

Research & Engagement Brief

Fourth Quarter 2012

The investment world is abuzz with a discussion of impact investing, an investment approach described as leveraging capital to solve social and environmental challenges while simultaneously generating financial profit. Impact investing is often associated with specialized vehicles that finance community economic development or beneficial products and services directly. Many of these investment opportunities have unique liquidity and risk-reward characteristics as compared to more traditional stocks and bonds.

Throughout our history Walden has achieved impact through both *investment* and *engagement*. On the investment side, holdings in our small and smid cap strategies, for example, are predominantly high quality companies with innovative products or processes that often have environmental and social benefits, such as resource conservation, waste reduction, and improved health care. Our clients also have the opportunity to invest a portion of their assets in high social impact community economic development initiatives, as well as municipal and agency bonds funding education, natural resource conservation, and other beneficial services and projects.

Engagement—utilizing ownership to influence corporate behavior through dialogues, shareholder resolutions, proxy voting, and public policy advocacy—is a Walden hallmark. We are pleased to provide the following summary of company engagement in 2012, a remarkable year in terms of Walden's degree of impact on corporate environmental, social and governance (ESG) performance. Highlights of public policy advocacy are provided in the box on page three.

REACH OF CORPORATE ENGAGEMENT

Nearly 100 portfolio companies were approached by Walden's ESG team in 2012, or approximately one-quarter to one-third of holdings in typical small, smid, and mid cap portfolios, and half of the companies in core (large cap) portfolios. This activity ranged from single communications to extensive dialogues and shareholder resolutions. We engaged with companies on multiple issues in many cases. For example, topics addressed in distinct interactions with **ConocoPhillips** included indigenous rights, greenhouse gas emissions, hydraulic fracturing, workplace equality, and political activities.

Looking solely at Walden's 2012 company interactions described as moderate or extensive, two topics accounted for a slight majority of our engagement work—political spending/

lobbying disclosure and sustainability reporting. The breakdown of our other advocacy was roughly equally divided among environmental, social and corporate governance matters.

MEASURING IMPACT

Reach is important but results matter. Walden believes that measuring the impact of company engagement is an exercise in identifying meaningful progress with respect to company policies, practices, or transparency. We also understand that change is almost always incremental along a continuum of corporate behavior. While the adoption of more sustainable polices or business practices are clear signs of corporate progress, much of Walden's engagement work aims to increase disclosure on single issues, such as lobbying, or across the board through comprehensive sustainability reporting. Our focus on transparency serves two goals: It enables investors and other stakeholders to more accurately assess opportunities and risks, and it strengthens public accountability, which is often an important precursor to further corporate change.

Overall, Walden fostered significant progress in roughly 45% of the well over 100 moderate or extensive engagement initiatives in 2012—meaning that companies increased transparency, improved policies or implemented more sustainable business practices. We still consider many of these successful outcomes to be works-in-progress.

Walden believes that our work on behalf of clients played a significant role in these positive engagement results. This progress was often made possible through collaboration with similarly concerned investors, as well as other active stakeholders seeking to influence corporate behavior.

CORPORATE POLITICAL ACTIVITY

What is an appropriate role for corporations in the political process? Corporate accountability related to political activity was the most prevalent topic among Walden's 2012 company interactions. The value of this focus is evident in the aftermath of the recent federal election that consumed more than \$6 billion for the House, Senate and Presidential races. Hundreds of millions of dollars of secret money was channeled through trade associations, such as the U.S. Chamber of Commerce (Chamber) or nonprofits like Karl Rove's American Crossroads GPS.

At dozens of companies Walden was a leading investor voice calling for disclosure of policies, oversight mechanisms, and a detailed listing of political spending and lobbying expenditures. We believe such transparency helps management and investors better evaluate business risk associated with efforts to influence regulatory and legislative processes. We also encouraged disclosure and evaluation of indirect spending through third parties, such as trade organizations or public policy think tanks, particularly when corporate policies appeared to contradict a key focus of the organizations they supported. Specifically, we challenged companies on the U.S. Chamber's Board as well as those with ties to ALEC (American Legislative Exchange Council) and The Institute—three demonstrably Heartland organizations pressing for public policies that can be antithetical to progress on critical ESG concerns such as climate change.

As the following examples illustrate, many companies responded positively. Accenture adopted a new policy that prohibits political spending with corporate funds and added a senior-level representative to the Chamber's Environment & Energy Committee to advance the company's interests. Johnson & Johnson and Microsoft committed to increased public disclosure of lobbying activities. Procter & Gamble increased disclosure of lobbying activities and reviewed and amended its Political Action Committee (PAC) contributions policy to explicitly reference corporate values among the criteria. J&J, McDonald's and P&G ended their membership in ALEC, and Pfizer cut ties with Heartland.

ENVIRONMENTAL IMPACT

Discussions with companies on environmental performance centered on risks and opportunities related to climate change, shale gas exploration and production (hydraulic fracturing or "fracking"), and water scarcity. In several ongoing dialogues and 2013 resolutions, Walden is encouraging robust greenhouse gas (GHG) reduction programs, explicit GHG emissions targets and goals as well as public reporting of progress and challenges. As part of the Investor Environmental Health Network and the Interfaith Center on Corporate Responsibility, we provided input on a guide, published in December 2011, that identifies best practices for natural gas operators using fracking technology. The guide, which emphasizes mitigation of environmental impacts (e.g. sound site assessments, reduction of toxic chemicals in fracking fluids, and water conservation), community input, and public disclosure has been a valuable resource in discussions with several companies including Apache and ConocoPhillips.

Walden dialogues have prompted several companies, including **Qualcomm**, **Sysco**, and **United Natural Foods**, to explore water risk assessments as a means to better understand how water scarcity could effect their businesses. Moreover, since our 2011 withdrawal of a shareholder resolution asking Sysco to evaluate exposure to water risk in

its agricultural supply chain, the dialogue has expanded to cover sustainable agriculture and GRI-based reporting. Notably, Sysco announced recently that it has established a Sustainability Excellence Award for 2013. The award will recognize suppliers that demonstrate a commitment to measurable sustainability practices.

SOCIAL IMPACT

Outreach to companies on social issues in 2012 focused on equal employment opportunity (EEO), international labor standards, and human rights. Walden's leadership encouraging companies to adopt and make public more inclusive EEO policies to help recruit and retain top talent was rewarded with substantial progress. Of 15 companies we approached, 7 amended their policies to include sexual orientation or gender identity and expression: Bank of Hawaii, Blount, Independent Bancorp, Lithia Motors, LKQ, Mettler-Toledo and T.Rowe Price. Four more companies expanded disclosure of their inclusive EEO policies. Additionally, Commvault and NetApp shared EEO data with Walden as we continue to monitor their progress to increase board and management diversity.

Substantial progress was evident in several ongoing company discussions on human rights and labor standards. Apple appears committed to addressing working conditions and wage concerns in its supply chain after high profile exposés of abusive practices at Foxconn, a major supplier in China. The company has become much more transparent and is implementing recommendations from an independent investigation by the Fair Labor Association. ConocoPhillips updated its human rights position to be consistent with the principles of the International Labour Organization Convention 169 concerning indigenous and tribal peoples and the United Nations Declaration of the Rights of Indigenous Peoples. The company also announced it would not pursue oil exploration in specific controversial areas in Peru, though the decision was not attributed to social factors. St. Jude Medical reported that it is reviewing tools to help trace and disclose exposure to conflict minerals (gold, tantalum, tin or tungsten sourced from or near war-torn Democratic Republic of Congo) while also examining materials declarations from suppliers.

CORPORATE GOVERNANCE & SUSTAINABILITY REPORTING

Walden encourages companies to adopt best practice standards in corporate governance to strengthen board independence, management oversight, and accountability to stakeholders. This past year our focus was on supporting annual elections of directors (as opposed to staggered board elections) and separation of Board Chair and CEO positions. With Walden's encouragement, **Apache**'s board of directors supported unanimously annual elections of directors after a shareholder resolution sponsored by Illinois State Board of Investment passed overwhelmingly. **Gentex** also adopted an annual election policy following a majority vote in favor of a shareholder resolution Walden led with a client.

Finally, at 25 companies in 2012, Walden continued to emphasize sustainability reporting because we believe tracking and reporting on ESG factors enables businesses to anticipate and respond better to ESG risks, changing legislation, and heightened public expectations for corporate environmental and social accountability. Comprehensive ESG reporting is also necessary for analysts to assess fully risks and opportunities associated with existing and potential investments. Several companies have been receptive, including small cap firms Calgon Carbon, Carbo Ceramics, and

Coherent where ESG reporting is less common. **Cisco Systems** and **Oracle** have shown new leadership with their agreement to encourage sustainability reporting throughout their supply chains.

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Walden is pleased to conclude 2012 with a sense of accomplishment. We anticipate that our engagement initiatives in 2013 will also be productive with a solid base of "in progress" actions to build upon.

2012 Public Policy Advocacy Highlights

ENVIRONMENTAL

- Supported the Obama Administration's proposal to dramatically increase fuel efficiency standards for vehicles between 2017 and 2025 to an average of 54.5 miles per gallon, estimated to reduce greenhouse gases and fuel consumption by 50 percent and 40 percent, respectively.
- Signatory of a letter to the governments of Canada and Alberta, commending their implementation plan for a strong monitoring system for oil sands development while also encouraging the establishment of independent oversight.
- Supported the Environmental Protection Agency's (EPA) proposed Carbon Pollution Standard for New Power Plants as a means to help spur innovation and investment in low and no-carbon technologies as well as new energy infrastructure and energy efficiency.
- Joined an investor coalition urging U.S. Senate leaders to back EPA's Mercury and Air Toxics Rule for power plants by opposing a resolution introduced to block the new EPA rule. The resolution was voted down in June.
- As part of the Investor Network on Climate Risk, advocated an extension of the Production Tax Credit for wind energy. The credit was extended in the final hours of the 112th U.S. Congress.

SOCIAL

- Co-led an investor coalition representing \$145 billion in assets that called on congressional leaders to enact comprehensive immigration reform that includes a pathway to legal status for undocumented immigrants.
- Co-led outreach by institutional investors to 18 companies with a significant presence in Washington to encourage their public support of that State's marriage equality legislation. The bill passed, as did the subsequent public referendum.
- Joined 21 institutional investors with more than \$400 billion in assets who provided comments to the U.S. State Department on the new Reporting Requirements on Responsible Investment in Burma. Coordinated by the Conflict Risk Network, the statement supported greater transparency and accountability to ensure respect for human rights in Burma as sanctions are lifted.
- Signatory of a letter to Secretary Clinton asking the U.S. State Department to urge the government of Uzbekistan to demonstrate its commitment to end child labor and forced labor by allowing the International Labour Organization to monitor the cotton harvest.
- Joined investors who wrote Securities and Exchange Commission (SEC) Commissioners to oppose the lawsuit filed by the U.S. Chamber of Commerce, the National Association of Manufacturers and the Business Roundtable attempting to block or weaken the SEC's recently issued Rule on Conflict Minerals.

GOVERNANCE

- Signatory of a letter endorsing S. 2219, the DISCLOSE Act, which would require transparency of campaign expenditures by outside groups and their donors that are attempting to influence federal elections, including disclosure of the money trail tied to campaign ads.
- Joined a statement by global investors with more than \$3 trillion in assets backing new U.S. government guidance that helps companies comply with U.S. Foreign Corrupt Practices Act, calling for vigorous enforcement.
- Participated in an investor delegation that met with SEC Chair Mary Schapiro and Commissioner David V. Aguilar to encourage SEC regulation mandating political spending disclosure. The SEC included this topic on its 2013 agenda.

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