Vanguard Investment Stewardship Insights

Voting insight: Shareholder proposal related to pay gaps, civil rights, and concealment clauses at Apple

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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. Vanguard's Investment Stewardship team is responsible for engagement with portfolio companies and proxy voting at the direction of the boards of our internally managed global equity funds, including Vanguard index funds. Investment stewardship activities, including proxy voting, for Vanguard's externally managed active funds are supported by those funds' external advisors.

Company: Apple, Inc. (Apple)

Meeting date: March 4, 2022

Proposal: Item 8—Report on gender and racial pay gaps, including associated risks; Item 9—Report on third-party civil rights audit of company policies and practices; Item 10—Report on use of mandatory arbitration, nondisclosure agreements, and other agreements that limit an employee's ability to discuss unlawful acts in the workplace.

How the funds voted

At the annual meeting for Apple, the U.S.-based technology and consumer electronics company, the Vanguard funds evaluated but did not support several shareholder proposals, including:

- a proposal requesting reporting of median gender and racial pay gap statistics
- a proposal requesting a third-party audit of the adverse impacts of Apple's policies and practices on the civil rights of company stakeholders
- a proposal calling for a report on Apple's use of concealment clauses.

Vanguard's principles and policies

Risks to shareholder value associated with human capital management (HCM), including diversity, equity, and inclusion (DEI) in the workplace, remain engagement priorities for Vanguard. Increased focus—from companies, consumers, regulators, investors, and employees—on racial and ethnic discrimination, pay disparity, and the treatment of workers has heightened scrutiny of public companies' HCM-related risks and opportunities, as have the COVID-19 pandemic and challenging economic conditions.

Boards are responsible for oversight of companies' long-term strategies and material risks. On behalf of the Vanguard funds, our Investment Stewardship team regularly assesses the board's own role in identifying, mitigating, and disclosing risks, including HCM-related risks. Clear, decision-useful disclosure of material risks can encourage sound governance practices and help investors and companies make better decisions.

Vanguard expects companies to continue to refine their disclosures to reflect evolving market, industry, and competitive norms. Vanguard's Investment Stewardship program advocates for progress on disclosure and oversight of HCM matters through our public advocacy and communications, direct company engagements, and relevant votes.

Our team evaluates the materiality and oversight of HCM risks case by case. If there are gaps in the company's current disclosures, the funds may support shareholder proposals that seek enhanced reporting of the company's approach to oversight of said risks.

Analysis and voting rationale

Vanguard has regularly engaged over many years with Apple's board and company leaders. Our recent discussion focused on the board's oversight of HCM risks, including those related to DEI. Our engagement and subsequent research and analysis informed how the Vanguard funds voted, as outlined below.

Report on median gender and racial pay gap. In evaluating pay gap proposals, Vanguard first examines what a company currently discloses on HCM, including whether it provides disclosure of its workforce composition and the existence of adjusted pay gaps. Pay gaps adjusted for such factors as location, experience, education levels, and specific job types aim to reflect whether there are inequities in pay for like-to-like roles. In many cases, a finding that a company provided inequitable pay based on an employee's gender or race would be material to the company's value and would raise litigation, reputational, and strategic risks.

The proposal requested that Apple report on median gender and racial pay gaps. Compared with adjusted pay gaps, median pay gap has sparked greater debate on its usefulness, and U.S. companies report on it less frequently (except where country-specific regulations require it for a portion of the workforce). Median pay gap may reflect inequities not in pay practices, but rather in representation in higher-paying roles versus lower-paying roles. Company-specific factors may drive these risks, but systemic and societal inequities may also influence them.

Although gaps in gender or racial/ethnic representation in higher-paying roles versus lower-paying ones could present a material risk to shareholders, a focus on median pay gap as the method for understanding, disclosing, and correcting these issues could be misleading and could potentially encourage undesirable behaviors.

In reviewing a company's median pay gap statistics, for example, investors, employees, and others may be led to believe that pay inequities exist in like-to-like roles at a company when, in fact, they do not. Furthermore, companies may be incentivized to stop hiring women or other underrepresented groups into roles at certain levels to avoid exacerbating a median pay gap. Companies that disclose representation of underrepresented groups in leadership roles and various role types (such as through EEO-1 disclosure)—along with goals and metrics for how the company recruits, retains, promotes, and includes a diverse workforce—can enable investors to see a fuller picture of how the company manages DEI over time.

Apple has disclosed that it has achieved and maintained adjusted gender pay equity globally since 2017 and has achieved adjusted pay equity by race and ethnicity in the U.S. It also has disclosure in place for its annual pay equity assessment process and the outcomes of its DEI initiatives. It reports representation among different levels of its workforce and across different functional roles. As a starting point for demonstrating representation across company levels, Apple has provided disclosure of gender, race, and ethnicity across its workforce by job type, and it has discussed policies and programs for continuing to improve representation proportionate to the communities from which it draws talent.

Apple also disclosed additional DEI metrics, such as recruiting statistics, and has discussed policies and practices for improving DEI in the workforce. Versus market and industry peers, Apple has ranked relatively high on these dimensions. For example, on worker issues, JUST Capital reports that Apple ranks third out of 21 peers in the technology hardware sector.[1] Given Apple's existing practices, policies, and current disclosures, the Vanguard funds did not support the proposal.

Report on civil rights audit. This proposal requested that Apple oversee a third-party audit that would analyze adverse impacts of the company's policies and practices on the civil rights of company stakeholders and make recommendations for improving the company's civil rights impact.

Our evaluation of whether the described civil rights audit would benefit Apple shareholders included considering:

- The scope and reasonableness of the request, including whether it would prioritize disclosure and oversight on matters that are financially material to shareholders and aligned to the company's stated strategy and risks.
- The extent to which Apple's strategy and business model have significant potential to impact the civil rights of company stakeholders in ways that could affect Apple's long-term value.

1 https://justcapital.com/rankings/?industry=technology-hardware&issue=worker

- Whether there were materialized risks demonstrating negative impacts of Apple's practices and policies on stakeholders' civil rights and a need to improve board oversight and transparency to investors.
- The board's independent oversight of management and material risks to long-term shareholder value.

Upon reviewing these factors and others, we lacked conviction that an independent audit of Apple's civil rights impacts was warranted. The request suggests that the audit should include "recommendations for improving the company's civil rights impact" as well as input from "civil rights organizations, employees and consumers." Although this may include financially material risks—especially those related to employees and consumers—the proposal did not state that the audit would prioritize or be limited to financially material impacts on long-term shareholder value.

The proponent, furthermore, did not highlight compelling evidence that Apple's strategy and business model are exposing the company to significant risks of infringing on stakeholders' civil rights.

In evaluating the company's business model, we found that although adverse impacts on its employees' civil rights could be material to long-term shareholder value—and we expect the board to oversee such risks—we did not find persuasive the proponent's argument that a third-party audit of all impacts to all company stakeholders, as the proposal requested, was in shareholders' interest.

Our review of Apple's reporting found a pattern of continuously improving disclosure related to HCM, including civil rights matters in the workplace and human rights policies and disclosures. We asked questions in a series of engagements with Apple, including with one of its directors, regarding whether the board had sufficient oversight into materialized HCM risks, such as those stemming from an employee movement criticizing Apple's culture.

Upon reviewing Apple's disclosures, and following our engagements with the company, we reached the view that its board exercises sufficient independent oversight of management and material risks to Apple's business, that it plans to continue advancing its disclosure of material DEI matters, and that support for a third-party audit was not warranted at this time.

With company leaders, we have discussed publicly committing to further disclosure on the board's oversight of HCM risks, such as those related to company culture. We also discussed with Apple's board how it will continue to identify other social risks that the board views as material to shareholder value. We will continue engaging with company leaders on regular disclosure of the board's assessment of any other potential material risks, which may include those related to civil rights impacts (i.e., impacts on non-employees).

Report on concealment clauses. This proposal requested that Apple report on potential risks related to its use of employment or postemployment agreements—such as arbitration, nondisclosure, or nondisparagement agreements (referred to as concealment clauses)—to limit employees' or contractors' ability to discuss unlawful acts in the workplace, including harassment and discrimination.

In response to the proposal, Apple disclosed in its proxy statement that it does not use concealment clauses in any manner that would prevent current or former employees from discussing or reporting discrimination, sexual harassment, or other unlawful acts to authorities.

Given Apple's clear disclosure in its proxy statement that it does not use concealment clauses in the context of discrimination, harassment, and other unlawful acts, and the fact that the company is actively contemplating incorporating more disclosure on this topic in future reporting, we did not believe that additional reporting on Apple's use of concealment clauses would be beneficial for shareholders at this time. The Vanguard funds thus did not support the proposal. We will continue to engage with the company on further disclosure of the board's attentiveness to this matter.

What we expect from companies on these matters

Vanguard expects companies and their boards to provide clear, decision-useful disclosure on oversight and management of a company's material risks, including DEI and other HCM risks. Market norms, regulations, and employee, consumer, and investor expectations are moving toward greater disclosure in the governance industry, and you can expect Vanguard—through our engagements, proxy voting, and public advocacy—to continue to seek relevant, decision-useful information on material risks.

Vanguard focuses primarily on whether DEI risks are financially material, how reasonable and prescriptive a proposal's request is compared with what the company has done to date, and how appropriate it is to expect of the board or company in question.

Although racial equity or civil rights audits may have merit, such as in cases where they are focused on previously materialized risks and are supported by the board, we consider whether a shareholder-requested third-party audit is in the best interest of long-term shareholders. Companies may already be focusing on the risks these audits could identify and have solid action plans in place. In a small number of cases, boards have commissioned audits after high-profile controversies. However, there is a lack of clarity about how an audit requested by a shareholder proposal—and not supported by the board—would be conducted by the portfolio company and received by investors.

In other cases, there might be more meaningful and relevant tools to help boards assess, monitor, and mitigate social risks. Finally, a third-party audit is only as constructive and effective as the third party a board selects. The quality of that party is critical to ensuring that these audits are not unintentionally detrimental to the populations they seek to help.

On behalf of the investors in the Vanguard funds, we firmly believe that companies should focus on issues that are most relevant to their business and long-term value. We want boards to have a clear sense of the specific problem they need to solve regarding the social risks that affect the companies they oversee, those companies' employees, and the communities and clients they serve.

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