Walden Asset Management

Advancing sustainable business practices since 1975

Research & Engagement Brief

Third Quarter 2014

"Help me scrub lobbying practices." With these words, Chistiana Figueres, Executive Secretary of the United Nations Framework Convention on Climate Change (UNFCCC), appealed to signatories of the Principles for Responsible Investment (PRI) to use their spheres of influence to ensure that corporate lobbying is not a barrier to progress on climate change. Ms. Figueres is responsible for the Paris 2015 UNFCCC conference, the objective of which is to achieve country-specific, legally binding agreements on climate change.

Walden couldn't agree more with Ms. Figueres' call to action. Encouraging responsible corporate political spending and lobbying is among our top priorities, particularly as these activities relate to public policy on climate change.

Coinciding with the United Nations Climate Leadership Summit in September, the World Bank launched a public statement, *Putting a Price on Carbon*, to demonstrate broad country and business support for a carbon pricing mechanism. Seventy-three countries and over one thousand businesses signed on, including several major companies where Walden made a direct appeal: **EMC**, **Johnson Controls**, **PepsiCo**, and **Pfizer**. Signatories affirmed the need for urgent action to address climate risk, including placing a price on carbon, and to do their part in reducing greenhouse gas emissions.

In August Walden challenged 35 companies to assess their support of ALEC (American Legislative Exchange Council), a controversial organization that is attempting to thwart state renewable energy legislation as well as other public policy initiatives on climate change. On the heels of **Microsoft**'s recent decision to cut ties with ALEC, **Google** followed suit in a very candid fashion. Speaking on NPR, Chairman Eric Schmidt described Google's support of ALEC as a "mistake" and remarked, "we should not be aligned with such people [who challenge the facts of climate change]—they're just, they're just literally lying." Next, the technology dominos began to fall with **Facebook**, **Yahoo**, and **Yelp** confirming that their ALEC memberships were not likely to be renewed in 2015(Walden did not engage with these three companies). Particularly notable, energy company **Occidental Petroleum** also recently confirmed to Walden that it is ending its ALEC membership.

Walden was among approximately 350 institutional investors representing $24 trillion in assets who called upon global governments to implement a meaningful price on carbon emissions. The investor statement, organized by Ceres' Investor Network on Climate Risk and other global investor coalitions, was released just prior to the United Nations Climate Summit.

Photo Credit: Antonio Peronace, ApolloPolitical.com

"We believe companies need to be transparent and open about how they are spending shareowners' money, and how that money is involved in the election process." —Tim Smith

Signed by many of the world's largest domestic and foreign pension funds and investment managers such as CalPERS and BlackRock, the statement also advocates phasing out subsidies on fossil fuels as a means to help redirect capital investment toward energy solutions. Walden and Calvert Investment Management also wrote 15 corporate leaders, asking them to publicly support the Environmental Protection Agency's Carbon Pollution Standards for existing power plants. Coal fired power plants are the single largest source of greenhouse gas emissions in the U.S.

One million comments have been submitted to the Securities and Exchange Commission (SEC) calling for corporate accountability in politics through mandatory disclosure of political spending. This is by far the largest expression of support in the history of the SEC's rulemaking. Walden's Director of ESG Shareholder Engagement, Tim Smith, joined Public Citizen and other NGOs, academics, government officials, and institutional investors in a rally outside the offices of the SEC to mark this tremendous milestone. The speakers urged SEC Chair Mary Jo White to heed the coalition's request for transparency (see photo above).

On the topic of corporate governance, Walden reached out to ten small capitalization portfolio companies that have no women or minority directors on their boards. We shared the business rationale for our proxy voting policy to vote against directors serving on nominating committees at boards without gender or racial diversity, and inquired about management and workforce diversity overall. Initial feedback from several companies points to the importance of communicating about our voting practices. As an example, our letter and subsequent conversation with **CoreSite Realty** prompted a board discussion and commitment to revise its governance documents to explicitly include gender and race as considerations in the nominating process.

Walden is also pleased to report the following recent progress at companies we have engaged, often in collaboration with other investors:

- **Apple** eliminated toxic benzene and n-hexane from iPad and iPhone final assembly and published the results of its investigation after pressure from NGOs and concerned investors.
- **Calgon Carbon** and **Wabtec** published their sustainability reports, commitments both companies made to Walden for withdrawing our shareholder resolutions.
- **ConocoPhillips** set an overall company greenhouse gas emissions reduction target of 3-5 percent in 2015.
- **MarketAxess** posted its inclusive nondiscrimination policy.
- **Johnson Controls** provided improved disclosure of employee blood-lead levels at lead battery recycling facilities globally, showing marked improvement in lead management practices.
- **PNC** reported continued headway on mortgage modifications, mitigating the negative economic impacts and human suffering associated with foreclosures.

Lastly, Walden is proud to have joined with others to assist our client, Susan White of the Oneida Tribe of Indians of Wisconsin, who introduced a floor resolution at the **FedEx** annual meeting in September asking the company to distance itself from the offensive NFL team name associated with FedExField. Ms. White proclaimed, "The Washington D.C. franchise's name, "Redskins," is a dehumanizing word with hateful connotations for Native American peoples and others concerned about human rights. We consider the Washington team name a racial slur, tracing back to colonial times when bounties were paid on a sliding scale for the skins of Native men, women and children, and traded like animal hides." NFL Commissioner Roger Goodell is besieged by controversies involving violence against women and player concussions; we hope to ensure that indigenous rights remain front and center as well.

Assessing the Carbon Footprint and ESG Profile of a Walden Portfolio

New tools are emerging to independently assess the environmental, social, and governance (ESG) characteristics and performance of investment portfolios. Walden recently asked two respected firms, Trucost and MSCI ESG Research, to evaluate the carbon footprint and ESG profile, respectively, of a representative Walden Core Equity portfolio (as of August 31, 2014).

First, some words of caution. While Walden recognizes the usefulness of independent verification of ESG integration, all such tools have significant limitations. For example, carbon footprint methodologies struggle to capture the positive or negative impacts associated with the use of products. Additionally, the assessments do not account for Walden's shareholder engagement with portfolio companies which aims to strengthen sustainable business practices and corporate accountability. Still, we believe the tools provide a helpful perspective as to how Walden Core Equity portfolios compare to their primary benchmark, the S&P 500.

Using $36 as the average annual price per ton of carbon emissions, Trucost calculates a market-weighted, total portfolio carbon footprint (carbon emissions per unit of revenue) using direct emissions from company operations as well as first tier supply chain impacts such as electricity, business travel, and logistics. The Walden core equity portfolio was evaluated to be 51 percent less carbon intensive than the S&P 500 benchmark, or put differently, the benchmark had twice the carbon footprint. More than 90 percent of the favorable result was due to decisions related to sector allocation, and the balance was attributed to stock selection. Our lack of exposure to utilities, for financial and ESG reasons, explained most of the result. Industrial gas manufacturer Praxair accounted for 9.5 percent of the portfolio's carbon footprint, more than the few energy companies in the portfolio. While Praxair has a sizeable greenhouse gas footprint, their business model enables other companies to reduce their emissions. By Praxair's estimate, the company enables emission reductions that are double its own footprint.

MSCI's Portfolio Analytics offers a comprehensive picture of the portfolio's ESG profile. Overall, the Walden core equity portfolio rated 19 percent better than the S&P 500, and relative performance was superior in each of the environment, social, and governance categories. The portfolio scored slightly worse than the benchmark in only one sector out of eight—industrials. The Walden portfolio's performance on most key sub indicators such as supply chain labor standards were positive or neutral, but several finance sector ESG indicators were less favorable. We attribute that, in part, to our investment in J.P. Morgan, where we remain actively engaged on mortgage financing, risk management practices, and corporate governance.

The direction is right: Through the lenses of Trucost and MSCI ESG Research, ESG performance of the Walden core equity portfolio is demonstrably better than its benchmark. We look forward to continued fine tuning of these and other measurement tools.