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NOTE: All data in this report cover U.S.-based companies unless otherwise mentioned. All data as of June 18, 2021, unless otherwise mentioned.
AN UNFORGIVING CLIMATE

THE ERA OF ESG ACTIVISM HAS ARRIVED THANKS TO A PERFECT STORM OF CIRCUMSTANCES. IT HAS PLENTY OF ROOM TO GROW INTO A FULL-SCALE BUSINESS FOR HEDGE FUNDS, WRITES INSIGHTIA EDITOR-IN-CHIEF, JOSH BLACK.

There can be little doubt that ESG activism has arrived. Many activists will tell you they’ve been doing the third leg (governance) for decades, and the incorporation of environmental and social issues into investment strategies and critiques of public companies was the hot topic in our Activist Investing Annual Review as far back as 2018.

But the victory of Engine No. 1 over Exxon Mobil in the first ESG-flavored proxy contest, winning the support of all three main index fund providers in the process, is an announcement like no other. At the same time, almost all new activist funds profess to be keen adherents of ESG, and support for environmental and social proposals has soared this year.

ESG activism – or the rise of “E” and “S” in activist campaigns, as we really mean when we talk about ESG – has been building steam and looking for an escape. As we predicted in the November 2018 issue of Activist Insight Monthly, activists have been forced to keep tabs on developments in ESG and have used the new skills it requires of directors to justify board changes at target companies. Inclusive Capital and Engine No. 1 have put climate change and the energy transition at the center of their activities to-date, accounting for almost all of the ESG-related board seat gains by activist investors.

What then, has allowed ESG activism to flourish? Substantial inflows into ESG-tracking funds and low interest rates that bring forward the value of long-term investments have created a valuation boom that activists can exploit, while issuers have been forced to re-evaluate their strategies because of shifts such as more conscious consumers and, in the case of energy companies, lower oil prices through the early and middle stages of the pandemic. A change in presidential administration and regulatory priorities have also given ESG issues extra exposure, particularly by allowing more shareholder proposals to go to a vote.

Even more importantly, institutional investors have shown greater willingness to support environmental and social issues at the ballot box, not just in private. In fact, some investors have taken a dim view of the “say on climate” campaign, which aims to make advisory votes on climate transition plans commonplace, precisely because it doesn’t have as much bite as threatening to unseat directors (see Proxy Monthly, May 2021 for more).

Along the way, some new developments have been surprising. ESG activism had its origins in sidecar funds for bigger names like Jana Partners and ValueAct Capital but is increasingly led by new operators launched by experienced professionals, as detailed in our key players article in this report. And victory has required more than simply berating a company over a sampling of ESG failures. Often, articulating challenges facing an entire industry has been required to gain credibility, connected to a strong slate of nominees with relevant skills.

What comes next? According to Starboard Value’s Jeff Smith, ESG activists need to demonstrate the changes they effect can stick. Others will be skeptical that as much value can be created, although that is rapidly being dispelled by well-chosen targets. More prosaically, activists have never quite shaken off the impression that ESG is a fundraising strategy designed to gain the attention of allocators and yet, although it is admittedly early days, today’s ESG activist funds are not as sizable as their more established rivals. It remains to be seen whether the likes of Jeffrey Ubben and Chris James will win big, light the way, or struggle with smaller players.

All of the above makes it an exciting time to be publishing our first report on ESG activism packed full of Insightia data and analysis, and we are grateful for the support of Olshan Frome Wolosky, Innisfree M&A, and FTI Consulting to bring it to our readers.

- Josh Black
@InsightiaLtd
ON THE FRONT FOOT

INVESTORS HAVE STEPPED UP THEIR SCRUTINY OF PUBLIC COMPANIES, BECOMING A DRIVING FORCE IN HOLDING COMPANIES TO ACCOUNT FOR THEIR ENVIRONMENTAL AND SOCIAL OUTPUTS. ACTIVISTS ARRIVED AT THE PARTY NOT A MOMENT TOO SOON, WRITES JASON BOOTH.

In less than five years, ESG-focused shareholder activism has grown from a niche sideline into a shareholder movement powerful enough to allow a fledgling fund like Engine No. 1 to force change at a behemoth like Exxon Mobil. But such a victory would not have been possible without a series of changes in securities regulation, new technology, and shifting investor perceptions that have been decades in the making.

SCANDAL AND CRISIS

It was a series of new regulations inspired by corporate scandals and financial crises early this century that made today’s ESG activism possible, according to Glenn Davis, Deputy Director of the Council of Institutional Shareholders in Washington DC.

The first was the Securities and Exchange Commission’s (SEC) Form N-PX rule of 2003 that required mutual funds and other registered management investment companies to disclose details to investors on how they vote proxies related to different securities they hold. In its ruling, the SEC made clear that it was responding to growing investor interest in knowing how their money is employed. “Recent corporate scandals have created renewed investor interest in issues of corporate governance,” the SEC stated when it rolled out the new rules. “Moreover, in some situations the interests of a mutual fund’s shareholders may conflict with those of its investment adviser with respect to proxy voting.”

“That really was a swift kick in terms of getting larger asset managers more interested in the proxy voting aspects of what they do,” said Davis.

Two other landmark regulations were implemented in the wake of the Great Recession. In 2009, the SEC ruled that brokers no longer had discretion to vote in director elections when they didn’t get instructed votes. And in 2011, the Dodd-Frank Act mandated “say on pay” votes, a true majority standard for director elections, and the availability of proxy access.

The new regulations resulted in a “regular cultural shift, so now every opportunity that shareholders have to cast a vote has become something of a referendum, a tool for communication,” said Davis. “And frankly, management’s interest in listening to the outcome of the vote started to shift.”

The second key element was the rise of the internet and other technology that has enabled investors to gather and trade information on public companies.

“I think technology has played a huge role,” said Francis Byrd, Managing Partner at ESG and shareholder engagement consultancy Alchemy Strategies Partners. “It erodes the advantage that companies used to have of being the only gatekeepers both to their boards, to management and to even their shareholders.”

SUCCESSFUL ENVIRONMENTAL SHAREHOLDER PROPOSALS

<table>
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<tr>
<th>Year</th>
<th>Basic Materials</th>
<th>Communications</th>
<th>Consumer Cyclic</th>
<th>Consumer Defensive</th>
<th>Energy</th>
<th>Financial Services</th>
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PROPORTION OF ENVIRONMENTAL SHAREHOLDER PROPOSALS PASSED AT U.S.-BASED COMPANIES BY SECTOR AND YEAR.
*AS OF JUNE 18
SOURCE: INSIGHTIA | PROXY INSIGHT ONLINE
This in turn has enabled smaller investors, foundations, and endowments, as well as activists like Engine No. 1, to assume a leadership role in lobbying institutional investors, proxy advisors, and even the SEC.

**LANDMARK CAMPAIGNS**

With investor sentiment, regulations, and data aligned in favor of ESG activism, traditional activists started to take notice.

In January 2018, Jana Partners teamed up with pension fund California State Teachers’ Retirement System (CalSTRS) to put pressure on technology giant Apple to study the effects of its flagship iPhone on teenagers. That campaign was successful but arguably failed to show how the changes enhanced shareholder value. But it apparently served as a training ground for Jana Portfolio Manager Charlie Penner, who went on to take on Exxon as one of the founders of Engine No. 1.

That same month saw veteran activist Jeffrey Ubben step down from his role of chief investment officer at ValueAct and set up ESG-focused Spring Fund. A month later, Lauren Taylor Wolfe and Christian Asmar, formerly of Blue Harbour, launched Impactive Capital, with a $250 million seed investment by CalSTRS and a promise of using ESG issues to create shareholder value.

But the strongest indicator of ESG’s influence came in early 2020, when Elliott Management argued that Kansas City-based power utility Evergy should stop repurchasing shares and instead invest in infrastructure that will “facilitate the company’s deployment of renewables and reducing its carbon footprint.” The venture into ESG was especially notable given that a couple years earlier Elliott faced widespread criticism after pressing NRG Energy and Sempra Energy to shed their renewable energy assets and because director nominee Barry Smitherman was said to view global warming as a “hoax” and not related to carbon emissions.

Elliott’s new interest in ESG might have been partly inspired by the fact that sustainable funds globally pulled in an estimated $45 billion during the first quarter of 2020, compared to an outflow of $384 billion for the overall fund universe amid the coronavirus pandemic market sell-off.

**THE FUTURE**

Engine No. 1 won its campaign at Exxon in part because shareholders saw the value of the oil giant reducing its dependence on what many see as a depreciating asset. Other ESG campaigns this year have fared less well. For example, Standard General’s accusations of racial insensitivity on the part of Tegna’s chief executive did not translate into victory at the ballot box, as shareholders apparently saw little connection with enhancing the company’s value. Whether activists can make viable, and sincere, arguments linking ESG with value may be critical to the movement’s future.

“The success of ESG has been the ability of those advocates to explain and defend the link between their issue and long-term shareholder value creation,” said Davis at CII. “On the other hand, if there’s a sort of a leap across the Rubicon where activists repurpose their objectives [to fit ESG] you may see the ESG train slow down.”

The history of ESG to date, however, indicates the movement is unlikely to halt. Byrd noted that not long ago it was a struggle to pass proposals to declassify boards and implement majority voting, which today are considered basic tenets of good governance, while this year some brand-new diversity proposals are already winning 30%-40% shareholder support.

### SUCCESSFUL SOCIAL SHAREHOLDER PROPOSALS

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<tr>
<th>BASIC MATERIALS</th>
<th>COMMUNICATIONS</th>
<th>CONSUMER CYCLICAL</th>
<th>CONSUMER DEFENSIVE</th>
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<th>HEALTHCARE</th>
<th>INDUSTRIALS</th>
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</tr>
</tbody>
</table>

*AS OF JUNE 18

PROPORTION OF SOCIAL SHAREHOLDER PROPOSALS PASSED AT U.S.-BASED COMPANIES BY SECTOR AND YEAR.

SOURCE: INSIGHTIA | PROXY INSIGHT ONLINE
ESG ACTIVISM BECOMES THE NORM

AN INTERVIEW WITH ELIZABETH GONZALEZ-SUSSMAN, PARTNER AT OLSHAN FROME WOLOSKY AND MEMBER OF THE FIRM’S CORPORATE/SECURITIES LAW AND ACTIVIST & EQUITY INVESTMENT PRACTICES.

WHAT HAS DRIVEN THE INCREASED ADOPTION OF ESG BY ACTIVIST INVESTORS?

Given the level of social activism occurring over the past few years in our country, I’m not at all surprised by the increased adoption of ESG considerations by activist investors. I think many of our activist clients realize that issues relating to climate change, racial justice, board diversity, human capital, and governance can impact their investment returns if not properly considered or addressed by management teams and boards. Obviously, the governance component of ESG has been a critical element of activist campaigns for a long time now, as the correlation between better corporate governance, particularly greater accountability to shareholders, has been a big driver of improved shareholder returns. Now, I think ESG considerations are also being viewed by shareholders as highly correlative to a company’s bottom line.

DO YOU THINK ENVIRONMENTAL AND SOCIAL OBJECTIVES WILL BECOME AS INTEGRAL TO ACTIVISM AS GOVERNANCE HAS FOR LONG-ESTABLISHED ACTIVIST FUNDS IN TIME?

Definitely. Almost all of our long-established activist clients have made significant efforts for years to better diversify boardrooms with female candidates and other members of underrepresented communities. This year, I saw an increased focus on the dramatic pay disparities between CEOs and their average employees, particularly in 2020 when many employees were furloughed for some time as a result of the pandemic. I also saw many activists push for ESG metrics to be included in executive compensation plans to better assess and hold management accountable for stated ESG goals.

I think we should expect more activist funds to seek enhanced ESG disclosures by companies, exceeding even the human capital disclosures currently required by the Securities and Exchange Commission (SEC), and other ESG-related disclosures relating to climate change, diversity, and political spending that the SEC is currently exploring and may soon be mandated.

HAS ESG ACTIVISM LED TO MORE CONSTRUCTIVE ENGAGEMENTS WITH MANAGEMENT TEAMS AND BOARDS?

In this proxy season, ESG-focused activism has primarily manifested through the submission of shareholder proposals for inclusion in the company’s proxy statement. The “say on climate” proposals from TCI Fund Management are particularly notable, given the fund’s stated intent to submit such proposals at hundreds of companies globally during the coming years. These engagements tend to be less hostile since directors are not at risk of being unseated and we have been involved in numerous amicable and constructive situations where the submitting shareholder agreed to withdraw an ESG-related proposal after management pledged to voluntarily implement the proposal.

It is too early to draw conclusions as to whether director nominations spurred by climate, social equality, or human capital themes will lead to more constructive or hostile engagements as we are only in the beginning stages of this activist strategy. The first such election contest – at Exxon Mobil – will certainly pave the way for many more ESG-focused contests. I think the Exxon board took a highly defensive and dismissive view toward Engine No. 1, clearly underestimating the extent to which institutional investors shared many of the concerns Engine No. 1 raised about Exxon’s energy transition strategy, which is why it was successful in winning three board seats despite its less than 1% ownership position in the company.

WHAT ADVICE DO YOU GIVE ESTABLISHED ACTIVISTS THINKING ABOUT LAUNCHING AN ESG CAMPAIGN?

Shareholders will support an ESG-focused campaign when they understand the financial benefits that can be achieved through implementation of the proposed ESG initiatives. Consistent with all activist campaigns, making a cogent and convincing case for ESG-related changes, and assembling a dissident slate possessing the qualities and characteristics that specifically address these changes will be paramount.
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OLSHAN AND ITS CLIENTS ARE ESG AND DIVERSITY-FOCUSED

50 female and/or minority directors seated in the past 2 years alone as part of our clients’ campaigns

from ACTIVIST INSIGHT MONTHLY:

“The Most Prolific Law Firm in Shareholder Activism”

“Olshan placed first in our law firm rankings, a position it has held since the inception of the awards and for six consecutive years.”

“[Olshan’s Shareholder Activism Practice consistently] creates an impressive gap between it and the rest of the advisers”

OLSHAN HAS THE DEEPEST BENCH IN SHAREHOLDER ACTIVISM

• 8 lawyers ranked by The Legal 500 as top attorneys in Shareholder Activism

• 5 lawyers named by Chambers USA as leading attorneys in Shareholder Activism

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THE KEY PLAYERS

A SMALL NUMBER OF FIRMS ON BOTH SIDES OF THE ATLANTIC HAVE TAKEN DIFFERENT APPROACHES TO ESG ACTIVISM, RANGING FROM MULTI-COMPANY CAMPAIGNS TO FLASHY PROXY FIGHTS AND BEHIND-THE-SCENES ENGAGEMENTS, WRITES JOSH BLACK.

INCLUSIVE CAPITAL PARTNERS
Key players: Jeffrey Ubben, Eva Zlotnicka  Year founded: 2020
Modus operandi: Perhaps the only dedicated ESG activist fund with over $1 billion in assets, former ValueAct Capital founder Jeffrey Ubben nonetheless plans for an even bigger future. Inclusive, run in parallel with the Council for Inclusive Capital, advocates companies reduce their carbon outputs, promote gender and racial diversity on boards, and lower the cost of social goods such as public education. It already holds several board seats.

ENGINE NO. 1
Key players: Chris James, Charlie Penner  Year founded: 2020
MO: Having just pulled off a shock proxy contest victory at Exxon Mobil on a platform of energy transition and climate oversight, the firm plans an exchange traded fund that would push large-cap U.S. companies “to invest in their employees, communities, customers and the environment.”

THE CHILDREN’S INVESTMENT FUND (TCI)/ CHILDREN’S INVESTMENT FUND FOUNDATION (CIFF)
Key players: Chris Hohn (TCI), Michael Hugman (CIFF)  Year founded: 2003 (TCI), 2002 (CIFF)
MO: Last year, the Children’s Investment Fund Foundation (CIFF) launched an ambitious campaign called “say on climate” to get companies around the world to draft climate change mitigation plans and put them to a shareholder vote. Chris Hohn, who founded the charity and the hedge fund TCI - a separate organization - is a noted environmentalist and supporter of the initiative.

IMPACTIVE CAPITAL
Key players: Lauren Taylor Wolfe, Christian Alejandro Asmar  Year founded: 2018
MO: The woman- and minority-owned fund likes to agitate for changes behind closed doors with minimal public attention but believes attention to ESG can build more sustainable and more valuable companies over the long term.

IDES CAPITAL
Key players: Robert Longnecker, Dianne McKeever  Year founded: 2016
MO: The fund says it takes a holistic approach to ESG, pushing companies to consider issues like employee wellbeing and diversity. Its approach is mostly constructive but it is always prepared to take its campaigns to shareholders.

BLUEBELL CAPITAL
Key players: Marco Tarrico, Giuseppe Bivona  Year founded: 2019 (fund)
MO: Bluebell uses a “one share” ESG strategy, researching companies that are underperforming and using the media and conversations with market participants to push for changes, as at Solvay last year.

CLEARWAY CAPITAL
Key player: Gianluca Ferrari  Year founded: N/A
MO: The soon-to-be launched fund promises to be Europe’s first activist fund solely dedicated to ESG activism.
U.S. OFFICIALS HAVE TAKEN SEVERAL ACTIONS TO UNDERLINE A NEW FOCUS ON ESG THIS YEAR – CHANGES THAT HAVE DRAWN SUPPORT FROM INVESTORS AND PRESENT NEW OPPORTUNITIES, WRITES JOHN REETUN.

Following Joe Biden’s inauguration earlier this year, the Securities and Exchange Commission (SEC) rolled out a number of initiatives focused on scrutinizing ESG metrics at public companies, a move heralded by some as a much-needed attitude adjustment, and one that may offer activists and other investors a larger platform to push for changes.

NEW DAY

The SEC was not shy in pushing out its new initiatives, starting under Acting Chair Allison Herren Lee in March and continuing after the appointment of Gary Gensler for a five-year term in April. Along with launching a dedicated ESG web page summarizing its actions, the regulator announced a taskforce aimed at identifying gaps and misleading statements in a company’s ESG metrics, and said it would examine proxy voting adviser voting policies and practices to ensure they reflect shareholders’ best interests. Lee, speaking in April, said the initiatives “are immediate steps the agency can take on the path to developing a more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures,” at companies.

In May, President Biden issued an executive order which laid out several government initiatives aimed at tackling climate risks, including examining the financial risks tied to environmental concerns. The order follows increased scrutiny from shareholders, which have been chasing an array of environmental disclosures.

Gensler’s arrival, and the appointment of John Coates as the acting director of the division of corporation finance were applauded by governance-focused activist Trillium Asset Management. Jonas Kron, director of shareholder advocacy at Trillium, argues that the SEC “is poised to make significant strides forward on ESG topics.”

PROGRESS AND PROTEST

Perhaps the headline news of the SEC’s ESG initiative is a potential decision to make climate disclosures mandatory. In March, Lee announced the regulator was considering introducing processes for companies to submit “consistent, comparable, and reliable information on climate change.”

The framework for such a process remains unclear, though the regulator opened a public comment window that closed in mid-June, seeking opinions on which metrics could be best measured, and other avenues the SEC could explore.

Public comments on the proposal has drawn clear battle lines. On one side, critics from the U.S. Oil and Gas Association have argued the SEC does not have the power to introduce such changes, and accused it of attempting to “aggressively regulate” what information companies share.

On the other side, Pimco Chief Investment Officer Scott Mather welcomed the proposal, saying that without a standardized criteria for companies to disclose, investors have found it difficult “to obtain reliable, timely, and comparable insights into companies’ climate footprints.” Senator Elizabeth Warren applauded the move too, while urging the regulator to consider tailoring disclosure requirements on a sector-by-sector basis.

BACKTRACKING

The SEC has also shown greater leniency for shareholder proposals, denying companies the exclusion requests that might have passed unquestioned in previous proxy seasons.

Rather than being a radical shift from the regulator, Kron said it reflects a return to normality for the SEC. “The SEC’s approach to climate change shareholder proposals under [former] Chairman [Jay] Clayton was deeply and blatantly flawed,” Kron said.

In June, Gensler announced the SEC will not enforce new rules on proxy voting advisers that were introduced under his predecessor, drawing criticism from Republican Commissioners Hester Peirce and Elad Roisman. The SEC has also been sued by a handful of shareholder proponents, seeking a reversal of new submission and resubmission thresholds for shareholder proposals. Despite the pushback, the ESG revolution could have a lot of room left to run.
Staying Ahead of the Curve

With sustainability increasingly becoming a critical component of core business decisions, FTI’s ESG Advisory end-to-end solutions help companies protect their license to operate and secure continued access to capital and stakeholder support.

- **Board Advisory**
  Evolve the governance and oversight of your ESG program

- **ESG Assessment**
  Understand your current position

- **Materiality Assessment**
  Set your ESG priorities

- **ESG Program Development**
  Develop and implement an ESG strategy

- **ESG Communications**
  Develop an authentic narrative and engage with stakeholders

- **ESG Intelligence**
  Identify threats through ESG due diligence and investigations

- **Executive Compensation**
  Advance your ESG agenda by aligning incentives

- **Climate Change Strategy**
  Assess risks and define your approach to climate change

- **Energy Transition**
  Prioritize, procure, and finance renewable energy projects

- **Net Zero Strategies**
  Develop your net zero strategy

- **ESG Activism**
  Secure ongoing shareholder support

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ESG@fticonsulting.com
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Let’s face facts. Despite the specter of regulation and the challenge of uniform metrics, standards and measurement, ESG is here to stay.

Greater transparency is becoming a competitive advantage. Many companies are posturing to voluntarily disclose more sustainability data than perhaps may be formally required, especially on environmental measures, where corporations can align with several international regimes to prove commitment and compliance.

Environmental considerations have been a part of the corporate landscape for decades and have broad appeal among both shareholders and stakeholders, as the recent proxy contest at Exxon Mobil proved. Europe has consistently led the world with regulatory frameworks to protect the environment, endangered species, and indigenous populations even as the U.S plays catch-up.

And good governance standards have been a mainstay of responsible companies for decades, inasmuch as solid returns, accountability, and ethics are the hallmarks of well-run corporations by any measure. Even with the recent, but warranted, addition of political spending and lobbying to the ESG matrix, the body of law on corporate governance is well-established and mature.

But not so much when it comes to social factors.

As important as environmental and governance matters are, social considerations are all the more. Left unattended, social issues can ignite regulatory scrutiny, congressional oversight, and popular disdain in ways environmental and governance matters cannot. They have the potential to set the house on fire and burn it down and have led to the premature ouster of more than a few CEOs.

As such, I would argue that within the sustainability trinity, the “S” in ESG is the first among equals. Companies neglect or mismanage it to their detriment.

Activist investors know, or should know, the evolving significance of social considerations. Societal mandates have grown louder and more sophisticated following the death of George Floyd in May 2020 and will continue to influence corporate perception, if not performance. Until public companies develop more effective frameworks for dealing with these matters, especially racial equity, they remain vulnerable to headline risk and diminution in value.

Entrenched corporate policies with negative social impact could trigger outsized consumer reaction, dragging shareholder value into the doldrums. Companies alleged to have engaged in reprehensible behavior involving predatory practices, privacy failures, or prejudice are – or should be – an opportunity for activists to push for substantial improvement. Changing directors and implementing responsible policies could be just the beginning of prudent action.

In April, Amazon, BlackRock, Google, Warren Buffett, and hundreds of other companies and iconic executives, stood up to oppose the Georgia voting law and “any discriminatory legislation” making it harder for people to vote. While the jury may be out on how investors view the corporate response to voter suppression laws in the states, it is now clear that politics is on the corporate agenda with an unprecedented public spotlight. And to the extent that the voting laws have a nexus to racial equity, activists cannot afford to ignore these developments.

With billions of corporate dollars pledged to a panoply of social and environmental organizations in 2020, activist investors need to develop a more expansive view of their relationship and, dare I say, responsibility to shareholders. If they are indeed “change agents,” as one hedge fund manager boasted, then change must not only include the replacement of a few directors at the top – even if they are diverse – but also a clear-eyed look at a company’s mission, values, and purpose.

Adonis Hoffman is CEO of The Advisory Counsel LLC, a leading minority owned advisory firm providing ESG, DEI and proxy advisory counsel to investors, institutions and corporations. He is a lawyer and serves as chairman of the American Social Impact Foundation. Hoffman served in senior legal roles in the U.S. House of Representatives and the FCC and is the author of Doing Good – the New Rules of Corporate Responsibility, Conscience and Character.
**Environmental Shareholder Proposals**

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*As of June 18. Source: Insightia | Proxy Insight Online

**Successful Shareholder Proposals**

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<td>2019</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>2020</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>2021*</td>
<td>12</td>
<td>5</td>
</tr>
</tbody>
</table>

*As of June 18. Source: Insightia | Proxy Insight Online

**Social Shareholder Proposals**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
<th>(29%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>28</td>
<td>29%</td>
</tr>
<tr>
<td>2019</td>
<td>34</td>
<td>24%</td>
</tr>
<tr>
<td>2020</td>
<td>29</td>
<td>28%</td>
</tr>
<tr>
<td>2021*</td>
<td>34</td>
<td>31%</td>
</tr>
</tbody>
</table>

*As of June 18. Source: Insightia | Proxy Insight Online
SAY ON CLIMATE PROPOSALS

SHAREHOLDER PROPOSAL

PASS  4  FAIL  4

MANAGEMENT PROPOSAL

PASS  15  0

NUMBER OF “SAY ON CLIMATE” PROPOSALS BY PROPONENT AND OUTCOME.
DATA SINCE “SAY ON CLIMATE” PROPOSALS BEGAN IN 2020.
NOTE: DATA IN THE ABOVE CHART ARE GLOBAL. IN THE U.S., ONE OUT OF FOUR SHAREHOLDER PROPOSALS REQUESTING A “SAY ON CLIMATE” VOTE HAVE BEEN SUCCESSFUL, WHILE THE TWO MANAGEMENT PROPOSALS ON CLIMATE TRANSITION PLANS BOTH PASSED.

ESG ACTIVISM IN THE NEWS

NUMBER OF ESG-MENTIONING NEWS STORIES BY YEAR.
*AS OF MAY 4, 2021
SOURCE: INSIGHTIA | ACTIVIST INSIGHT ONLINE

ESG WORDCLOUD

WORDCLOUD OF POPULAR WORDS WRITTEN IN ESG-MENTIONING STORIES ON THE INSIGHTIA NEWSWIRE.
SOURCE: INSIGHTIA
HOW IMPORTANT IS THE RESULT OF THE EXXON MOBIL PROXY CONTEST, AND WHAT HAS CHANGED AS A RESULT?

GABRIELLE WOLF: Engine No. 1 was a new fund that owned only 0.02% of the $250 billion market cap behemoth, yet won the support of three of the four biggest pension funds and the three largest index funds in the first major ESG-focused proxy contest. But heralding the win as the beginning of a green revolution ignores that Engine No. 1’s environmental arguments were integrally related to Exxon’s fiscal bottom line. Said another way: the Exxon vote showed that sustainability arguments can be extremely effective when they have strategic and economic merit.

CRAIG PAIS: Engine No. 1’s success in the Exxon Mobil contest shows just how significant ESG issues have become. The dissident’s victory is a warning sign to energy companies unprepared for the global energy transition: major pension funds and the largest asset managers are willing to hold boards accountable when it comes to financially material ESG concerns like climate change. Engine No. 1’s campaign may very well encourage additional ESG activism. And the firm’s success is a reminder of the importance of regularly engaging with your shareholders, including small but vocal investors.

ENVIRONMENTAL ISSUES DOMINATED THIS PROXY SEASON. WHAT GOALS ARE UNITING INVESTORS?

GW: This proxy season, environmental proposals passed in greater numbers than in prior years, particularly to reduce greenhouse gas emissions or report on lobbying activities. In addition, institutional investors moved climate narratives beyond merely supporting shareholder proposals and voted against directors for a lack of oversight over environmental risks. The results of shareholder proposals and director elections in the 2021 proxy season demonstrate the need for companies to do more than clearly communicate sustainability performance data. Prominent institutional investors are pressing companies to track progress against quantifiable sustainability goals and show meaningful improvement.

HOW SUCCESSFUL HAS THE “SAY ON CLIMATE” CAMPAIGN BEEN AND HOW SHOULD COMPANIES POSITION THEMSELVES?

GW: Three-quarters of proposals to establish an annual “say on climate” vote have failed – surprisingly, in light of the “Big Three’s” stewardship priorities. BlackRock, Vanguard, and State Street expect issuers to disclose a coherent strategy or transition plan to reduce material climate-related risks. However, large institutional investors, including State Street and some pension funds, have expressed reservations about “say on climate” votes, worrying that shareholders will express their dissatisfaction with companies’ climate strategies through a non-binding vote instead of holding the board directly accountable through director elections. For a company to garner strong voting support for its directors, it must not only disclose clear policies to manage climate risk but also provide a detailed roadmap to achieve measurable climate targets – especially if those targets are not easily achievable.

IS DIVERSITY THE NEXT BIG THING IN ESG?

CP: Given the dire need to address global warming, climate change is commonly viewed as the top priority for investors, but diversity is a close second. In the most recent proxy season, more than half of diversity disclosure proposals passed, and the “Big Three” started voting against the chairs of nominating and governance committees at companies that failed to disclose board diversity demographics or if progress on board diversity fell behind expectations. Next year, State Street will vote against compensation committee chairs at S&P 500 companies that do not disclose EEO-1 data. BlackRock expects companies to disclose EEO-1 data, and if it finds the disclosure to be inadequate, it will vote against directors responsible for human capital management. Vanguard asks companies to disclose workforce diversity measures at the executive, nonexecutive, and overall workforce levels, but has not been as prescriptive in requiring the disclosure of EEO-1 data.
When it Matters Most.
For Hedge Funds, E Leads S

Environmental issues are a more popular campaign platform with activist investors than social ones because they are easier to measure, have more support from institutional shareholders, and are arguably more profitable, writes Iuri Struta.

Just a few years ago, environmental shareholder proponents were mostly unsuccessful in pushing the world’s largest polluters and carbon-emitting companies to move away from fossil fuels, beyond sporadic improvements in disclosure. While some institutional shareholders, including pension funds and some sovereign funds were supportive of such moves, it was not enough without the weight of passive index funds like BlackRock, Vanguard, and State Street.

In recent years, however, environmental activism has moved mainstream. Jeffrey Ubben’s Inclusive Capital Partners has so far been mostly preoccupied with environmental campaigns at companies like AES and Hawaiian Electric. Engine No. 1 took on oil major Exxon Mobil on a climate change platform. Over in Europe, Bluebell Capital’s environmental complaints at Solvay and The Children’s Investment Fund’s “say on climate” are the predominant examples of ESG activism.

The triumph of environmental activism is partly surprising, since one of the first ESG-themed activist campaigns tackled a social issue. In 2018, Jana Partners and pension fund CalSTRS successfully called on Apple to introduce tools to minimize screen time among children and teenagers, arguing it was good for business and society. However, Charlie Penner, the then-Jana executive that led the fund’s Apple effort, focused on climate change at Exxon.

“S is perhaps the least quantifiable pillar of ESG,” Gianluca Ferrari, a former Shareholder Value Management director who is now working on setting up ESG activist fund Clearway Capital, told Insightia. “It is much more complex to quantify the social issues that affect a business and material social aspects are less uniform across businesses and industries, but this should not undermine their importance.” Ferrari says his fund will use a holistic approach on ESG engagement.

### Average Support for Environmental Proposals

<table>
<thead>
<tr>
<th>Year</th>
<th>BlackRock</th>
<th>Vanguard</th>
<th>State Street</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>12.0%</td>
<td>23.4%</td>
<td>46.9%</td>
</tr>
<tr>
<td>2019</td>
<td>17.2%</td>
<td>14.8%</td>
<td>14.8%</td>
</tr>
<tr>
<td>2020</td>
<td>17.9%</td>
<td>25.9%</td>
<td>51.9%</td>
</tr>
<tr>
<td>2021*</td>
<td>DATA NOT YET AVAILABLE</td>
<td>66.7%</td>
<td>75.0%</td>
</tr>
</tbody>
</table>

*As of June 18. Please note that 2021 figures are based on limited disclosure. Source: Insightia | Proxy Insight Online
In addition, support from institutional investors seems to be higher for environmental proposals. According to data from Insightia, environmental shareholder proposals at U.S.-based companies have received a record average support of 45% so far in 2021, up from 33% in 2020 and 23% in 2015. Partly, this is due to passive index funds managers raising their level of support, after years of largely voting against them.

Indeed, BlackRock, the largest asset manager in the world with nearly $9 trillion in assets, backed around 75% of environmental proposals in the first quarter of 2021, versus 10% in the whole of last year. All three index funds backed board changes at Exxon Mobil, in a watershed proxy contest focused on the company’s climate oversight.

Meanwhile, shareholder support for socially minded resolutions has also increased, but not as much. So far in 2021, social proposals received an average backing of 31%, up from 28% in 2020 and 24% in 2019.

Easier quantification and higher institutional support are not the only reasons for the environment’s primacy over social issues. Higher valuation multiples for best-in-class energy companies have led to a wave of campaigns by the likes of Inclusive Capital Partners and even Elliott Management, which pointed out that utility company Evergy could increase profits by generating more energy from renewables.

In the current circumstances, just announcing a credible environmental strategy can justify a re-rating. Energy producer AES was trading at an enterprise value to Ebitda of 7 at the end of 2018, when it announced a bold plan to reduce carbon intensity by 70% by 2030 amid engagement with Jeffrey Ubben. The following year, AES was valued at 9.5 times Ebitda, and in 2020 at 16.5 times. In an even more glaring example, Exxon shares have outperformed peers Chevron, BP, and Royal Dutch Shell in 2021, helped by Engine No. 1’s challenge to be greener after years of underperformance as the company doubled down on fossil fuel extraction.

Pushing companies to improve their environmental track record via increased disclosure, clear carbon-reduction targets, and accelerated investments in renewable energy sources could make companies attractive to environmentally mindful investors, leading to a decline in the cost of capital and a higher valuation. A good environmental strategy is no longer about being a responsible citizen only, it’s also about maximizing returns.

### Key Environmental Campaigns

<table>
<thead>
<tr>
<th>Year</th>
<th>Thesis</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>Work with the company to shift its energy production away from fossil fuels to renewable energy.</td>
<td>Board seat gained. Stock up 115% since Ubben joined the board.</td>
</tr>
<tr>
<td>2019</td>
<td>Devise plan to quantify carbon emissions and reduce them.</td>
<td>Say on climate votes increasingly adopted worldwide.</td>
</tr>
<tr>
<td>2020</td>
<td>Redirect funds from share repurchases toward infrastructure spending, including renewable investments.</td>
<td>Two settlements under which Elliott and partner Bluescape Resources won four board seats.</td>
</tr>
<tr>
<td>2020</td>
<td>Change capital allocation away from fossil fuel investments and change executive compensation.</td>
<td>Five new board members, including three from Engine No. 1 slate and Jeffrey Ubben.</td>
</tr>
</tbody>
</table>

### How Change Won

**Voting Rationales from the Exxon Mobil Proxy Contest**

**FOR**

Industry analysts have raised questions about Exxon’s overall strategy, including its approach to capital allocation amid increasing levels of debt, which has not preserved value nor driven operational efficiencies within the enterprise... We have further observed that an increasingly pressing need exists for Exxon to better align its climate strategy with (1) target setting in line with global peers and (2) its public policy efforts related to climate risks. (Vanguard)

[We believe more needs to be done in Exxon’s long-term strategy and short-term actions in relation to the energy transition in order to mitigate the impact of climate risk on long-term shareholder value. Specifically, unlike many of its peers, Exxon has committed limited capital expenditure toward the diversification of its portfolio. (BlackRock)]

[The experience and skills of the proposed four candidates would, in our view, make a positive contribution to board effectiveness and oversight, providing much-needed constructive challenge at a time of industry disruption. (Legal & General Investment Management)]
WHAT MAKES ESG ACTIVISM SO POPULAR?

The largest institutional shareholders have realized that mismanagement of ESG issues may negatively impact enterprise value. As a result, they are directly demanding that their portfolio companies better manage ESG risks and opportunities, writes Rodolfo Araujo, Head of Corporate Governance & Activism at FTI Consulting.

In a research paper we published last year about the 2020 proxy season, we found that companies with more shareholder-friendly governance practices – having fewer shareholder rights restrictions in their corporate governance programs, and boards that are independent and diverse – are more likely to have better reporting and oversight practices of ESG issues. This analysis also revealed that companies that already face a higher risk of investor opposition due to corporate governance concerns compound the risk of investor scrutiny by being laggards in the management of environmental and social issues, thus making themselves easy targets.

WHERE DO PROXY ADVISORY FIRMS STAND ON ESG ISSUES?

In the same way that boards are required to manage governance issues, including protecting shareholders against agency risk, they are also expected to manage environmental and social issues that may negatively impact shareholder value. Both Institutional Shareholder Services (ISS) and Glass Lewis have already stated that mismanagement of ESG issues may influence their recommendations on the election of directors in uncontested elections, potentially driving against recommendations. Directors should expect a similar approach from the proxy advisers to contested elections.

Another aspect is that the proxy adviser’s board assessment has become more complex. There is an overall shift happening in the evaluation of boards: from structural issues such as independence to increased scrutiny of behavioral issues such as board oversight. Meeting those governance standards is no longer enough. We see a growing case-by-case focus on boards having the right skills and experiences to exercise oversight of ESG issues.

WHAT SHOULD COMPANIES DO TO MAKE THEMSELVES LESS VULNERABLE TO ESG ACTIVISM?

The first step is to take a proactive approach to ESG management. Directors should understand what ESG risks are material to their companies and develop an ESG strategy to mitigate those risks. Companies should also realize that environmental and social issues are moving targets as society changes its expectations of how companies manage such issues.

The second step is to communicate and engage with shareholders prior to the approach of an activist. Nobody sees the great work you have been doing unless you tell your story. Anecdotally, most of our clients reported that ESG was a main driver of engagements during the second half of 2020 and this year. This type of engagement is very productive, and it should be seen as an opportunity to secure shareholder support.

Directors should never forget that anything they do or say after an activist discloses a public campaign is generally perceived as reactive by shareholders and their proxy advisers. To avoid this issue, companies need to tell their stories prior to any activist approach.

COULD WE SEE MORE PROXY CONTESTS ON ENVIRONMENTAL OR SOCIAL ISSUES?

Certainly. In addition to presenting demands, institutional investors have also become willing to support proposals brought by other shareholders or even the replacement of directors. Such a scenario offers a significant opportunity for activists. Governance issues are already heavily explored by activists to showcase how financial underperformance is connected to failures at the board level. Similarly, environmental and social issues will increasingly be part of the activist’s arsenal. For example, consider a retailer that mismanaged health and safety during the pandemic and, as a result, lost its best employees to competitors. An activist can easily link operational underperformance to talent loss and describe it as a failure at the board level.
IDENTIFYING VULNERABILITIES IS JUST THE BEGINNING

FTI Consulting does more than just point to vulnerabilities. We help clients navigate through a complex set of challenges to develop successful long-term strategies and protect against shareholder activism risk.

With decades of experience and subject matter expertise in shareholder activism and investor stewardship, our team helps clients develop winning strategies in today’s complex and challenging activism environment. FTI’s approach is grounded in an in-depth understanding of investors’ perspectives and activist approaches to prepare clients with strategy development, communications, and their engagement with shareholders and their proxy advisors. FTI’s shareholder advisory service is focused on building trust and securing support to help our clients advance their long-term objectives.

www.fticonsulting.com
activism@fticonsulting.com
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Compensation has been subject to increased investor controversy in the wake of COVID-19. As of June 18, 2021, 54 “say on pay” proposals at U.S.-listed companies failed to gain majority support, compared to 45 in the same period in 2020, according to Proxy Insight Online data.

And while some of the controversy over pay relates to the COVID-19 pandemic, a neglected part of the equation is ESG concerns. In Q1 of 2021, 10% of U.S.-listed companies which failed to receive majority support for their “say on pay” proposals also faced upwards of 50% support for shareholder proposals, compared to 6.7% of companies through 2020. In one notable example, IBM’s “say on pay” proposal received 51.3% opposition, while Nia Impact Capital’s shareholder proposal, seeking annual reporting on the company’s diversity, equity, and inclusion (DEI) programs, won 94.3% of votes.

As shareholder engagement with ESG concerns continues to accelerate, ESG metrics are fast becoming an integral aspect of compensation structures.

In response to a shareholder proposal asking Apple to implement ESG metrics into its compensation structure, which won 12.4% support at the technology giant’s 2020 annual meeting, Apple announced in January that ESG metrics will be given a 10% weighting in executive bonus incentive programs, primarily focused on sustainability and diversity targets.

Chipotle and PepsiCo have similarly tied executive annual bonuses to sustainability goals, while McDonald’s announced in February that 15% of executive bonuses will be tied to meeting racial and gender diversity reporting targets.

Social concerns have proved especially popular among investors at U.S.-listed companies this year, with 34 social shareholder proposals subject to a vote as of June 18, 2021, compared to 25 and 29 in 2020 and 2019, respectively.

The 2020 Black Lives Matter protests prompted increased investor engagement with diversity concerns, five of the nine proposals seeking diversity reporting and/or EE0-1 disclosure in the first five months of 2021 winning majority support.

“We are seeing investors saying to portfolio companies that now is the time to act boldly on equity, diversity, and inclusion,” said Jonas Korn, chief advocacy officer at Trillium Asset Management, in an interview with Insightia. “Racial justice is unquestionably one of the most significant policy issues confronting corporate America right now.”

Requests for Union Pacific to disclose its EE0-1 data and for Badger Meter to report on how it intends to advance board diversity won 86.4% and 85.3% support respectively, despite both boards arguing such resolutions were “unnecessary.”

Eight proposals seeking racial audits and racial justice reporting have also won impressive levels of support so far this year, primarily targeting banks such as JPMorgan Chase & Co. (40.5%) and Citigroup (38.6%).

Further contributing to the success of social resolutions is the Securities and Exchange Commission’s (SEC) rejection of no-action requests for proposals of this kind. The SEC has denied all nine exclusion requests for lobbying disclosure proposals so far this year, as well as all three exclusion requests for racial audits and civil rights reporting proposals at Amazon, JPMorgan, and Johnson & Johnson.

“We are encouraged that the SEC has upheld investors’ right to ask these tough questions so we can determine what our portfolio companies are doing to address the risk of systemic racism,” New York State Comptroller, Thomas DiNapoli, told Insightia in an interview. “Fortunately, some companies seem to be listening, but there’s a lot more work to do.”
**AVERAGE SUPPORT FOR SOCIAL PROPOSALS**

<table>
<thead>
<tr>
<th>Year</th>
<th>BlackRock</th>
<th>Vanguard</th>
<th>State Street</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>7.1%</td>
<td>10.7%</td>
<td>10.7%</td>
</tr>
<tr>
<td>2019</td>
<td>6.1%</td>
<td>9.1%</td>
<td>18.2%</td>
</tr>
<tr>
<td>2020</td>
<td>11.1%</td>
<td>23.1%</td>
<td>23.1%</td>
</tr>
<tr>
<td>2021*</td>
<td>Data Not Yet Available</td>
<td>Data Not Yet Available</td>
<td>Data Not Yet Available</td>
</tr>
</tbody>
</table>

Average support for social proposals at U.S.-based companies by BlackRock, Vanguard, and State Street by year. *As of June 18. Please note that 2021 figures are based on limited disclosure. Source: InsightIA | Proxy Insight Online

**VOTING RATIONALES**

**ASSESS FEASIBILITY OF INCLUDING SUSTAINABILITY AS A PERFORMANCE MEASURE FOR SENIOR EXECUTIVE COMPENSATION (APPLE, 2020)**

**FOR**
- Incorporating sustainability performance measures would incentivize executives to ensure that company performance on sustainability considerations is appropriately aligned with management’s interests, the firm’s stated commitments to social responsibility, and long-term corporate strategy. (Aviva Investors)
- Compensation committees should consider targets linking environmental and social management objectives to compensation where poor management of these can impact long-term shareholder value. (BMO Global)

**AGAINST**
- Executive compensation matters should be left to the board's compensation committee, which can be held accountable for its decisions through the election of directors. (BlackRock)
- The proposed resolution is considered to be too prescriptive. The company should be able to choose a strategy which is suitable for its context and current position. (Capital Group)

**RACIAL EQUALITY AUDITS (ALL 2021)**

**FOR**
- We believe a racial equity audit will support the company in conveying to investors and other interested stakeholders the positive steps that it is currently taking and developing. (Aberdeen Standard Investments at State Street)
- Shareholders would benefit from additional information allowing them to better measure the progress of the company’s existing diversity and inclusion initiatives. (Pensionskasse SBB at Goldman Sachs Group)

**AGAINST**
- The company’s commitments to diversity and inclusion efforts are showing signs of improvement and the company commits to future goals. (BMO Global at State Street)
- The company has board oversight of the issue, provides workforce demographics, publishes diversity and equity goals and goal progression for 2020 and 2021. It does not seem that an additional audit would provide shareholders with added benefits. (Norges Bank at Amazon)