Vanguard Investment Stewardship Insights

Voting insights: Racial equity audit shareholder proposal at Wells Fargo

April 2021

Vanguard publishes Investment Stewardship Insights to promote good governance practices and to provide investors and public companies with our perspectives on important governance topics and issues that come up for shareholder votes.

Company: Wells Fargo & Company (Wells Fargo)

Meeting date: April 27, 2021

Proposals: Item 2 – Advisory Vote to Ratify Named Executive Officers' Compensation; Item 7 (shareholder proposal) – Report on Racial Equity Audit

How the funds voted

Third-party racial equity and civil rights audit proposals are gaining prominence on U.S. public company ballots this proxy season. Shareholder proponents filing these proposals ask that companies conduct a third-party audit of potential risks related to diversity, equity, and inclusion (DEI) to provide an independent assessment of any direct or indirect impact a company may have on communities of color and that they publicly disclose the results.

At the annual meeting for Wells Fargo, a large U.S. multinational financial services company, the Vanguard funds did not support a shareholder proposal requesting that the company conduct a racial equity audit and publicly report the results. The proposal did not pass, receiving 12.9% support.

The Vanguard funds also voted against management's advisory proposal to ratify executive compensation. The proposal drew 57.3% support from shareholders.

Vanguard's principles and policies

Boards are responsible for overseeing a company's long-term strategy and material risks. We regularly assess the board's understanding of a company's strategy as well as the role of the board in identifying, mitigating, and disclosing risks, including DEI-related risks.

Additionally, Vanguard views performance-linked compensation policies and practices as fundamental drivers of sustainable, long-term value. On behalf of the Vanguard funds, our Investment Stewardship team evaluates executive remuneration proposals on a case-by-case basis. It looks for pay plans that incentivize long-term outperformance relative to peers and promote sustainable value for company investors.

Analysis and voting rationale

Absent significant risk-management failures, Vanguard is not likely to view third-party audits as a necessary measure to promote shareholders' long-term interests, as long as boards demonstrate sufficient oversight processes and reporting on a company's DEI risks.

The Investment Stewardship team met with members of the Wells Fargo board and management team, including the chairman of the board and chair of the compensation committee, ahead of the annual meeting. After a series of scandals and legal troubles, Wells Fargo has undergone a board and executive team refreshment over the past few years and appears to have strengthened its risk oversight and controls and redefined parts of its culture. In our engagement, the company detailed the steps it is taking to address material DEI-related risks, with a focus on where they have the most impact.

These actions include providing diversity training for employees, continuing disclosures on DEI and racial equity efforts, and creating a new position reporting directly to the CEO that is responsible for the oversight and advancement of DEI efforts (both externally and internally). The company shared that it also met with the shareholder proponent to better understand its request and concerns. Further, Wells Fargo has engaged with a third party to conduct a human rights impact assessment that will include a focus on racial equity. The company has committed to publicly disclose a summary of the assessment and subsequent actions it takes.

In our assessment, Wells Fargo is taking appropriate steps to address its DEI-related risks, especially compared with its peers. We determined that the proposal's request for a third-party racial equity audit, which would be carried out in addition to the measures Wells Fargo has already committed to, was not warranted at this time. As a result, the Vanguard funds did not support the shareholder proposal. We will continue to monitor the company's progress in this area.

Separately, the Vanguard funds voted against the company's advisory proposal on executive compensation. In our evaluation of the proposal, we identified several areas of concern, including a misalignment between pay and relative performance as short-term incentive payments did not align with shareholders' experience or the company's financial performance versus peers, and a lack of disclosure about the plan's structural changes.

What we expect from companies on this matter

Financial firms, especially those within the U.S., have seen an increased focus on DEI-related matters from a variety of stakeholders, including investors, regulators, and employees. Where DEI-related risks are financially material to a company, it is important for companies and their boards to continue to take proactive steps to mitigate these risks and provide greater disclosure to investors. If a board's existing oversight processes or disclosures suggest a failure to sufficiently oversee DEI risks, the Vanguard funds may support a racial equity audit shareholder proposal or other actions.

We will continue to engage with Wells Fargo and monitor its progress as the board and management team continue their culture transformation journey and release their human rights impact assessment report.

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