Research & Engagement Brief

Third Quarter 2016

Walden rarely divests of a portfolio company as an immediate response to a reported ethical breach, but we recently did just that for most clients.

In September the Consumer Financial Protection Bureau announced a $185 million settlement with **Wells Fargo** for "the widespread illegal practice of secretly opening unauthorized deposit and credit card accounts." Cross-selling programs that ran amok were identified as a root cause of the fraudulent activity, which resulted in customer fees on sham accounts and the dismissal of approximately 5,300 relatively low ranking employees in the past 5 years (about 2% of the workforce). Moreover, some employees allege that they were let go for whistleblowing. Under fire from regulators and Congress, the board and management began to take action. Sales quotas in its retail banking segment are being eliminated and compensation claw-backs valued at $41 million and $19 million were announced for the CEO and former head of retail banking, respectively. Amidst growing pressure, the CEO abruptly stepped down on October 12.

The systemic breakdown has caused significant reputational harm to Wells Fargo and calls into question the sustainability of a business model that thrived on fee income from cross-selling. We were disappointed that Wells Fargo's senior management initially disclaimed any oversight failure. Notwithstanding the bank's response thus far, we remain concerned about corporate culture, risk oversight and controls, and management accountability. We will engage with Wells Fargo on these issues on behalf of the few remaining shares, and will continue to monitor its progress.

ENGAGEMENT UPDATE

Board Diversity

Walden reaches out annually to companies with relatively low representation of women and people of color on their boards. This direct engagement reinforces our proxy voting policy to withhold support for directors serving on nominating committees on boards that fail to meet a minimum diversity threshold (usually 2 directors). This year, 60% of 33 companies we contacted have already responded through emails, letters, phone conferences, and in-person meetings. Two companies that we have engaged for several years, **CoreSite** and **IPG Photonics**, added a woman director subsequent to their 2016 annual shareholders meeting. **The Cheesecake Factory** improved governance policies to explicitly identify gender and ethnicity among the factors considered in the nominating process. Seven companies have had board level discussions on the topic and nearly that many expect positive changes in the coming year. All in all, these conversations demonstrate meaningful progress and increasing recognition of the business benefits of a diverse board of directors.

Climate Change

Following up on our agreement to withdraw a shareholder resolution earlier this year, **Hubbell** reported that it is on track to complete a baseline measurement of its energy use that will enable the company to set an energy efficiency goal in 2017. A multi-year dialogue at **PNC Financial** that initially focused on financing carbon emissions—particularly on mountaintop coal mining which the bank no longer funds—has evolved into a broader discussion with the CEO and management. PNC reported progress on environmental stress-testing of its loan portfolios and more generally spoke to the growing importance of sustainable business practices as a means to attract employees and differentiate PNC.

Food Waste

The U.S. Department of Agriculture estimates that an astounding 30-40% of the U.S. food supply is wasted. Food

(Continues on next page)

In September, Walden's Tim Smith (at right) received the ICCR Legacy Award from ICCR's Seamus Finn for his decades-long leadership shaping the landscape of shareholder advocacy for more just and environmentally sound business policies and practices.

waste is the largest component of municipal landfills that in turn are the third largest U.S. source of methane (a highly potent greenhouse gas). Moreover, the annual cost of food waste measures in the 100s of billions of dollars. The issue embodies a constellation of concerns—food security, climate change, resource conservation, and a substantial economic toll. Walden co-filed a resolution at **Costco Wholesale**, led by Trillium Asset Management, that seeks a report on efforts to assess, reduce, and optimally manage food waste. We withdrew the resolution upon Costco's commitment to address food waste in its next sustainability report.

Sustainability Reporting

Following Walden's engagement, **BB&T** and **CLARCOR** have reported progress in developing their first sustainability reports, with the latter indicating it will implement a best practice GRI-aligned report that will include a carbon footprint analysis. We also joined an investor coalition at an in-person meeting with **Apache**'s CEO that addressed a range of topics from political spending transparency and board diversity to energy efficiency and carbon asset risk. Apache expects to boost transparency and accountability through improved web-based disclosures.

Walden's Climate Strategy 2016-2017

Walden's engagement on climate continues to focus on two areas: science-based greenhouse gas (GHG) reduction goals and climate-related public policy. Walden, in coalition with likeminded investors, aims to encourage the business community to support science-based goals – entailing global reduction of GHG emissions by 55% by 2050 and reaching net zero emissions between 2050 and 2100. We are also encouraging companies to support effective climate-related public policy, or at a minimum, to stop actively obstructing progress. The two objectives are closely related.

There is a strong long-term business case for setting GHG goals and addressing climate change. Moreover, a robust science-based target signals to lawmakers that action on climate change can be taken without risking economic penalty. This should enable our policymakers to develop the laws and regulations necessary to put us on a path toward a neutral carbon future.

Engaging companies on climate change mitigation and adaptation has been a high priority for many years at Walden. We are pleased to report that in typical large cap client portfolios the number of companies with GHG emissions reduction targets has increased. As of August 2016, 61% (49/80) of these companies have set GHG reduction goals, an increase from 52% in 2013 (the first year this analysis was completed). Twenty portfolio companies have set new or replaced existing goals over the period. Walden has engaged more than three-quarters of these companies. However, while some of the goals can be characterized as science-based targets, the vast majority cannot. We also note that corporate change results from numerous factors, Walden's engagement being but one contributor to progress.

Similarly, we see company progress related to public policy and lobbying on climate change. Tech giants including **Apple**, **Google** and **Microsoft** submitted an amicus brief in support of the Clean Power Plan, the Obama Administration's new carbon pollution standards for existing fossil fuel-fired power plants. The companies unequivocally made the case for action to mitigate climate change, stating, "[D]elaying action on climate change will be costly in economic and human terms…" Numerous companies, including **PepsiCo**, endorsed the American Business Act on Climate Pledge that supported the U.S. government's negotiating efforts at the Paris Climate Conference in December 2015. On lobbying transparency, approximately 35 companies have improved their disclosure according to AFSCME, Walden's partner in coordinating the investor campaign. These include **American Express** and **Becton Dickinson**.

LOOKING AHEAD

Science-based Goals: We plan to engage the largest GHG emitters as well as companies with smaller emissions footprints on setting science-based GHG goals. For those companies that currently have only modest goals, we will encourage more ambitious future goals. Simultaneously, we will continue to advocate for robust climate-related disclosure.

Climate Policy: A pricing mechanism for carbon emissions is considered by many experts as the most economically efficient way to limit warming to 2°C above pre-industrial levels — the level climate scientists indicate may be the maximum allowable to avoid the worst impacts of climate change. Many policy experts are indicating that the prospects for climate legislation at the national level have increased greatly. In addition, there are numerous opportunities at the state level for engagement on climate policy. We will continue asking companies for greater transparency on their direct lobbying activity as well lobbying done on their behalf by trade associations and other third parties. We will also encourage companies to speak out proactively for climate policy solutions. Finally, Walden will continue to use our own voice as investors to advocate directly for smart climate policy.

The challenge of addressing climate change is daunting, but Walden's commitment to action is steadfast. Emboldened by our partnerships with coalitions of committed investors as well as numerous examples of leadership in the business community, we believe there is reason for optimism.

The information contained herein has been prepared from sources and data we believe to be reliable, but we make no guarantee as to its adequacy, accuracy, timeliness, or completeness. We cannot and do not guarantee the suitability or profitability of any particular investment. No information herein is intended as an offer or solicitation of an offer to sell or buy, or as a sponsorship of any company, security, or fund. Neither Walden nor any of its contributors makes any representations about the suitability of the information contained herein. Opinions expressed herein are subject to change without notice.