability Reporting

BlackRock will continue to ask that companies report in accordance with the Task Force on Climate-related Financial Disclosure ("TCFD") framework. In recognition of continuing advances in sustainability reporting standards, the 2022 voting guidelines recognize that in addition to TCFD, many companies report using industry-specific metrics other than those developed by the Sustainability Accounting Standards Board ("SASB"). For those companies, BlackRock asks that they highlight metrics that are industry- or company-specific. It also recommends that companies disclose any multinational standards they have adopted, any industry initiatives in which they participate, any peer group benchmarking undertaken, and any assurance processes to help investors understand their approach to sustainable and responsible business conduct.

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Climate Risk

BlackRock continues to ask companies to disclose Net Zero-aligned business plans that are consistent with their business model and sector. For 2022, it is encouraging companies to: (1) demonstrate that their plans are resilient under likely decarbonization pathways and the global aspiration to limit warming to 1.5°C; and (2) disclose how considerations related to having a reliable energy supply and a "just transition" (that protects the most vulnerable from energy price shocks and economic dislocation) affect their plans. BlackRock also updated its voting policies to reflect its existing approach of signaling concerns about a company's plans or disclosures in its votes on directors, particularly at companies facing material climate risks. In determining how to vote, it will continue to assess whether a company's disclosures are aligned with the TCFD and provide short-, medium-, and long-term reduction targets for Scope 1 and 2 emissions.

ESG Performance Metrics

BlackRock does not have a position on the use of ESG performance metrics, but it believes that where companies choose to use them, they should be relevant to the company's business and strategy, clearly articulated, and appropriately rigorous, like other financial and non-financial performance metrics.

Votes on Committee Members at Controlled Companies

BlackRock may vote "against," or "withhold" votes from, directors serving on "key" committees (audit, compensation, nominating/governance), that it does not consider to be independent, including at controlled companies. Previously, this policy was limited to votes on insiders or affiliates serving on the audit committee, and did not extend to other committees.

2. Vanguard

Vanguard's voting policy updates address several of the same areas as BlackRock's, including oversight of climate risk, and board diversity and related disclosures. The introduction to the voting policies also contains more explicit language emphasizing that proposals often require fact-intensive analyses based on an expansive set of factors, and that proposals are voted case-by-case at the direction of the boards of individual Vanguard funds.

Climate Risk Oversight "Failures"

Vanguard's voting policies outline certain situations in which funds will oppose the re-election of directors on "accountability" grounds—that is, "because of governance failings or as a means to escalate other issues that remain unaddressed by a company." Under Vanguard's current policies, funds will consider votes "against," or "withhold" votes from, directors or a committee for governance or material risk oversight failures.

For 2022, Vanguard has updated this policy to clarify that in cases where there is a risk oversight "failure," funds will generally vote "against," or "withhold" votes from, the chair of the committee responsible for overseeing a particular material risk (or the lead independent director and board chair, if a risk does not fall under the purview of a specific committee). The policy has also been updated to reflect that it covers material social and environmental risks, including climate change. On the subject of climate change, the updated policy lists factors that funds will consider in evaluating whether board oversight of climate risk is appropriate, including: (1) the materiality of the risk; (2) the effectiveness of disclosures to enable the market to understand and price the risk; (3) whether a company has disclosed business strategies, including reasonable risk mitigation plans in the context of anticipated regulatory requirements and changes in market activity, in line with the Paris Agreement or subsequent agreements; and (4) company specific-context, regulations and expectations. Funds will also consider the board's overall governance of

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climate risk and the effectiveness of its independent oversight of this area.

Board Diversity and Qualifications

For 2022, Vanguard has clarified its expectations on disclosure about board diversity and qualifications. The policy states that boards can inform shareholders about the board's current composition and related strategy by disclosing at least: (1) statements about the board's intended composition strategy, including expectations for year-over-year progress, from the nominating/governance committee or other relevant directors; (2) policies for promoting progress toward greater board diversity; and (3) current attributes of the board's composition. The policy states that board diversity disclosure should cover, at a minimum, the genders, races, ethnicities, tenures, skills and experience that are represented on the board. While disclosure about self-identified personal characteristics such as race and ethnicity can be presented at the aggregate or individual level, Vanguard expects to see disclosure about tenure, skills and experience at the individual level.

Under its policy on board "accountability" votes, a lack of progress on board diversity and/or disclosures about board diversity may lead to votes "against," or "withhold" votes from, the chair of the nominating/governance committee. Vanguard has updated this policy for 2022 to reflect its expectations about the various dimensions of diversity (gender, race, etc.) that should be represented on boards and about companies' disclosures. The policy includes a reminder that "many boards still have an opportunity to increase diversity across different dimensions," and that these boards "should demonstrate how they intend to continue making progress."

Director Overboarding

Vanguard has clarified how its overboarding policy applies to directors who are named executive officers (NEOs). Although Vanguard's limit of two public company boards remains in place, the policy updates clarify that the two boards could consist of either the NEO's own board and one outside board, or two outside boards if an NEO does not sit on the board at their own company. Vanguard funds will generally oppose the election of directors who exceed this limit at their outside board(s), but not at the company where they are an NEO.

For other directors, Vanguard's existing limit of four public company boards is unchanged.

Vanguard funds will also look for companies to have good governance practices on director commitments, including adopting a policy on outside board service and disclosure about how the board oversees the policy.

Unilateral Board Adoption of Exclusive Forum Provisions

Vanguard has updated its voting policy on board "accountability" votes where a company adopts policies limiting shareholder rights. Under this policy, Vanguard funds will generally oppose the election of the independent board chair or lead director, and the members of the nominating/governance committee, in response to unilateral board actions that "meaningfully limit" shareholder rights. For 2022, this policy has been updated to specify that these board actions may include the adoption of an exclusive forum provision without shareholder approval.

Proposals on Virtual and Hybrid Shareholder Meetings

According to Vanguard, data show that virtual meetings can increase shareholder participation and reduce costs. Vanguard funds will consider supporting proposals on virtual meetings if meeting procedures and requirements are disclosed ahead of time, there is a formal process for shareholders to submit questions, real-time video footage is available, shareholders can call into the meeting or send recorded messages, and shareholder rights are not unreasonably curtailed.

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3. State Street

In his letter, State Street CEO Cyrus Taraporevala announces that in 2022, State Street's main focus "will be to support the acceleration of the systemic transformations underway in climate change and the diversity of boards and workforces." To that end, the letter attaches three guidance documents outlining State Street's expectations and voting policies for the 2022 proxy season in the areas of climate change and diversity, equity and inclusion. State Street has also published other guidance documents on director overboarding/time commitments and human capital for the 2022 proxy season.

The guidance documents are worth reading in their entirety because they provide detailed information about the practices and disclosures State Street expects to see from its portfolio companies in both 2022 and 2023, and about State Street's related voting policies. A summary of the key highlights is below.

Corporate Climate Disclosures

General

State Street expects all companies in its portfolio to provide disclosures in accordance with the four pillars of the TCFD framework: governance, strategy, risk management, and metrics and targets. In approaching its disclosure expectations, State Street will begin by engaging with companies. The guidance document includes a list of questions (organized by the four TCFD pillars) that State Street may ask companies as part of its engagement efforts.

For companies that it believes are not making sufficient progress after engagement, State Street will consider taking action through its votes on directors and/or shareholder proposals. Starting in 2022, at S&P 500 companies, State Street may vote against the independent board leader if a company fails to provide sufficient disclosure in accordance with the TCFD framework, including about board oversight of climate-related risks and opportunities, total Scope 1 and Scope 2 greenhouse gas ("GHG") emissions, and targets for reducing GHG emissions.

Companies in "Carbon-Intensive Sectors"

For several years, State Street has had specific disclosure expectations for companies in "carbon-intensive sectors" (oil and gas, utilities and mining), and the guidance document outlines what State Street expects to see beginning in 2022. Disclosures are expected to address: (1) interim GHG emissions reductions targets to accompany long-term climate ambitions; (2) discussion of the impacts of scenario-planning on strategy and financial planning; (3) use of carbon pricing in capital allocation decisions; and (4) Scope 1, Scope 2 and material categories of Scope 3 emissions.

Climate Change Shareholder Proposals

State Street will evaluate climate-related shareholder proposals on a case-by-case basis, taking into account factors that include the reasonableness of a proposal, alignment with the TCFD framework and SASB standards where relevant, emergent market and industry trends, peer performance, and dialogue with the board, management and other stakeholders. For companies in carbon-intensive sectors, State Street will consider alignment with its disclosure expectations specific to these companies. The guidance also addresses specific factors State Street will consider in assessing climate-related lobbying proposals.

Climate Transition Plan Disclosures

Related to the broader subject of climate disclosures, State Street has also issued guidance specific to disclosures about companies' climate transition plans. In the

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guidance, State Street notes that there is no one-size-fits-all approach to reaching Net Zero, and that climate-related risks and opportunities are highly nuanced across and within industries. It plans to continue developing its disclosure expectations over time, including taking into account any disclosures mandated by regulators. In his letter, State Street CEO Cyrus Taraporevala emphasizes that what State Street is seeking from climate transition plans, as a long-term investor, "is not purity but pragmatic clarity around how and why a particular transition plan helps a company make meaningful progress." Mr. Taraporevala also emphasizes the need to take a big-picture look at whether the climate commitments individual companies make have the effect of reducing climate impacts at the aggregate level. In this regard, he observes that so-called "brown-spinning" (public companies selling off their highest-emitting assets to private equity or other market participants), "reduces disclosure, shields polluters, and allows the publicly-traded company to appear more 'green,' without any overall reduction in the level of emissions on the planet." State Street recognizes that in the near term, additional investments in light fossil fuels may be necessary to propel the transition to Net Zero.

In light of these considerations, State Street intends its guidance document on climate transition plans as a "first step" to provide transparency about the core criteria State Street expects companies to address in developing their plans. These criteria are organized into ten categories that generally align with those found in two external frameworks: the Institutional Investors Group on Climate Change (IIGCC) Net Zero Investment Framework and Climate Action 100+ Net-Zero Company Benchmark. The criteria include decarbonization strategy, capital allocation, climate governance, climate policy and stakeholder engagement.

As a companion to its 2022 policy on holding independent board leaders accountable for climate disclosures (discussed above), this year, State Street plans to launch an engagement campaign on climate transition plan disclosure targeted at "significant emitters in carbon-intensive sectors." Starting in 2023, it will hold directors at these companies accountable if their company fails to show adequate progress in meeting its climate transition disclosure expectations.

Diversity Disclosures

State Street's guidance document lists five topics it expects all of its portfolio companies to address in their diversity disclosures:

1. Board oversight—How the board oversees the company's diversity, equity and inclusion efforts, including the potential impacts of products and services on diverse communities;
2. Strategy—The company's timebound and specific diversity goals (related to gender, race and ethnicity at a minimum), the policies and programs in place to meet these goals, and how they are measured, managed and progressing;
3. Goals—Same as Strategy.
4. Metrics—Measures of the diversity of the company's global workforce and board. For employees, this should include diversity by gender, race and ethnicity (at a minimum) where permitted by law, broken down by industry-relevant employment categories or seniority levels, for all full-time employees. In the U.S., companies are expected to use the disclosure framework from the EEO-1 at a minimum. For the board, disclosures should be provided by gender, race and ethnicity (at a minimum), and can be on an aggregate or individual level; and
5. Board diversity—Efforts to achieve diversity at the board level, including how the nominating/governance committee ensures diverse candidates are considered as part of the recruitment process.

State Street also encourages companies to consider providing disclosures about other dimensions of diversity (LGBTQ+, disabilities, etc.), as it views these attributes as

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furthering the overarching goal of contributing to the diversity of thought on boards and in the workforce.

Diversity and Proxy Voting

State Street will consider disclosures about board diversity in deciding how to vote on directors, as follows:

Racial/Ethnic Diversity – S&P 500 Companies

In 2022, State Street will vote "against," or "withhold" votes from:

- The chair of the nominating/ governance committee if the company does not disclose the racial and ethnic composition of its board, either at the aggregate or individual level;
- The chair of the nominating/ governance committee if the company does not have at least one director from "an underrepresented racial or ethnic community"; and
- The chair of the compensation committee, if the company does not disclose its EEO-1 report, with acceptable disclosure including the original report, or the exact content of the report translated into custom graphics.

Gender Diversity

State Street may vote "against," or "withhold" votes from, the chair of the nominating/governance committee:

- Beginning in 2022, for companies in all markets, if there is not at least one female director on the board; and
- Beginning in 2023, at Russell 3000 companies, if the board does not have at least 30% female directors. State Street may waive this policy if a company engages with it and provides a specific, timebound plan for reaching 30%.

If a company fails to meet the gender diversity expectations for three consecutive years, State Street may vote against all incumbent nominating/governance committee members.

The guidance also outlines State Street's approach to voting on diversity-related shareholder proposals, including specific criteria relating to proposals seeking reporting on diversity, "pay gap" proposals, and proposals seeking racial equity audits.

State Street notes that its voting policies currently focus on increasing board diversity, but that in coming years it intends to shift its focus to the workforce and executive levels. Related to the subject of workforce diversity, the guidance previews ten recommended areas of focus for boards in overseeing racial and ethnic diversity. These are addressed in more detail in a publication issued by State Street in partnership with Russell Reynolds and the Ford Foundation.

Director Overboarding

For 2022, State Street is moving toward an approach that relies more heavily on nominating/governance committee oversight (and enhanced disclosures) about whether directors have enough time to fulfill their commitments. The updated approach is designed to ensure that nominating/governance committees are evaluating directors' time commitments, regularly assessing director effectiveness, and providing disclosure about their policies and efforts. State Street cites two factors as the key drivers of these updates: its own research showing that boards with overcommitted directors have been slower to adopt leading governance practices and provide robust shareholder rights, and concerns about "tokenism" (nominating already-overcommitted diverse directors) and the

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need to broaden the candidate pools of diverse directors. The policy updates also address service on SPAC boards.

As a result of the policy updates, beginning in March 2022, State Street will apply the following overboarding limits to directors:

- For board chairs or lead directors, three public company boards; and
- Other director nominees who are not public company NEOs, four public company boards.

State Street may consider waiving these limits and support a director's election if the company discloses its policy on outside board seats. This policy (or the related disclosure) must include:

- A numerical limit on public company board seats that does not exceed State Street policies by more than one;
- Consideration of public company board leadership positions;
- An affirmation that all directors are currently in compliance with the policy; and
- A description of the nominating/governance committee's annual process for review outside board commitments.

This waiver policy will *not* apply to public company NEOs, who remain subject to State Street's existing limit of two public company boards.

In calculating outside boards, State Street will not count mutual fund boards or SPAC boards, but it expects the nominating/governance committee to consider these boards in evaluating directors' time commitments.

Human Capital Management (HCM) Disclosures and Practices

State Street's guidance document lists the five topics it expects companies to address in their HCM disclosures: (1) board oversight; (2) strategy (specifically, how a company's approach to HCM advances its overall long-term business strategy); (3) compensation, and how it helps to attract and retain employees and incentivize contributions to an effective HCM strategy; (4) "voice" (how companies solicit and act on employee feedback, and how the workforce is engaged in the organization); and (5) how the company advances diversity, equity and inclusion.

State Street emphasizes that it expects companies to provide specificity on these subjects. For example, rather than disclosing that employees are surveyed regularly, State Street suggests that companies disclose survey frequency, examples of questions asked, and relevant examples of actions taken in response to employee feedback. State Street also encourages companies to consider emerging disclosure frameworks, such as the framework outlined by the Human Capital Management Coalition, which includes 35 institutional investors representing over $6.6 trillion in assets.

State Street will approach HCM issues by starting with engagement, focusing on the companies and industries with the greatest HCM risks and opportunities. For companies that it believes are not making sufficient progress after engagement, State Street will consider taking action through its votes on directors and/or shareholder proposals. It will consider supporting shareholder proposals at companies whose HCM disclosures are not sufficiently aligned with State Street's disclosure expectations.

The following Gibson Dunn lawyers assisted in the preparation of this client update: Elizabeth Ising and Lori Zyskowski.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding

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these issues. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work in the Securities Regulation and Corporate Governance and Executive Compensation and Employee Benefits practice groups, or any of the following practice leaders and members:

Securities Regulation and Corporate Governance Group: Elizabeth Ising – Washington, D.C. (+1 202-955-8287, eising@gibsondunn.com) Lori Zyskowski – New York, NY (+1 212-351-2309, lzyskowski@gibsondunn.com) Ron Mueller – Washington, D.C. (+1 202-955-8671, rmueller@gibsondunn.com) Thomas J. Kim – Washington, D.C. (+1 202-887-3550, tkim@gibsondunn.com) Mike Titera – Orange County, CA (+1 949-451-4365, mtitera@gibsondunn.com) Aaron Briggs – San Francisco, CA (+1 415-393-8297, abriggs@gibsondunn.com) Julia Lapitskaya – New York, NY (+1 212-351-2354, jlapitskaya@gibsondunn.com) Cassandra Tillinghast – Washington, D.C. (+1 202-887-3524, ctillinghast@gibsondunn.com)

Executive Compensation and Employee Benefits Group: Stephen W. Fackler – Palo Alto/New York (+1 650-849-5385/+1 212-351-2392, sfackler@gibsondunn.com) Sean C. Feller – Los Angeles (+1 310-551-8746, sfeller@gibsondunn.com) Krista Hanvey – Dallas (+ 214-698-3425, khanvey@gibsondunn.com)

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