# Annual Impact Report 2016

We present below our fifth annual report on the impact of Walden's company engagement initiatives to encourage more sustainable business policies, practices, and transparency on a range of environmental, social, and governance (ESG) topics. Our achievements continue to demonstrate that investors can have a constructive influence on corporate behavior and accountability.

## REACH & IMPACT IN 2016: THE NUMBERS

Walden engaged approximately 44 percent of companies held in client portfolios across investment strategies in 2016 (Table 1). These initiatives include written communications, private conversations with company representatives, shareholder resolutions, outreach through ad hoc groups of investors with common holdings, and organized coalition actions that address pertinent ESG issues across sectors or industries. Topics most addressed by Walden during the year, in order of frequency, were climate change and board diversity (tied), lobbying disclosure, sustainability (or ESG) reporting, and LGBT equal employment opportunity.

Table 1 does not represent the entirety of Walden's engagement activity as it excludes outreach to companies that are not held in Walden client portfolios. This occurs frequently when we participate in collaborative engagements spanning entire sectors. Walden may also engage directly with companies not held in client portfolios if we believe there is a compelling reason to be involved. For example, helping to convince a leading manufacturer to adopt science-based greenhouse gas (GHG) goals would provide a model for portfolio companies to act.

Our reported reach of 44 percent also obscures Walden's frequent practice of engaging on multiple ESG issues at a single company. Furthermore, the metric does not distinguish between companies that receive one communication from those with multiple points of contact.

The number of companies we interact with provides important context, but we believe that actual outcomes matter more. In 2016, Walden achieved an impact rate of 31 percent (Table 2), which is our measure of the effectiveness of engagement. The impact rate is expressed as the percentage of companies demonstrating improvement relative to the companies reached through engagement. Table 2 also shows impact rates by primary ESG topic areas ranged from 17 to 53 percent.

| Table 1: Walden's Reach in 2016 | |
|---|---|
| **Reach** | |
| # of Portfolio Companies Engaged | 147 |
| **Reach Rate: % of Portfolio Holdings Engaged*** | **44%** |
| **Most Frequent ESG Topics (# of Companies)** | |
| Climate Change | 41 |
| Board Diversity | 41 |
| Lobbying Disclosure | 21 |
| Sustainability Reporting | 17 |
| LGBT Equal Employment Opportunity | 16 |

| Table 2: Walden's Impact in 2016 | |
|---|---|
| **Impact** | |
| # of Portfolio Companies | 45 |
| **Impact Rate: % of Companies Engaged (147)** | **31%** |
| **Impact Rates for Most Frequent ESG Topics** | |
| Climate Change | 17% |
| Board Diversity | 29% |
| Lobbying Disclosure | 19% |
| Sustainability Reporting | 53% |
| LGBT Equal Employment Opportunity | 38% |

**The 334 companies in the universe considered for engagement includes several companies that are not widely held in actively managed accounts. These include smaller positions held in Boston Trust client accounts that may not be held for Walden clients as well as low cost basis positions held in taxable accounts. Walden International Equity Fund holdings are currently excluded from the universe, pending an evaluation of the opportunities for engagement and strategy assets.*

## A Closer Look: The Cheesecake Factory

Walden first purchased shares of The Cheesecake Factory (CAKE) for our clients in July of 2014; currently, their collective holdings rank among the company's top 25 shareholders. Our initial ESG analysis identified several areas of superior performance, most notably a strong workplace culture and benefits that contributed to low employee turnover as well as recognition for the first time on *Fortune* magazine's venerated "100 Best Companies to Work For" list.

Notwithstanding CAKE's positive ESG record, our 2014 assessment also identified two areas for improvement where we believed shareholder engagement could be beneficial: board diversity and LGBT policies. CAKE's 7-member board of directors had no women or people of color, significantly lagging its self-identified peer group. Also, in 2009 CAKE settled for $345,000 an Equal Employment Opportunity Commission lawsuit alleging same-sex sexual harassment.

Walden's shareholder engagement with CAKE began with a September 2014 letter encouraging greater board diversity. Though we did not receive a prompt response, CAKE's Director of Investor Relations reached out prior to its annual meeting of shareholders in May 2015 to discuss general matters of corporate governance and simultaneously committed to address our other ESG concerns. As we prepared for a follow up phone conference, Walden also sought information about CAKE's equal employment opportunity (EEO) policy with respect to LGBT protections. An ensuing phone meeting in October 2015 marked the beginning of an ongoing, constructive conversation between Walden's ESG and securities analysts and CAKE's management team that included the General Counsel, CFO, and ultimately, the CEO at an in-person meeting in our office in September 2016.

From the onset, CAKE, a company founded by a woman, articulated its commitment to women in leadership roles on the board and in management as well as its goal to uphold best practices regarding nondiscrimination policies. CAKE listened to our proposals on how to make this commitment more apparent to stakeholders by fine-tuning corporate policies and posting them on the corporate website. We made the business case for being proactive in identifying diverse board candidates, encouraging long term thinking that would not be satisfied with one woman or person of color on the director slate.

Since our first interactions, we have been pleased to observe significant progress in policies, practices, and transparency consistent with our advocacy. CAKE added "gender identity" and "gender expression" to its EEO policy, which is now featured prominently on its website. Its "Corporate Governance and Nominating Committee Policies and Procedures Regarding Board of Directors Candidates" was amended in February 2016 to explicitly include gender and ethnicity as factors considered in identifying candidates. Lastly, in December 2016 CAKE appointed a woman director with 30 years of restaurant experience to its Board, where she will also serve on the Corporate Governance and Nominating Committee.

As long term investors who appreciate that ESG progress is usually incremental over time, we believe that we have developed a relationship of trust with CAKE's management that fosters openness to our perspective and input. Certainly, before Walden's engagement, CAKE was committed to high standards (for the third consecutive year CAKE made the 100 Best list in 2016, the only restaurant chain to make the cut). But we also believe that our interactions helped build significant momentum for positive change.

What constitutes improvement in ESG performance? Unlike recording and counting the numbers of companies engaged and the issues addressed, assessing impact can be a subjective process. As reported previously, we consider engagement to be successful when we observe progress toward one or more of three potential outcomes: <u>better corporate policies</u> (e.g., amending board nominating charters to include explicit consideration of gender and race), <u>more sustainable business practices</u> (e.g., adoption of science-based GHG goals), and <u>increased transparency</u> (e.g., initiating or substantially improving sustainability reports).

Collaborating with other investors often extends our reach when the engagement activity—typically in the form of a signatory letter—involves numerous companies. The flip side of these partnerships, which oftentimes function to build corporate awareness, is that they dilute Walden's calculated impact rate. For example, in 2016 we joined a group that wrote S&P 100 companies asking for their support of a new Equal Employment Opportunity Commission proposal to increase wage disclosure by gender, race, and job categories. We believe it is important for investors to signal their interest and support, but portfolio company follow up on this issue is a lower priority. Hence, improvement in policies, practices, or transparency is less likely at these companies.

In our 2015 annual impact report, a separate section "Limitations to the Measurement of Impact" described five primary challenges. To better understand and interpret the reported impact metrics, a summary of these challenges follows:

- **The continuum of progress**: Corporate progress is often incremental and can span multiple years. Walden counts milestones achieved in reporting periods as evidence of progress.
- **Attribution**: Observed progress may be primarily catalyzed by Walden's engagement but also often represents the combined efforts of numerous investors and other stakeholders, as well as internal company advocates.
- **Quality vs. Quantity**: Improvements in policies, practices, and transparency are not all equal in terms of the time and resources required to implement them or in the magnitude of the impact; yet they are counted equally.
- **Transparency**: On occasion, progress may be counted in our reporting based on private conversations and commitments before we publicly report the details.
- **Real World Progress vs. Corporate Change**: Our current definition of ESG impact is usually at least one step removed from real world impacts such as the amount of emissions avoided, a decrease in workplace discrimination incidents, or a diminution of corporate money in politics.

## EXAMPLES OF IMPACT IN 2016

### Climate Change

While Walden's approach to addressing climate change is multi-faceted, we focus engagement on two primary objectives. We encourage companies to adopt science-based GHG goals, entailing global reduction of GHG emissions by 55% by 2050 and reaching net zero emissions between 2050 and 2100. We also seek to influence companies to support effective climate-related public policy because we believe a vocal corporate constituency is crucial for continued progress.

- **U.S. Bancorp** set a new science-based GHG reduction goal in 2016: a 40 percent reduction in GHG emissions from operations by 2029 and 60 percent by 2044 relative to 2014 levels.
- Electronic products manufacturer **Hubbell** conducted a baseline study of energy efficiency in 2016 and plans to set a goal in 2017.
- **ConocoPhillips** increased disclosure on carbon asset risk—how it addresses physical, operational, and financial risks associated with climate change—and is now recognized as a leader in considering the impacts of a transition to a low-carbon global economy.
- **PNC Financial Services** continued to develop its portfolio environmental stress test framework to better inform its lending, financing, and investing activities and also enhanced disclosure on this initiative.

**Alphabet** (Google), **Apple**, **Microsoft**, and Amazon submitted an amicus brief backing the EPA's Clean Power Plan, which limits GHG emissions from existing fossil fuel power plants and is central to the U.S. commitment to combat climate change. Having pledged to power their business operations exclusively with renewable energy, these technology companies wrote, "delaying action on climate change will be costly in economic and human terms, while accelerating the transition to a low-carbon economy will produce multiple benefits with regard to sustainable economic growth, public health, resilience to natural disasters, and the health of the global environment." Additionally, we asked several companies to consider adding their names to a Ceres-organized, joint investor-company statement to President-elect Trump and members of the U.S. Congress to express strong support for the Paris Climate Agreement. We applaud **Johnson & Johnson** for endorsing the statement.

### Water Risk

The supply of fresh water is increasingly stressed by climate change, water pollution, and population growth. Water scarcity is not only a threat to public health; it poses a significant risk for the highly water dependent global food and beverage value chain. Conversations addressing water stewardship at two companies continued to demonstrate progress in 2016.

- **Flowers Foods** used the Global Water Tool provided by the World Business Council for Sustainable Development to assess global water risk, completed the CDP water questionnaire, and set a goal to reduce water use by 10 percent per metric ton of product.
- **McCormick** is launching a pilot farmer support program addressing water risk (and sustainable agriculture generally) with top suppliers, and enhanced its disclosure in the annual CDP water questionnaire.

## Board Diversity

Walden engages companies that have one or no women or people of color on their boards of directors. This often follows our practice of voting on the annual proxy ballot against directors serving on nominating committees. Growing pressure from major institutional investors as well as business leaders has helped change the dynamic of our conversations with companies. For example, the Business Roundtable recently made the business case for ethnic and gender diversity in its updated governance principles. For the most part, portfolio companies appear to know they need to improve board composition as part of board refreshment and they are taking appropriate steps.

- **Bruker**, **Cabot Oil & Gas**, **The Cheesecake Factory**, **CLARCOR**, **Cohen & Steers**, **CoreSite**, **Discovery Communications**, and **IPG Photonics** each added a woman director in 2016. Four of these firms had previously amended their corporate governance policies to explicitly consider gender and race in the nominating process.
- **Hub Group** agreed to strengthen corporate governance policies by committing to a diverse candidate pool and expanding recruitment networks.

## Equal Employment Opportunity (EEO): LGBT

North Carolina's passage of House Bill 2 (HB2) last March brought to the fore that LGBT individuals continue to lack legal protections in many areas of the country. The significant economic impact of the discriminatory law was plainly visible as businesses canceled investments (e.g., PayPal terminated a planned global center), major sports events were relocated, and entertainers boycotted North Carolina. HB2 served as a reminder to Walden of the importance of our advocacy for inclusive company EEO policies that explicitly protect employees from discrimination based on sexual orientation or gender identity and expression. **Applied Industrial Technologies**, **Avery Dennison**, **Brown & Brown**, **Calgon Carbon**, and **Chart Industries** adopted more inclusive EEO policies over the year and posted them to their websites. On this issue, companies appear to be leading policymakers.

## Sustainability (or ESG) Reporting

In November, the Forum for Sustainable and Responsible Investment released its biennial report on trends in U.S. SRI (Sustainable, Responsible, and Impact) investing. The headline finding was that U.S. SRI assets increased 33 percent from 2014 to $8.72 trillion, representing about one out of every 5 dollars under professional management. One would think that, with this large commitment to SRI, robust, standardized, and verified ESG reporting would be commonplace, providing portfolio managers with good information to guide investment decisions. Unfortunately this is not the case, especially with respect to smaller companies.

Walden finds that many companies are responsive to requests for sustainability reports that describe how they measure, manage, and monitor their ESG risks and opportunities. **BB&T** published its inaugural sustainability report in the fall. After high levels of support for shareholder resolutions calling for sustainability reports at their 2016 annual meetings, **CLARCOR**, **Emerson Electric** and **ESCO Technologies** agreed to develop ESG reporting. **Nordson** also committed to produce its first report and to update it annually, and hired a consultant to start the process.

## Other

The following examples of company initiatives addressing other ESG topics provide additional evidence of the impact of Walden's engagement activity.

- **American Express** increased lobbying disclosure, including third-party lobbying through trade associations, and detailed board and management oversight of political spending.
- **PPG** committed to phase out the use of lead from commercial coatings, the last of its products to contain this potent neurotoxin. The company also agreed to provide an update in its 2017 sustainability report.
- Embroiled in controversy following the $185 million settlement in September for "the widespread illegal practice of secretly opening unauthorized deposit and credit card accounts" (Consumer Financial Protection Bureau statement), **Wells Fargo** announced in December a by-law amendment to require separation of the CEO and Chair positions. This separation of responsibilities fosters independent oversight and is considered a best practice in corporate governance.

## Public Policy Advocacy

Public policies are often an essential part of the solution to complex and systemic environmental, social, and governance (ESG) concerns. For example, encouraging companies one-by-one to adopt science-based GHG reduction goals is a worthy endeavor, but a policy mandate in support of a price on carbon is needed to level the playing field economy-wide and ensure broad based action. Walden is committed to federal and state level public policy advocacy that complements and strengthens our company engagement initiatives.

Policy advocacy takes many forms: joining investor coalitions in letters or statements to governmental entities and standard-setting organizations; responding to requests for comment on new or proposed changes to policies; and in-person visits to legislators or agencies that have direct policy-making responsibilities.

In 2016 Walden participated in over two dozen signatory letters and statements addressing an array of ESG topics. While we often provided input, these initiatives were led by a diverse group of NGOs and other stakeholders such as Ceres/INCR (Investor Network on Climate Risk), the Cotton Campaign, the Council on Institutional Investors, ICCR (Interfaith Center on Corporate Responsibility), Public Citizen, PRI (Principles for Responsible Investment network), US SIF (U.S. Forum for Sustainable and Responsible Investment), as well as large institutional investors including CalSTRS and the NYC Comptroller. As examples, investor statements this past year called for:

- Securing the Paris 2015 Climate Agreement;
- Methane emissions reductions in the oil and gas sector;
- Adherence to a set of carbon pricing principles to ensure strong standards;
- Full repeal of North Carolina's HB2 legislation that curtailed protections for LGBT individuals;
- Ending the use of forced labor in cotton production in Uzbekistan and Turkmenistan;
- Banning the use of antibiotics important to human medicine in meat production; and
- SEC mandated disclosure of corporate political spending.

We submitted public comments to the SEC regarding Regulation S-K on corporate disclosure requirements, making the case for enhanced disclosures on political spending, pay equity, board and management diversity, and climate risk. Separately, in a letter to President Obama, we encouraged an executive order requiring political spending transparency for corporate entities receiving government contracts. Walden also provided guidance on listing requirements to the World Federation of Exchanges as well as input to the Financial Stability Board's Task Force on Financial Related Climate Disclosure. Lastly, we provided public comments in support of the Equal Employment Opportunity Commission's (EEOC) proposal to increase disclosure of wage data as a means to address persistent wage gaps experienced by women and people of color. Representatives of the EEOC followed up with us to explore the adequacy of different wage metrics.

As a participant in US SIF's "Hill Day," Walden had the opportunity to address directly many of the issues identified above with White House staff and state lawmakers. Here in Boston, we joined Ceres at a meeting with representatives of the Massachusetts Department of Environmental Protection and Office of Energy & Environmental Affairs to express support for the Regional Greenhouse Gas Initiative and urge more ambitious emissions reduction targets.

Walden does not quantify the impact of our public policy advocacy, though we report on any changes that are consistent with our positions. Still, we are convinced that investors, including Walden, are a critical constituency to hold policymakers accountable on matters of social and environmental responsibility.

We begin 2017 facing significant uncertainty about the direction of U.S. public policy related to many priorities that we share with our clients—climate change; the rights of women, people of color, and LGBT individuals; income inequality; corporate influence in politics; among them. While aspects of the current political and social discourse are profoundly unsettling, Walden believes that with encouragement from an active investor constituency, many companies are poised to ensure forward progress. We are also heartened by a new December 29 Department of Labor Interpretive Bulletin that supports the rights of investors, like Walden, to engage with companies on critical environmental and social matters. (Walden had joined US SIF in advocating for this guidance.) We are as committed as ever to doing just that.

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