

### How does our ESG team enrich our investment research and increase our risk awareness?

Our ESG team is a key resource for our firm's portfolio managers and analysts across industries and disciplines. Examples of how we work with investors include:

- Research and provide company- and sector-specific ESG analysis
- Engage directly with company management teams on ESG topics
- Analyze and execute proxy voting for over 5,000 company meetings
- Perform portfolio reviews to identify holdings with the greatest ESG risks and opportunities

# The impact of ESG engagement

A CRITICAL COMPONENT OF ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE (ESG) INTEGRATION at Wellington Management is meeting with companies to discuss ESG issues. We learn about their perspectives and approaches, provide them with feedback on how they can improve, and incorporate our findings into our research. This process plays a vital role in identifying, understanding, and appropriately considering ESG risks.

Increasingly, we find that ESG issues have a quantifiable impact on the performance of the companies that we invest in on behalf of our clients, globally. Some recent examples include:

- **Environmental:** A large US food and beverage company reported that it has achieved nearly US\$15 million per year\* in cost savings by improving its water efficiency.
- **Social:** An Asian automobile manufacturer announced that it expects to spend US\$363 million\* on product recalls due to concerns over its product safety and supply chain.
- **Corporate governance:** A South American oil and gas company recognized a US\$2 billion\* loss due to acts of corruption.

Given the impact that issues like these can have on financial performance, we believe it is our fiduciary duty to integrate ESG analysis into our investment process to help pursue better investment results for our clients.

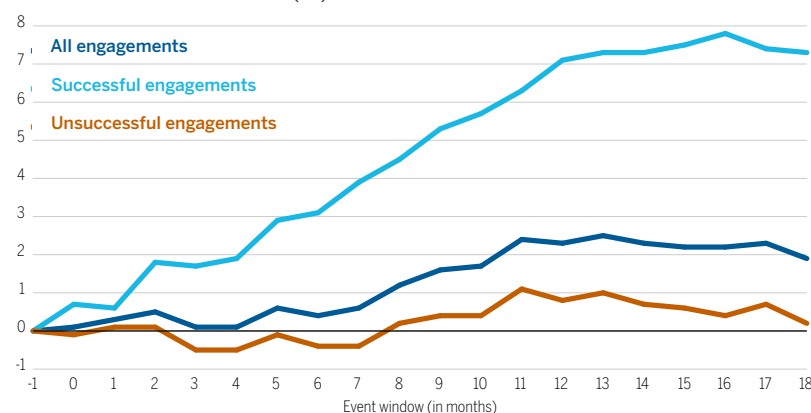
### ESG engagement can have a positive effect on stock performance

Research suggests that engaging with companies on ESG-related topics is associated with better stock performance. FIGURE 1 shows abnormal returns (the difference between actual and expected returns) of 2.3% in the 18 months following the first ESG meeting — regardless of whether that engagement caused a change in corporate behavior. Abnormal returns following successful ESG-related engagements, where the dialogue accomplished previously identified objectives, were even greater: 7.1% over 18 months.

FIGURE 1

#### Better performance follows successful ESG engagements

Cumulative abnormal return (%)



Past performance is not a guarantee of future results. | Source: Credit Suisse, *Credit Suisse Global Investment Returns Yearbook 2015*, p.25; Dimson, Karakas and Li (2015); Fama-French size decile returns from Professor French's web site, <http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/>.

\*All example data has been sourced from specific company reports.

*“The relationships we build over many years with company management teams allow us to more easily engage on ESG topics, and ultimately yield insights that we integrate into our portfolio decision making.”*

— Brendan J. Swords, CEO



The analysis, which is based on data from 2,152 engagements by a large active institutional investor for 613 publicly listed US companies from 1999 – 2009, found an 18% “success rate” (desired outcomes were achieved) for engagements, which typically included two to three interactions during a one- to two-year period.

### Integrating engagements into our ESG research

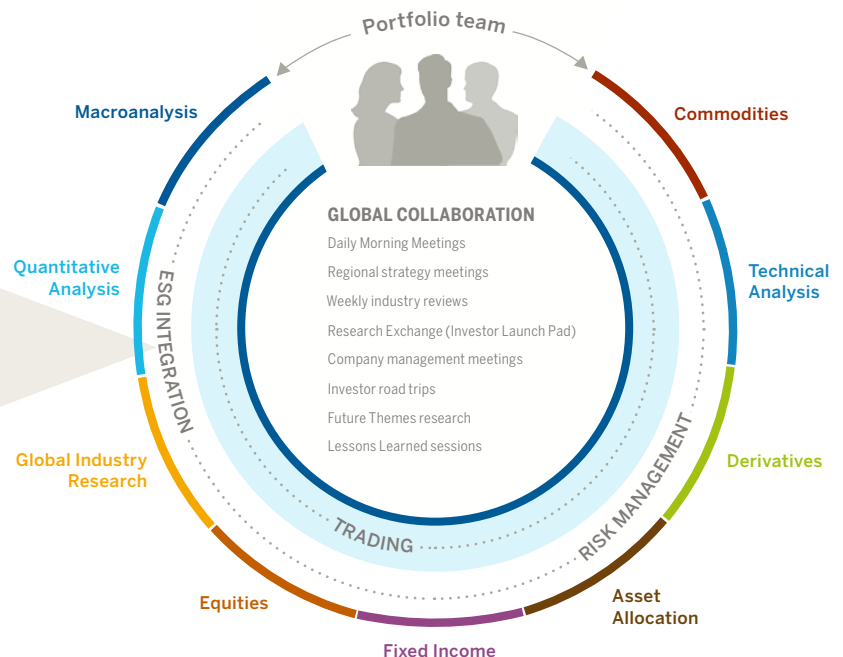
As a firm with a long history of conducting independent fundamental research, direct engagement with company managements on a range of issues has always been a core part of our investment process. Having a dedicated ESG team that conducts ongoing dialogue with companies is a powerful tool that our investment teams can leverage. Specifically, a company management team’s responsiveness to our feedback on ESG issues is a key input to our overall ESG research process. And since our ESG team has built internal systems to methodically track the discussion points from each meeting, feedback that we provided, and action items from all of our historical ESG engagements, these internal tools offer us an exclusive look at how companies have performed on ESG over time.

### Partnering with our investment colleagues

In addition to the research we gather directly from company meetings, we also receive ESG data, ratings, and research from over 400 external providers globally. We assess this data, in collaboration with our Global Investment Research and Macroanalysis teams, and employ a proprietary algorithm to produce sector- and market-neutral ESG ratings on companies. Through the culmination of our research and ratings efforts, we often discover new areas and opportunities for discussion topics in future engagements. This iterative cycle between ESG engagement, research, and ratings provides our portfolio teams across the firm with actionable ideas that they can incorporate in their investment decisions (FIGURE 2).

FIGURE 2  
Our firmwide ESG process

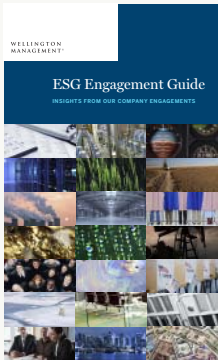
#### ESG Team



FOR PROFESSIONAL OR  
INSTITUTIONAL INVESTORS ONLY

Want more engagement examples?

Read our *ESG Engagement Guide*, which provides a look into how our ESG analysts engage with public companies and offers sample ESG questions. Please contact your relationship manager to request a copy.






Voting at shareholder meetings is a key element of company engagement

Proxy voting is another powerful tool for our ESG and investment teams, providing leverage in engagements with company management teams and also the opportunity to directly change corporate policy. Many of our clients ask us to vote company proxies on their behalf for their portfolios, and we take that responsibility seriously. We have policies and procedures designed to ensure that we collect and analyze relevant information, including our considerable ESG research findings, for each meeting; apply our proxy voting guidelines accurately; and execute the votes in a timely manner. Portfolio managers and analysts — supported by our Corporate Governance Committee, which represents the firm’s diverse investment views — have discretion to vote proxies in the best interests of each client portfolio they manage.

Results of our ESG engagements

We use the results of our company engagements on ESG topics in two ways: as inputs to our ESG research and to work with the companies we invest in to help them improve on the issues we believe are material to their performance. Some of our recent engagement examples can be seen in **FIGURE 3**.

FIGURE 3  
Recent Wellington Management ESG engagement examples

	Issue	Outcome
	<p><i>Environmental disaster</i></p> <p>We met with a utility company following a major environmental disaster to convey our disappointment at how it was handled and to urge the company to consider adding environmental management expertise to their board.</p>	<p>The board responded to our input and appointed a science and environmental expert to the board.</p>
	<p><i>Conflict minerals*</i></p> <p>The ESG team spoke with an auto parts company to discuss their supply-chain-management system, and their process for tracking, auditing, and reporting on their use of conflict minerals.</p>	<p>While impressed with the company’s supplier policies and smelter oversight, we encouraged them to set specific goals for their suppliers. Interestingly, the company informed us that we were the first investment adviser to inquire about ESG issues.</p>
	<p><i>Executive compensation</i></p> <p>After a large health care company failed their “say-on-pay” vote, we met with the company four times over the course of the next year to offer improvements to their executive compensation plan.</p>	<p>The company redesigned its executive pay plan to diversify how performance is gauged and lengthen the performance measurement period. Shareholders valued the redesign and subsequently supported the proposal.</p>

\*Conflict minerals are defined as any mineral or mineral derivative determined by the US Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires companies to report where the minerals used in their products originate. | Source: Wellington Management

*“My team has found that keeping track of how companies handle ESG issues can be a phenomenal early warning system. Each quarter we get a stock-by-stock ESG report card and then meet with our in-house ESG team to discuss whether we should take action. For us, keeping track of ESG considerations is an alpha tool and performs an important risk function — that’s why we’re so serious about it.”*

— Kenny Abrams, Equity  
Portfolio Manager



**Incorporating ESG engagements into the investment process**

Each day during Wellington Management’s Morning Meeting, investment professionals share ideas, debate investment perspectives, and investigate how these ideas and perspectives can benefit our clients. Our ESG ratings are integrated into the Morning Meeting and posted on the various live data displays that are shown as the discussion and debate progresses.

Separately, to help investors assess ESG risks and opportunities at the portfolio level, the ESG team conducts in-depth portfolio reviews that leverage our research, ratings, and engagements to identify companies within the portfolio exhibiting the greatest ESG risks and strengths (see **Figure 4**). Through this process, we highlight whether the portfolio manager is underweight the positively rated companies or overweight the negatively rated ones. The ESG team then meets with the portfolio manager to discuss possible courses of action. Depending on the portfolio manager’s investment style and philosophy, action items typically include a mix of further engagement with management teams and adjustments to portfolio weightings.

**Improved risk/return profiles for our clients**

ESG is just one of many inputs in the overall risk/reward mosaic of investing. However, integrating these factors into the investment process can have a material impact on investment performance, as well as risk mitigation. Risk management has garnered more attention in recent years as institutional investors have increasingly come to view ESG integration as tail-risk management. Investment managers who are able to integrate ESG considerations into their processes may be better positioned to assess risks and opportunities in client portfolios. We believe our robust, integrated process benefits our clients over the long term. ■

FIGURE 4: Sample ESG Portfolio Review

The ESG team uses its research and engagement efforts to assign each portfolio holding a rating of 1 through 5; a score of 1 indicates outperformance on ESG issues and 5 indicates underperformance on ESG issues. We then use these scores to generate our ESG Portfolio Review, where we identify specific and actionable ESG issues by highlighting the portfolio positions that receive the highest and lowest ESG scores.

	High-scoring ESG companies		Low-scoring ESG companies	
	Company	Score	Company	Score
Overweight positions	Automobile manufacturer	1	Metals company	5
	Software provider	1	Airline	4
	Bank	2	Semiconductor builder	4
	Food products distributor	2	Pharmaceutical firm	5
	Capital goods manufacturer	1	Chemicals company	4
Underweight positions	Machinery company	1	Apparel maker	4
	Bank	2	Beverage company	4
	Oil & gas company	1	Internet provider	4
	IT provider	1	Oil & gas company	5
	Biotech firm	2	Media company	5

For illustrative purposes only. Not representative of an actual investment or underlying allocation. | Source: Wellington Management

## PRINCIPLES FOR RESPONSIBLE INVESTMENT

Our firm also collaborates with a number of ESG-related investor networks such as the United Nations-backed Principles for Responsible Investment (PRI). The PRI is an international network of nearly 1,400 investors — including more than 900 investment managers and representing more than US\$59 trillion — working toward putting responsible investment practices in place globally.\*

### PRI presentation

Wellington Management's director of Macroanalysis, Spencer Glendon, delivered the keynote address at the United Nations Principles for Responsible Investment (UN PRI) annual conference last year in Montreal. His thought-provoking presentation examines why, despite great advances in education, science, and technology, the world has been unable to solve some of its biggest problems. Watch the [video replay\\*\\*](https://www.wellington.com/en/publication-page?article_id=2276&publication_types_id=396&asset_class_id=14&filter_nid=2276) of Spencer's speech, entitled *Each, Every, and Altogether: Specialization, Diversification, and the Conundrum of Responsibility*, in its entirety.



\*Source: [www.unpri.org](http://www.unpri.org)

\*\*[https://www.wellington.com/en/publication-page?article\\_id=2276&publication\\_types\\_id=396&asset\\_class\\_id=14&filter\\_nid=2276](https://www.wellington.com/en/publication-page?article_id=2276&publication_types_id=396&asset_class_id=14&filter_nid=2276)

## ABOUT THE AUTHORS



### JEFFREY BARBIERI

Jeff engages with companies on governance issues, conducts corporate governance research, and works closely with the firm's investment teams to formulate proxy-voting decisions.



### HILLARY FLYNN

Hillary conducts in-depth research and engages with company managements to identify and assess risks. This analysis informs the customized ESG portfolio reviews she provides to our investment teams.



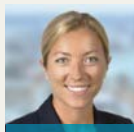
### TIM MCCARTHY, CFA

Tim is the director of Investor and Counterparty Services. He oversees the firm's research relationships, market-data services, counterparty risk, due-diligence efforts, and our ESG integration and proxy-voting efforts.



### ANDREW MORALES

Drew works with our portfolio managers and investment teams to identify and assess ESG risks and opportunities within the companies they hold in their portfolios. He also engages with companies on ESG issues and works with our investment teams to integrate this data into the investment process.



### CHRISTINA ZIMMERMANN

Christina is a tenured ESG specialist who works closely with Wellington Management's portfolio managers and analysts to help identify and assess ESG risks within investable companies. She leads our ESG research and engagement efforts at the firm.





The Morning Meeting at Wellington Management

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