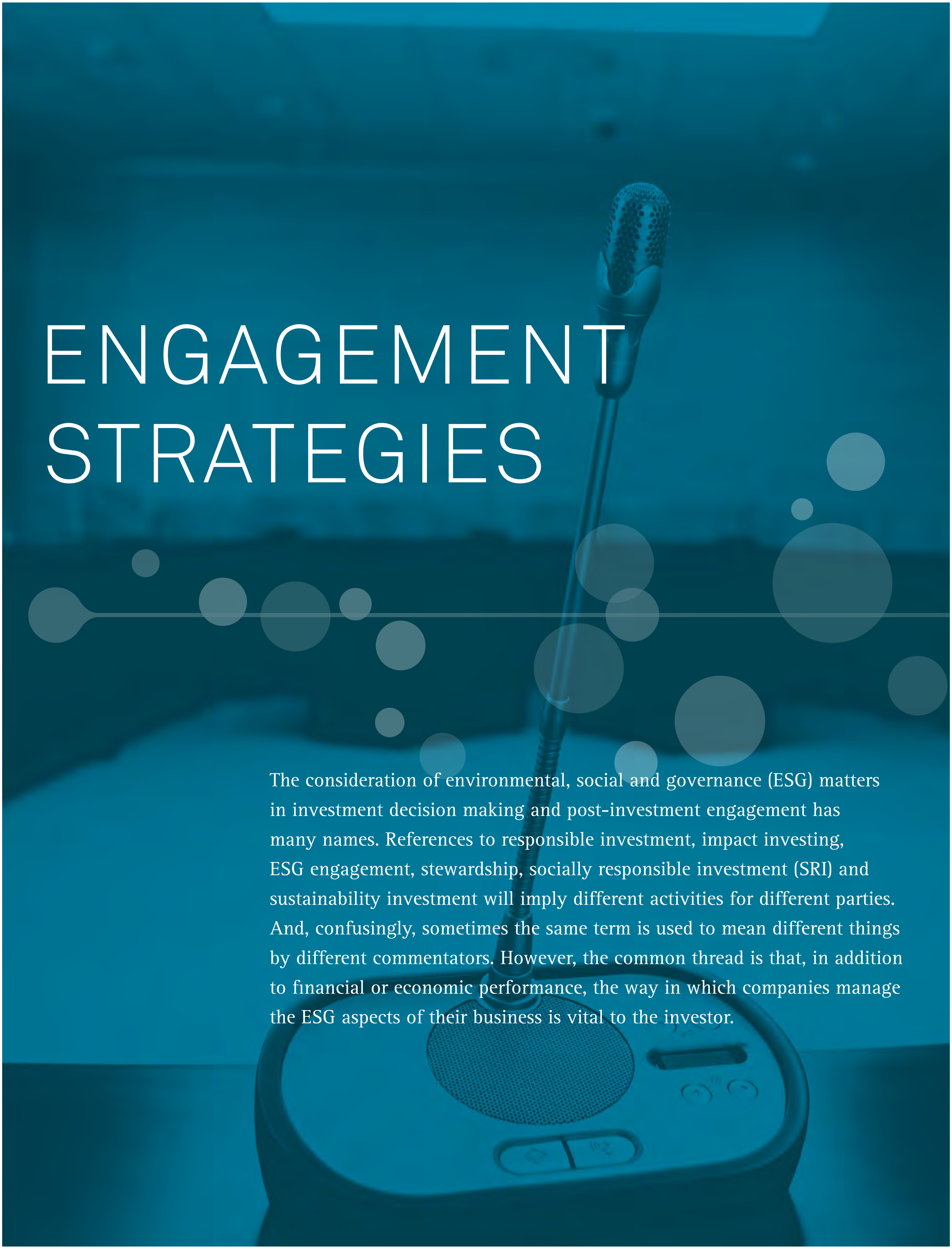


ENGAGEMENT STRATEGIES

The consideration of environmental, social and governance (ESG) matters in investment decision making and post-investment engagement has many names. References to responsible investment, impact investing, ESG engagement, stewardship, socially responsible investment (SRI) and sustainability investment will imply different activities for different parties. And, confusingly, sometimes the same term is used to mean different things by different commentators. However, the common thread is that, in addition to financial or economic performance, the way in which companies manage the ESG aspects of their business is vital to the investor.

The Significance of ESG Engagement

Michelle Edkins, BlackRock

Engagement—direct communication between investors and companies—on environmental, social and governance matters is on the rise in the United States. A number of factors seem to be driving this change. First, companies seem more interested in understanding their shareholders' views. Many are engaging with the ESG specialists at their long-term investors as part of their broader investor relations programs, which have historically focused solely on Wall Street. Second, investors are developing specialist teams to conduct those conversations, in recognition of the connection between sound ESG management and corporate resilience. And third, there is today much greater public scrutiny of companies and investors and the role they play in the economy and society more generally.

> *"The key is to make conscious decisions about whether, and where, engagement fits into the investment strategy."*

It's difficult to precisely quantify the value created by shareholder engagement. But it is easy to see the problems created in its absence—evidence of value destroyed or unattained—arguably by disengaged shareholders enabling companies' poor management of ESG matters. Even so, the value proposition for shareholders will depend on the investment mandate and consequent investment strategy. There will always be investors who determine that selling is their best option when signs of poor management emerge, just as there will be investors who see a path to long-term growth driven in part by their engagement and influence. The key is to make conscious decisions about whether, and where, engagement fits into the investment strategy.

For those inclined to engage, active investors—those analyzing companies individually to identify the better investment alternative—can use engagement to their benefit, both before and after investing. Understanding ESG business drivers at a company helps investment decision-making by enabling portfolio managers to identify the full range of potentially unrewarded risks and otherwise unidentified opportunities.

Once an investment is made, engagement is often the preferred option to selling shares in underperforming companies, particularly for those with large stakes or a long investment horizon. For investors in indexed strategies, engagement (including proxy voting) is the only option for signaling concern to companies and is often seen as a fundamental part of fiduciary responsibilities. For some, the concept of stewardship responsibilities is intertwined with investment style, requiring engagement over passivity regardless of how the investment is made.

While engagement is fundamentally about communication, it can take a variety of forms. The approach taken by an investor will be influenced by the way they invest, by their investment time frame, by their philosophy around shareholder responsibilities and, often, by the level of interest from clients or others to whom they are accountable. When there is engagement, the technique used will also be influenced by the urgency of the situation and by the responsiveness of the company.

Some investors define "engagement" as any communication with a company that enhances mutual understanding. Others believe engagement, by definition, is intended to bring about a change of approach or behavior at a company. Many see it as a continuum covering all this and more, including full-blown activism. The point is to express views and concerns to those who can do something to address them—a company's board and management.

This variety of perspectives and techniques is expertly covered in the pages that follow. They reflect not only the influences mentioned above, but also the nuanced interaction that engagement tends to be. Underpinning them all is a framework of well-thought-through policies, specific to each investor's circumstances, and the objective of protecting long-term shareholder value. Nonetheless, it is clear that ESG engagement is more an art than a science. We hope this collection of experiences provides some guidance and helps inform your own approach.

REASONS TO ENGAGE ISSUERS ON ESG TOPICS

- *Inform your proxy voting and voting guidelines*
- *Augment your research*
- *Clarify public information*
- *Identify quality of management indicators*
- *Gauge sophistication of a company's strategy*
- *Understand peer performance indicators*
- *Identify potential vulnerabilities*
- *Develop insights into investment and growth opportunities*
- *Understand potential regulatory impacts and threats*
- *Identify how companies are positioned to mitigate risks or leverage opportunities*
- *Improve your reputation as an active and engaged owner*

Laying the Foundation for Successful Engagement

Anne Sheehan and Brian Rice, California State Teachers Retirement System (CalSTRS)

Step One: "The Plan"

The first step in deciding whether an engagement program is right for you and your firm is to solicit buy-in from key decision makers, and then to memorialize your engagement approach in documentation that can be shared with the companies with which you will be engaging. For example, at the California State Teachers Retirement System (CalSTRS), we lay the foundation for our engagement program through our Investment Management Plan (Plan). This Plan is the foundation for all our investment efforts at CalSTRS, and it identifies at a high level that we will "engage corporate management to seek information and understanding of the corporate decision and its ramifications on ESG issues." Our Environmental-Social-Governance (ESG) policy serves as an overlay to the Plan, and is applied across all asset classes. The Plan is updated through internal staff analysis and recommendations to our Board. Our Board then uses independent fiduciary counsel and fiduciary consultants to fully review all investment considerations and to ensure alignment of the Plan with our fiduciary duty to beneficiaries.

Our Plan is publicly available at: www.calstrs.com/sites/main/files/file-attachments/a_-_investment_policy_and_management_plan_9-2013.pdf

> *"The first step in deciding whether an engagement program is right for you and your firm is to solicit buy-in from key decision makers..."*

Each asset class integrates the CalSTRS ESG policy into its investment implementation. We have formed high-level, cross-asset teams consistent with our total portfolio approach. These teams consist of directors, portfolio managers and investment officers from each asset class within the total CalSTRS portfolio. Each representative must consider ESG opportunities and risks not only for their own asset class but also for the total fund. These teams do not rely entirely on internally generated data, but are also responsible for working collaboratively with other members of the global investment community to further the Board's goals. Notably, we've successfully engaged with companies on issues of diversity, climate change, stranded assets, energy efficiency and sustainable business practices, all intended to produce economic growth, profits and positive cash flows across all asset classes and fully consistent with our Plan.

Step Two: Practical Implementation

Many forms of engagement can be used to potentially increase the value of your assets and to mitigate risk, including:

1. Holding **direct conversations** with portfolio companies, regulators and issue experts
2. Doing **educational outreach** with the marketplace
3. **Collaborating** with other investors, companies and advocates
4. **Convening summits** to identify and reach tipping points
5. **Soliciting** shareholder proposals
6. **Sponsoring** academic and other intellectual **analysis** on the issues, to increase market participant awareness

You will need to decide for your organization which of these forms of engagement is most appropriate for you and your beneficiaries or clients. However, it's important to note that these forms of engagement can be used for all types of investment funds and products, and may also be leveraged within specific investment allocations, or with funds intending either to capture positive impact or to explicitly mitigate risk from ESG factors, in what might be called SRI funds or products.

> *"Notably, we've successfully engaged with companies on issues of diversity, climate change, stranded assets, energy efficiency and sustainable business practices, all intended to produce economic growth, profits and positive cash flows..."*

Step Three: Develop a Focus List

Some public pension funds may have their list of ESG engagement efforts developed externally, as when they are mandated by state legislatures through prohibited or restricted investments. Other funds may have their ESG efforts developed by a fund board of directors working to establish ESG priorities that address portfolio risk issues or respond to concerns raised by beneficiaries. Finally, some funds may develop their engagement candidate lists through internal staff analysis.

Formulating a focus list can be done in several ways. A common way is to review the financial return of identified companies and then look at the worst performers over a specific period, generally one, three and five-year periods for long-term investors. CalSTRS uses a blend of both the bottom-up (or specific company) approach, and the top-down (or systemic issues) method, in designing its annual engagement plan. It is important to note that some companies do remain on engagement lists for a number of years.

For additional information on the CalSTRS approach on ESG issues, please visit: www.calstrs.com/corporate-governance-overview

METHODS FOR SELECTING COMPANIES FOR ENGAGEMENT

- *Select a consistent review period each year for the portfolio to identify outliers in terms of financial/ESG performance where it is possible to influence change.*
- *Review these factors at the companies:*

1. **Financial performance**—Are they a financial outlier?
2. **ESG ratings**—How do they measure compared to their industry?
3. **Ownership structure**—How much do you own? Is it a controlled company, or how much is owned by insiders or your peers? (i.e., to determine your ability to affect change)
4. Which ESG practices are of concern at the companies, and of those, which are most important to your organization or your clients or beneficiaries?
5. Has there been a controversial proxy vote or a controversy in general?
6. Has the company been unresponsive to majority votes on shareholder proposals?
7. Has the company worked against shareholder rights (e.g., through bylaw amendments) without shareholder approval?

Determining the Initial Approach to a Company

Anne Simpson, California Public Employees Retirement System (CalPERS)

Communication is the simple key to enable shareowners to effectively engage with companies. Yet the question of with whom, when and how to engage is not so simple. Here are some thoughts on terms of engagement for owners—how to navigate the dialogue on sustainability.

Who

When investors are concerned with sustainability issues, with whom should they engage? It is important to consider where it is appropriate to direct the issue. Is it a matter for the board of directors in its entirety? The chair or the lead director? Or a particular committee that may be responsible for the issues of concern, such as risk or audit? Is it better to address concerns to the company's staff, such as its General Counsel or Corporate Secretary? Should the matter be channeled though an Investor Relations Chief or the Sustainability Officer? Is it an issue for Public Affairs or Stakeholder Relations? Circumstances will vary according to company size, policy and circumstance.

Investors need to engage the company board, for a straightforward reason: The board of directors is appointed by and should be accountable to the company's owners. The board's chief is its chair or lead independent director, who has the role of ensuring that the board fulfills its critical role of overseeing management. One of the most important tasks for the chair or the lead independent director is setting the agenda for board meetings. If a sustainability issue seems of strategic importance, then it is entirely appropriate that the investor ask that the matter be discussed by the board and a full response be provided.

> *"Investors need to engage the company board, for a straightforward reason: The board of directors is appointed by and should be accountable to the company's owners."*

An example is climate change risk and opportunity. The Ceres-led Carbon Asset Risk Initiative is posing tough questions to fossil fuel–based energy majors about their risk scenarios, and plans to devote new capital to further the development of carbon intensive fuels, which may pose hazards to their balance sheets. These are not questions for staff, however well-intentioned. Rather, they are fundamental, strategic questions about the companies' long-term future success and critical issues in both risk management and scenario planning. As such, they are properly matters for the board.

Other issues of concern to investors may arise that are equally valuable for the board to be aware of. An example is seen in Duke Energy, which saw a massive coal ash spill at a time when precious few of its board members had any coal industry experience. Questions were raised primarily by just two investors—the New York City Comptroller and CalPERS. An investor protest can signal serious issues that a board needs to address. Massey Energy is another example, where the state of North Carolina, CalPERS and other funds engaged around the company's poor governance. This was an early cause of investor protest. When these and other health and safety disasters strike, it often becomes clear that poor governance allowed lax standards, and human tragedy followed.

(See page 28 for the case study Lessons Learned from the Massey Energy Engagement.*)*

An investor may have questions that can be answered by an explanation of current operations—for example, the company's record of compliance with particular environmental regulations. In this case, the company staff will be ready to provide information. As such, that information should be made public; which is why CalPERS supports integrated reporting in order that the ESG factors which drive value and risk are fully presented to investors, and we support initiatives like the Global Reporting Initiative and the Sustainability Accounting Standards Board which provide useful guidance. In turn, CalPERS publishes its own sustainability report[1] and our engagement guidelines in our Global Governance Principles.

Investor inquiries can be a tremendous advantage to companies. They serve as a vital early warning on issues. BP saw such an earthquake in its share price after the Gulf oil spill disaster prompted engaged investors to use their voting rights to call for the removal of the chair of the board's risk committee.

1 *CalPERS Towards Sustainable Investment & Operations: Making Progress*

> *“Investor inquiries can be a tremendous advantage to companies. They serve as a vital early warning on issues.”*

When

Companies' own flow of announcements is in part governed by the regulatory regime, which quite properly means that certain times are not conducive to conversation. Investors should take advantage of the period after companies' annual general meetings (AGMs) to have conversations about the longer term, which cannot always be addressed in the intensely busy period in the run up to the AGM. Or they should have the conversations before announcements when companies are in a closed period. It is also important to note announcements concerning retirements and appointments. In making contact with a board, check first with the Corporate Secretary whether board meetings are held monthly, quarterly or otherwise. It will be important to know when the board might discuss your issue of concern and whether it will do so before filing of the company's annual proxy statement.

How

It is always helpful to companies to have advance warning of concerns. A call is usually appreciated, be it to the General Counsel, the Corporate Secretary or the Investor Relations Chief. Better still, a letter of concern to the board can be delivered via the General Counsel or the Corporate Secretary, although addressed to the board chair or lead independent director. CalPERS usually sends hard-copy letters to board members through registered mail, and does not rely solely on email, to ensure that concerns are seen. As needed, we translate letters into local languages to facilitate communication.

Some investors use this moment to inform the press. A company's board may well be reading about the issue in the media before it has had a chance to respond to the investors' letters. CalPERS prefers to raise the issue with companies first so that boards have an opportunity to respond.

Another issue is discretion. Once discussions have begun, it is important that investors exercise discretion and, at minimum, clearly state their intentions. On occasion, investors have spoken to the media during discussions, thereby losing trust. If an investor intends to speak to the media, they should tell the company that is their plan before discussions begin.

It is important the investors set out their views clearly in advance. CalPERS has a framework of Investment Beliefs[2] which explains where ESG issues factor into our fiduciary duty to foster long-term, sustainable, risk-adjusted returns. We state that value is created from the effective management of three forms of capital: financial, human, and physical, hence our concern with integrated reporting. We also state that risk is multifaceted, and that our long-term investment horizon is both an advantage and a responsibility. Engaging with companies, intermediaries and policy makers is part of that responsibility.

If diplomacy breaks down and an agreement cannot be reached, investors will often turn to more formal methods, such as shareholder proposals. They will argue that filing a proposal is a clear way to get management's attention, if not the board's, and once investors have that attention, progress can likely be made.

The situation can vary both at the company and with the shareowner. If both sides navigate with care, then engagement can be fruitful. Shareholder votes on sustainability resolutions are rising, year after year, so there is good reason to engage with companies before the voting season begins.

2 CalPERS Beliefs

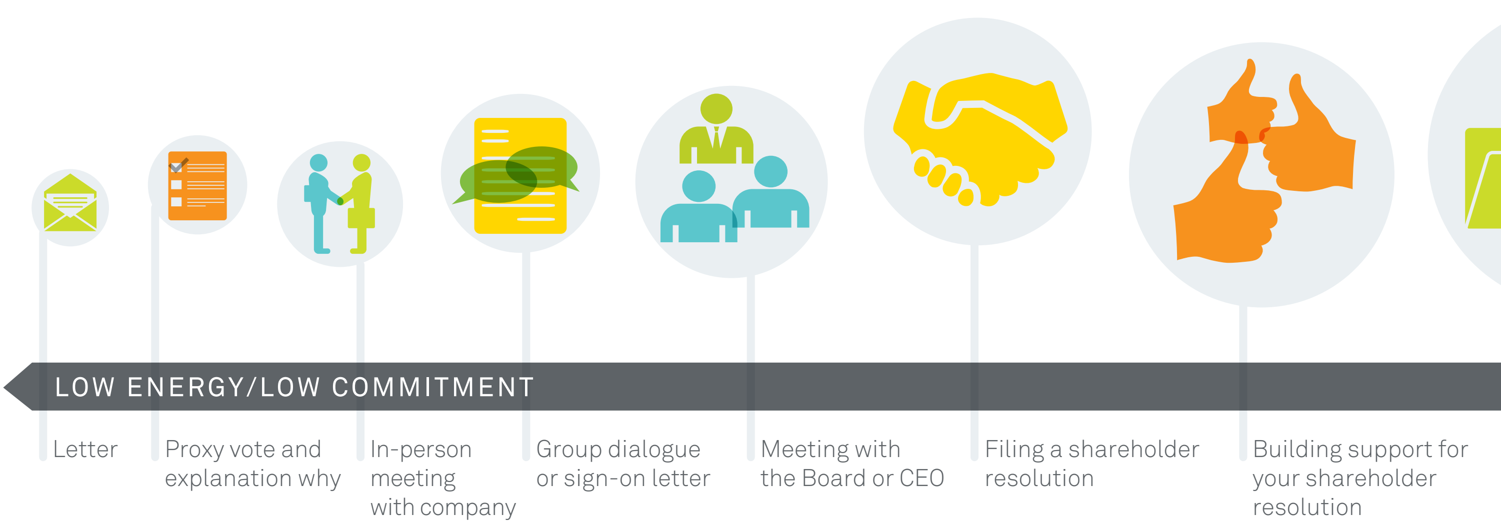
Tailoring Your Engagement Plan

Tracey C. Rembert, Ceres

No matter the level of resources you can devote to engaging with companies, there are situations where certain strategies are more appropriate to use than others. Engagement strategies range from sending letters and making phone calls to informed proxy voting, filing a shareholder proposal or attending an annual meeting and making remarks. They can also include dialogue with a company or with a large group of shareholders, having private communication with company experts or targeting directors through "vote no" campaigns and other board-focused strategies. Whichever strategy is used, research, follow-through and setting clear expectations are a must for successful engagement.

Fitting the right engagement strategy to the relevant corporate context can be tricky, but a few questions can help guide you in selecting the strategy that might be most effective:

1. **Has the company or its board ignored repeated attempts by yourself (or other shareholders) to discuss needed improvements, increased disclosure or greater risk oversight?** Then perhaps shareholder collaboration or public strategies are actually what are needed.
2. **Has the C-suite become so entrenched and recalcitrant that private measures no longer have traction?** If so, the board may be a better target for communication.
3. **Do you know if other shareholders share your concerns?** If so, collaboration with other investors will be easier and more effective.
4. **Are investors already engaging on the company or industry and topic?** Do your homework to make sure you are not duplicating effort, or that companies are not approaching an issue with a divide-and-conquer strategy.
5. **Is your engagement focused on multiple asset classes?** If so, you will need different tools for them and must set different expectations for outcomes.
6. **Are you worried that public knowledge of your engagement might harm the company's reputation or impact the share price?** Then keeping dialogue confidential might be your best option.
7. **Do you prioritize deep and long-term relationships with some of your core holdings?** Then holding an in-person meeting with the Chief Executive or board members might get you further than meeting merely with a company expert.
8. **Do you have access to a company's board or the CEO?** It might be more effective, and use fewer resources, to start at the top.
9. **Does the company have a respected internal advocate on the topic of concern?** If so, meeting with junior staff might produce more lasting results if that person can help build buy-in internally.
10. **Have you held the company for a number of years, and do you plan to continue holding for years more?** Again, this might prioritize more direct and high-level contact with a company, even if you are a smaller shareholder.



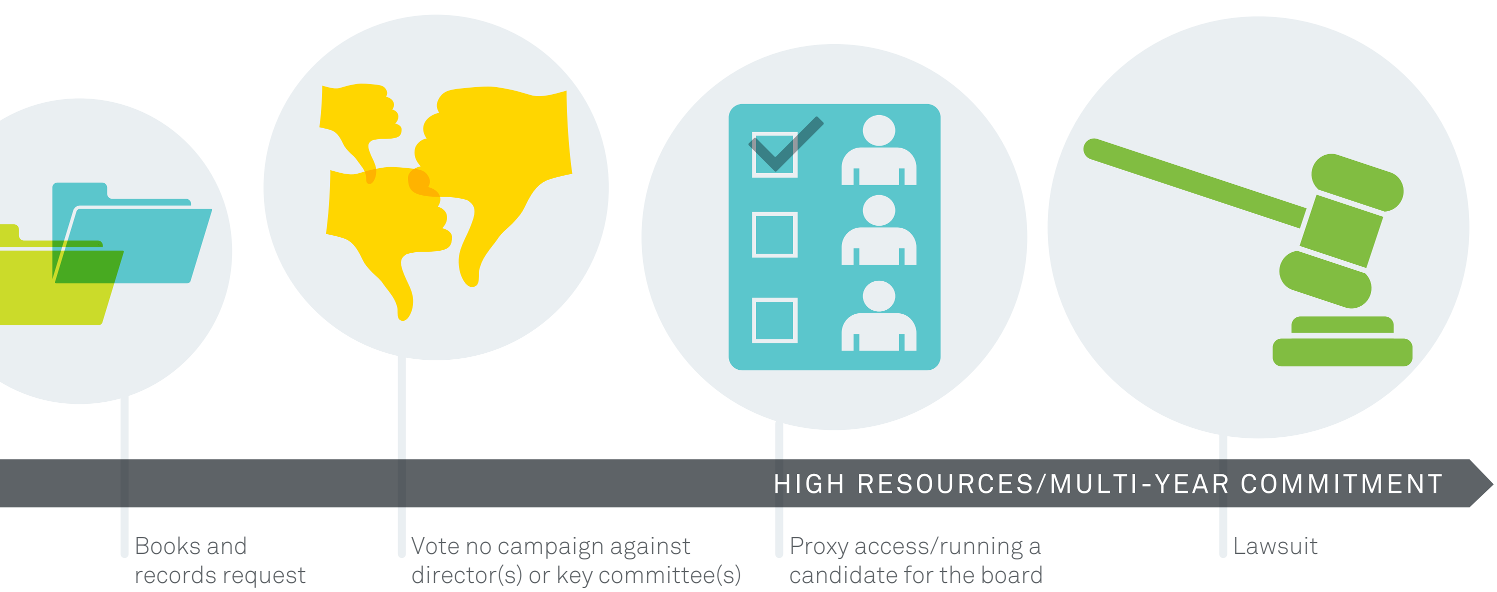
> *"Whichever strategy is used, research, follow-through and setting clear expectations are a must for successful engagement."*

Once you have figured out which companies you'd like to focus on, you've lined up support internally to engage them, and you've determined how you want to initially approach a company, then it's time to jump in and test the waters. The strategies on the following pages, shared by leading experts in governance and ESG engagement, are only a few of many well-tested methods for communicating your concerns to corporate leaders.

We have chosen not to focus on three strategies in this guide—lawsuits, books and records requests, and proxy access—because these have, to date, either been used largely for financial or corporate governance matters, or regarding proxy access, do not have a multi-year track record of use on ESG matters (as a substantial proxy access campaign tied to diversity and carbon asset risk was just launched in late 2014 by the New York City Comptroller).

ENGAGEMENT CHECKLIST

- *Develop your institutional plan and garner internal buy-in.*
- *Do your research—both internal and hiring external—to prepare you for the engagement to come.*
- *Fine tune your issues focus and any pertinent sectors involved.*
- *Develop a focus list.*
- *Establish which types of engagement you are likely to employ as well as your level of resources to achieve your goals.*
- *Determine how you will initiate communications with the company or entity.*
- *Give the company clear guidance on what to respond to, and by what date.*
- *Be explicit about why you need the information you seek, or why you are suggesting specific management or performance changes.*
- *Prepare to measure outcomes or impacts, and plan early for needed follow-through and staff time and resources.*



Reaching Out to the Board of Directors

Brandon Rees, American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)

Shareowner engagement with boards of directors is one of the best ways to advocate for attention to material ESG issues. Here are some tips and ideas for engaging with directors effectively:

1. **Identify the best director to engage.** Research your company's board of directors and evaluate each director's background and professional experience. Generally, the best director to engage with is an independent director who is in a leadership position on the board (e.g., the lead director or a committee chair).
2. **Write a letter.** Send a letter addressed to the director articulating your concerns. Explain why your ESG issue is a concern for shareowners more broadly. Do not assume that the director is aware of the issue you are raising. Let the facts speak for themselves, and try to write persuasively, rather than argumentatively.
3. **Send the letter.** You should refer to the company's proxy statement for instructions on how to communicate with the board. You may wish to copy the entire board. In addition to sending the letter via the company, send your letter to the director's primary place of business or hand deliver the letter at the annual general meeting (AGM). Registered mail works well.
4. **Follow up.** If a satisfactory response is not received after a reasonable time, contact the director by telephone, or engage a director privately at a public forum, such as an investor conference. Or try an annual meeting of another company where the director serves on the board.
5. **Meet with the director.** If the director responds to your letter, offer to meet in person or arrange a telephone call. Consider including other shareowners in the conversation (but make that transparent to the director). Usually, a representative of company management (e.g., a Corporate Secretary or General Counsel) will also want to participate.

> *"Shareowner engagement with boards of directors is one of the best ways to advocate for attention to material ESG issues."*

In some cases, shareowner engagement with directors may not be successful. In these cases, you may decide to run a "vote no" campaign to urge shareowners to withhold their vote from the director's re-election. Alternatively, consider nominating a new director to the board by suggesting names to the nominating committee or conducting a proxy solicitation.

Here are some key steps for running a successful "vote no" campaign:

1. **Identify your fellow shareowners.** Research the proxy voting policies and contact information for key decision-makers at the company's major shareowners.
2. **Send shareowners a "fight letter."** Circulate your campaign materials as soon as practical after the company publishes its proxy statement. Consider using Broadridge Financial Solutions to forward your materials to beneficial owners who are bank and broker clients.
3. **Comply with the SEC's solicitation rules.** Under Rule 14a-2(b)(1), "vote no" campaigns are generally exempt from certain SEC proxy rules so long as you do not seek to act as a proxy for other stockholders. However, if you own more than $5 million in shares, you must file your materials and a "notice of exempt solicitation" with the SEC under Rule 14a-6(g).
4. **Educate proxy voting advisors.** Share your campaign materials with key proxy voting advisors, such as Institutional Shareholder Services and Glass, Lewis.
5. **Contact the proxy voters.** Although many institutional investors will not disclose how they plan to vote, call their proxy voting staff to explain your concerns.
6. **Publicize your campaign.** Talk to reporters who follow the company, industry, or issue area, and use social media, like blogs and networking sites.
7. **Attend the annual general meeting.** Speak from the floor at the company's AGM to voice the concerns of shareowners that supported your campaign.

Engagement Through the Proxy Vote

Michael McCauley, State Board of Administration (SBA) of Florida

The State Board of Administration (SBA) of Florida frequently attempts to influence and make improvements in the corporate governance structures and ESG practices of individual companies we own. We achieve these objectives through a number of different, but integrated, strategies. One element of these efforts includes the development of comprehensive corporate governance principles and proxy voting guidelines. Managing stock ownership rights and the proxy vote includes the establishment of written proxy voting guidelines, which must include voting policies on issues likely to be presented, procedures for determining votes that are not covered or that present conflicts of interest for plan sponsor fiduciaries, procedures for ensuring that all shares held on the record date are voted, and procedures for documentation of voting records and making them transparent. The SBA's proxy voting guidelines reflect internationally recognized governance practices for well-managed public companies, covering the independence of boards of directors, performance-based executive compensation vehicles, high-quality accounting and audit practices, and emerging ESG issues of concern, as well as transparent board procedures.

> *"We achieve these objectives through a number of different, but integrated, strategies. One element of these efforts includes the development of comprehensive corporate governance principles and proxy voting guidelines."*

Through the development and implementation of comprehensive principles and proxy voting guidelines, the SBA ensures that our proxies are voted consistently across all portfolios and market structures. We are reliant on our Corporate Governance Principles to direct our activities related to ESG engagement and proxy voting. These principles, in conjunction with other relevant policies, set the parameters for company engagement and provide a framework for our initiatives. The SBA's Proxy Voting Guidelines are formulated and revised in accordance with these principles, on at least an annual basis.

Our voting guidelines are based on rigorous empirical research, industry studies, investment surveys, and other general corporate finance literature. SBA proxy voting policies are based on both market experience and balanced academic and industry studies, which aid in the application of specific policy criteria, quantitative thresholds, and other qualitative metrics. Empirical citations provide evaluation of specific items over long time frames, in excess of three years—and also are applied extensively, analyzing companies of various sizes and geographic locations.

Although we believe that it is essential to confront corporate boards with poor oversight practices, we also recognize the necessity of allowing boards to direct the businesses that they have been entrusted to oversee without excessive interference; therefore, we do not attempt to impose highly prescriptive procedures upon the companies we own. However, to balance our position, we vote "against" any proposal that limits shareowner rights or makes it more difficult for shareowners to have a voice in company practices, as well as certain board structures, super-majority requirements, and others.

Frequently, the SBA discusses proxy voting issues and specific ESG topics directly with owned companies. For example, we may write letters to members of a board to communicate our general or specific concerns. Less frequently, we may seek opportunities to meet with individual directors or committees of the board to express similar views or submit shareowner proposals for approval on a company's proxy statement. Incorporating the information achieved through direct engagement helps the SBA to make better voting decisions, with an opportunity to apply timely and nuanced factors within our decision-making process.

The SBA discloses all proxy voting decisions once they have been made, several days before the date of the shareowner

"Although we believe that it is essential to confront corporate boards with poor oversight practices, we also recognize the necessity of allowing boards to direct the businesses that they have been entrusted to oversee..."

meeting. Disclosing proxy votes prior to the meeting date improves the transparency of our voting. Disclosing votes in advance of their effective dates emphasizes the SBA's position on corporate governance and ESG practices.

Our votes across all primary ballot items and topics of focus are compared to other major investors' voting decisions (generally the largest or top five shareowners) as well as to the entire voting market. In addition to benchmarking voting against other market participants, the SBA regularly evaluates the policy frameworks implemented by our external proxy advisors. Vote benchmarking helps shareowners identify new topics requiring policy treatment within their own guidelines. Finally, a comprehensive report is published for our stakeholders annually, providing a detailed summary of voting results across a variety of topics and highlighting significant trends in company engagement and regulatory changes.

VOTING: IT'S ALL ABOUT COMMUNICATION

Vicki Bakhshi, F&C Investments (Part of BMO Financial Group)

Proxy voting is one of the main levers investors have to promote high standards of governance at the companies they own. Yet too often, as long as their resolutions are passed, company attention to shareholder views fades the day the AGM ends. At F&C Investments, we believe there is great value in engaging with companies not only ahead of the ballot, but also afterward, by highlighting to companies when we have voted against management, and telling them the reasons why.

When we cast a vote, we record comments, summarizing the rationale behind our voting decisions. These comments are entered into our service provider's platform when the vote is executed, and are published the day after the meeting.

In principle our commitment could end there. Some particularly diligent companies might then go to F&C's website and look up the reasons for our voting decision; but realistically this will be a small minority. We believe we have a duty to go further, and that it is part of our responsibility as shareholders to actively alert companies to the decisions we have taken.

We therefore write to all companies where we have opposed at least one resolution or board nomination to alert them to this, and to direct them to our online vote reporting where they can find out the reasons why. In 2014, this meant contacting over 3,500 companies, by email and letter. We receive responses from companies keen to secure our support in future years—some reassuring us about their commitment to good governance and sound ESG practices, and others asking for further dialogue about our voting decision and the standards we apply.

Where our vote was accompanied by active engagement, we will often write a more personalized letter directly to the Chairman, summarizing the reasons for our final decision. This helps to put our engagement definitively on the record and serves as a point of reference for the next year's vote. Such letters can also help to provide internal leverage for those within companies pressing for improved standards, by giving them evidence of investor support.

Escalation Strategies: The Council of Institutional Investors' Ignored Majority Votes Initiative

Matthew Frakes, Council of Institutional Investors (CII)

The Council of Institutional Investors (CII) has long held that if a majority of investors support a shareholder proposal, the board should adopt the recommended action. Similarly, CII's policies call for directors who fail to win majority support to step down from the board. In short, CII believes that boards should take shareholder votes seriously—and act on them.

To advocate for these long-held policies and to hold boards accountable, CII has written since 1996 to all Russell 3000 companies reporting majority votes on shareholder proposals. The letters ask them to adopt the majority-recommended action and report back to CII. In 2010, CII expanded its letter campaign to call on any Russell 3000 director who failed to win majority support—a so-called "zombie director"—to step down from the board. Both efforts were launched following concerns that boards were simply disregarding these majority votes.

Company responsiveness to CII's outreach has markedly improved over the years. In the earliest days, a 10 percent response rate was considered high, and the tone of at least some responses was less than cordial. However, times have changed. By 2014, when CII sent letters to 65 companies with 78 majority votes, the company response rate had climbed to 43 percent—the same rate as in 2012 and 2013, when the majority votes included a sustainability reporting proposal that received 67 percent support at CF Industries Holdings.

> *"By 2014, when CII sent letters to 65 companies with 78 majority votes, the company response rate had climbed to 43 percent..."*

Real results have followed these increasingly robust response rates. By the start of the 2015 proxy season, companies had taken substantive action to implement 75 percent of the majority-supported shareholder proposals from 2012, 74 percent of the 2013 majority-vote-winning proposals, and 31 percent of the majority votes from 2014.

> *"By the start of the 2015 proxy season, companies had taken substantive action to implement 75 percent of the majority-supported shareholder proposals from 2012..."*

Still, more than half of the contacted companies do not respond to CII or fail to adopt the majority-recommended action. To spotlight these non-responders, CII tracks all letters sent—including the reason for the letter and the number of consecutive years similar letters have been sent to the company—and makes all responses and follow-up actions available to CII members, who frequently use this data to identify companies for special attention in the following year.

CII plans to continue this program, which it believes has been highly successful in holding boards accountable for their actions and keeping shareholders informed of company responsiveness.