The Investor Rationale for Responsible Investment

As an institutional investor, Wespath Investment Management adheres to our obligation as a prudent fiduciary. As a division of the General Board of Pension and Health Benefits of The United Methodist Church, we also understand that financial transactions carry ethical implications. These two perspectives form the basis of our well-rounded investment strategy, which utilizes traditional financial metrics and also considers the investment risk caused by environmental, social and corporate governance (ESG) practices.

When ESG risks are identified in companies whose shares we hold, we attempt to engage the company's management in dialogue and persuade them to take steps to reduce the risk to the company's operations and shareholders. Often, these conversations continue over the course of several years.

This paper documents the relationship between shareholder value and Wespath's five advocacy priorities:

I. Sustainability Reporting
II. Environment
III. Social
IV. Corporate Governance
V. Health

Each section begins with a brief introduction to the issue. This is followed by the investor perspective section, which describes the business case for the issue, and concludes with The United Methodist Church position. Appendix I describes how the advocacy process is implemented by Wespath's expert staff.

I. Sustainability Reporting

Introduction

To produce a sustainability report, an organization will evaluate, quantify and report on the impact of its ESG practices on their business. Such disclosure of ESG policies, programs and performance allows investors to identify and evaluate potential sources of financial risks and/or opportunities within their portfolio. As shown under "The Investor Perspective," research supports our belief that ESG factors can be material to corporate financial performance.

Since 2003, we have encouraged companies in which we invest to evaluate the impact of its ESG policies and practices on the long-term sustainability of their business and to publicly report on their findings. These reports are commonly called "Sustainability Reports" or "Corporate Responsibility" reports, and are typically available on corporate websites.

The Investor Perspective

According to the Corporate Register (www.corporateregister.com), approximately 4,000 companies published sustainability reports in 2010, a 63% increase from just three years earlier. Nearly half of the companies are European, another 15% from North America and Asia, and the remainder from other continents.

Through the process of sustainability reporting, companies have stated they are often able to improve efficiencies and save millions of dollars in tangible areas such as:

1. Energy conservation
2. Water conservation
3. Better supply chain management
4. More efficient use of raw materials
5. Less waste

However, intangibles also play an important role in corporate finances. Strong ESG policies and practices can protect brand reputation, help recruit and retain talent, foster customer loyalty, and reduce the risk of lawsuits. In the *2009 Intel Corporate Responsibility Report*, Paul S. Otellini, president and CEO of the company, stated: "Our approach has created value not only for our stakeholders and society, but also for Intel. We have reduced costs through energy conservation investments, minimized risks by proactively working with our communities and supply chain, and enhanced our reputation as a leading corporate citizen by building trusted relationships around the world."

The following studies and reports discuss the link between ESG factors and financial performance:

- The United Nations Environment Program Finance Initiative (UNEP FI) examined the publications of sell side research houses, asset managers and an investment consultant to determine if ESG factors affected company value. Among the findings:
    1. ESG issues are material; there is robust evidence that ESG issues affect shareholder value in both the short and long term.
    2. The impact of ESG issues on share price can be valued and quantified.
    3. Material ESG issues are becoming apparent, and their importance can vary between sectors.[1]

- In a 2010 survey of 1,500 global corporate executives, there was a strong consensus that sustainability is having – and will continue to have – a material impact on how corporate executives think and act. More than 92% of respondents said they were addressing sustainability in some way. Most were in the early stages of incorporating sustainability into their strategic planning; however, a small number are acting aggressively and reaping substantial rewards. Once companies begin to act, they tend to find more opportunity than expected, including tangible bottom-line impacts and new sources of competitive advantage.[2]

- After surveying nine major brokerage firms, such as ABN AMRO, HSBC, Deutsche Bank and Goldman Sachs, "There was agreement that environmental, social and corporate governance issues affect long-term shareholder value. In some cases those effects may be profound."[3]

- A meta-analysis of 52 studies examining the link between corporate social performance and corporate financial performance found a positive correlation between the two. The relationship varied from modestly positive to highly positive, and carried across industries.[4]

United Methodist Instruction

In 1987, the World Commission on Environment and Development, also known as the Brundtland Commission, defined sustainability as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

Resolution 4071, *Investment Ethics*, provides the basic guidelines for all United Methodist investing. It specifically encourages the entities responsible to General Conference "to invest in corporations, companies, institutions, or funds…pursuing such targeted goals as…maintaining a commitment to sustainability so that current business practices do not detract from future viable business operations," and "to persuade corporations to integrate responsible business practices on environmental, social, and governance issues into their operations and to be transparent in documenting these endeavors in public reports…"

United Methodism is keenly aware of the importance of stewardship and sustainability. In its very opening paragraphs (¶160), the Social Principles recognize "the responsibility of the church and its members to place a high priority on changes in economic, political, social, and technological lifestyles to support a more ecologically equitable and sustainable world leading to a higher quality of life for all of God's creation."

In ¶163D, the Principles call upon consumers to "evaluate their consumption of goods and services in the light of the need for enhanced quality of life rather than unlimited production of material goods" and to "express dissatisfaction with harmful economic, social, or ecological practices through such appropriate methods as boycott, letter writing, corporate resolution, and advertisement."

Recognizing that "corporations are responsible not only to their stockholders, but also to other stakeholders, their workers, suppliers, vendors, customers, the communities in which they do business, and for the earth, which supports them," … the Social Principles (¶163I) "support the public's right to know what impact corporations have in these various arenas…"

Resolution 4052, *Economic Justice for a New Millennium*, calls on "the general program agencies of the church and the General Board of Pension and Health Benefits to work with the Interfaith Center on Corporate Responsibility and support its *Principles for Global Corporate Responsibility*." The *Principles for Global Corporate Responsibility* attempt to establish benchmarks by which to measure corporate social responsibility "consistent with the responsibility to sustain the human community and all creation." Specifically, the Principles call for "a sustainable system of production and a more equitable system for the distribution of the economic benefits of production and environmental services."

II. Environment

Introduction

Globally, the cost of human activity as it affects the environment (comprised of such factors as greenhouse gas emissions, overuse of water, pollution, and unsustainable natural resource use) was estimated to be $6.6 trillion in 2008. Comparatively, this figure is 20% higher than the $5.4 trillion decline in the value of pension fund assets during the 2007/2008 global economic crisis.[5]

As a result of the diminishing availability of natural resources, companies may experience increased costs, decreased output and stricter regulatory standards. Because environmental externalities can pose material risk to investment portfolios, many investment valuation models should incorporate an assessment of environmental factors. Before this can be achieved, however, companies must consistently disclose an assessment of their environmental assets and liabilities.

Wespath supports the integration of ESG factors into portfolio construction. We regularly ask companies to measure, monitor and publicly report on many types of environmental issues. For example, we encourage companies to set goals to achieve safe and sustainable food systems, reduce waste, improve water and energy efficiency, and publicly disclose their environmental performance.

Companies regularly affirm the importance of these matters by reporting significant cost savings after implementing environmental management programs — benefits frequently amount to tens of millions of dollars.

The Investor Perspective

Climate Change

Climate change caused by higher levels of greenhouse gases (GHG) in the atmosphere is a concern of many stakeholder groups — legislators, regulators, investors, insurers and consumers, to name a few. Prudent investors are conscious of the following factors and the potential impact on their portfolios.

Financial/Competitive Risk

- In May 2009, Goldman Sachs reported, "We find that while many companies acknowledge the challenges climate change presents….there are significant differences in the extent to which companies are taking action. Differences in the effectiveness of response across industries create opportunities to lose or establish competitive advantage, which we believe will prove increasingly important to investment performance."[6]

- The 2006 Stern Review on the Economics of Climate Change, led by the former chief economist at the World Bank, estimated that the overall (worldwide) costs and risks of climate change will be equivalent to losing up to 20% of global GDP each year, now and forever. In contrast, the cost of mitigating action would be about 1% of global GDP each year.[7]

- Internationally, carbon emissions laws have already been passed in the European Union, Canada, Japan and Russia.

Legislative/Regulatory Risks

- More than 20% of states have enacted regulations to reduce carbon emissions, requiring many electric utility companies to develop complex delivery systems to meet the differing emissions targets.

- The U.S. Environmental Protection Agency requires the 10,000 largest emitters (representing approximately 85% of GHG emissions) to report their emissions data.

- More than 1,000 mayors have joined the U.S. Conference of Mayors' Climate Protection Agreement, vowing to reduce carbon emissions in their cities below 1990 levels, in line with the Kyoto Protocol.[8]

- In 2010, the Securities and Exchange Commission published "Commission Guidance Regarding Disclosure Related to Climate Change" (Release Nos. 33-9106; 34-61469; FR-82), in which the Commission said, "This interpretive release is intended to remind companies of the obligations under existing federal securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents to be filed with us and provided to investors."

Opportunities

By implementing energy efficiency measures, companies can immediately realize substantial cost savings and reductions in emissions. Participants in the EPA's Climate Leaders program report savings of tens — and sometimes hundreds — of millions of dollars through energy efficiency and emissions reduction programs.[9]

Corporate energy efficiency helps electric power companies manage their own emissions. This is an important step, as the electric power sector is responsible for one-third of global GHG emissions. Better efficiency in the production of electric power is a key leverage point to achieve the goal of reducing global emissions.

When examining the risks and opportunities climate change presents, investors can consider whether companies are prepared in the following ways:

- Do the companies have policies that address climate strategies?
- Have they enacted those strategies, or are they prepared to act?
- Are they measuring and disclosing their outcomes?

Likewise, a 2010 report by the Carbon Disclosure Project examined whether carbon management should be elevated to the level of a strategic priority. Two of the report's findings are:

- ***Significant cost savings and potential new revenue streams dispel the carbon cost myth*****:** Firms leading on carbon reductions are already experiencing benefits in the form of cost savings through areas such as energy reduction, waste minimization, travel substitution and a lowering of fuel use. In addition, revenue-fueling innovation and marketing benefits open up new revenue streams.

- ***Carbon management must be embedded through the business*****:** The impacts of the different market drivers are not solely the responsibility of the sustainability department but are felt across a company: energy costs impact finance; employee expectations demand communication between sustainability and human resource teams; and the inclusion of carbon management in customers' procurement criteria affects sales, marketing and supply chain departments. Individually the different factors related to carbon management are set to grow, but they are also interrelated and interact in many ways…[10]

Water

Water is the world's third largest industry (only oil and electric power are larger). As a utility, it is highly capital-intensive, essential and a finite resource. Less than 3% of the Earth's water is fresh water and, of that, less than 0.5% is accessible for use.

The global economy is critically dependent on water — industries cannot operate without it. Population growth and economic development are driving significant increases in demand for water. However, water is already over-appropriated in many regions of the world, and approximately one-third of the world's population lives in water-stressed countries.[11] Thus, water is increasingly identified as a strategic business risk. In November 2009, the Carbon Disclosure Project (CDP) launched the CDP Water Disclosure program and in the accompanying report stated, "[i]nvestors need to be concerned about water because it is already impacting companies' operations and costs and it will continue to do so…"

Financial/Competitive Risks

Water resources are affected when economic growth and environmental sustainability are not conducted in concert. For example, the depletion of China's natural capital (including water resources) is estimated to cost the country's economy as much as 12% of GDP annually.[12]

Companies producing water-intensive products may lose market share to less "thirsty" alternatives, especially in areas where consumers have experienced water rate hikes. For example, Coca-Cola and PepsiCo lost their license to operate and were forced to shut down plants in Kerala, India, after local residents protested the large water withdrawals from their already-stressed aquifers.

Business/Financial Risks

In 2010 the U.S. Securities and Exchange Commission acknowledged the impact of water scarcity by saying, "Changes in the availability or quality of water … can have material effects on companies." This is being borne out with increasing frequency:

- In 2009, water shortages in California devastated the state's agricultural industry, leading to estimated losses of 21,000 jobs and $1 billion in revenues.
- During the 2007-2008 drought in Georgia, electric power firm Southern Company was forced to buy $33 million in fossil fuels to replace lost hydropower generation in Atlanta.
- Newmont mining relinquished access to 3.9 million ounces of gold reserves in Peru after local residents protested the company's impact on water reserves.[13]

Companies in water-intensive industries (such as agriculture, food and beverage, semiconductor, electric power generation and resource extraction) may be among the first to be affected by water restrictions. However, it is incumbent upon *all* companies to assess their supply chains for areas that are vulnerable to water scarcity. For example, a drought in the corn belt can materially impact the meat, processed food, pet food, oil and gas, transportation, automotive and retail industries.

Regulatory Risks

Increased water shortages will lead to regulatory caps and/or higher costs for water.[14] Following several years of drought in California, farmers had to choose between reducing production or paying extra money to "opt out" of the state-mandated water supply reductions.

Issues may also arise as water-stressed areas compete for available resources. In several instances, upstream water withdrawal plans have been challenged by downstream jurisdictions. For example, Alabama and Florida successfully sued Georgia over plans to withdraw water from Lake Lanier, which feeds into the Chattahoochee River and supplies water to the lower states.[15]

Implications for Fixed Income

Municipalities are also impacted as they struggle to maintain aging infrastructures and offset rising costs while delivering affordable services to their customers. Credit rating agencies typically assign a lower credit rating to municipal bonds than to a similar corporate issue, since corporate bonds offer better disclosure of the underlying financials. To be competitive, municipalities may purchase expensive "credit enhancement" insurance. In an attempt to improve its credit rating and reduce the cost of borrowing, Charleston Water (Charleston S.C.), became the first public water utility in the U.S. to receive ISO 14001 certification for its environmental management system. Partially as a result of providing evidence of substantial, verifiable operational and environmental improvements, the utility was successful in upgrading its bond rating.[16]

In water-stressed areas, investors should carefully examine bond offerings to determine if the municipalities have sufficient ability to mitigate water shortages — for example, through the ability to raise rates, implement conservation measures, or raise additional capital to develop new water delivery systems.

Opportunities

Businesses can undertake several measures to turn many risks into competitive opportunity:

1. Conduct water assessments and adopt a policy that sets out reduction goals.
2. Implement water-efficiency measures in company-owned facilities that encompass both water inputs and water discharges.
3. Consider water availability in the assessment of future operational sites.
4. Examine the supply chain for water risk, and discuss water efficiency measures with suppliers.
5. Publicly disclose the results of the company's initiatives and the accompanying cost or savings.

In order to analyze water risk, investors should examine corporate public disclosure against the above criteria. If necessary, investors should contact the company and request improved disclosure.

Food Safety

A safe and sustainable food supply is critical to the human population. In the United States, agricultural production has shifted from a large network of independent farms to a concentrated system of "factory farms." The industrialized system has vertically integrated the agricultural sector, and companies benefit from the subsequent economies of scale. However, heavy reliance on externalization of environmental liabilities may present long-term business risks.

Livestock

The poultry and swine markets are dominated by a few large, integrated companies. The benefits of this highly-controlled structure include enhanced brand recognition, consistent taste and texture of meat products, and better ability to select for desirable genetic traits.

This structure also concentrates large numbers of animals — and large amounts of animal manure — in geographic clusters. The untreated waste — which contains high levels of nitrogen, phosphorus and possibly E. coli, antibiotics residue and other pathogens — is typically stored in waste lagoons or sprayed as fertilizer onto fields. Excessive land application can overwhelm the soil's ability to absorb it naturally, raising the risk that byproducts will leach into wells and create runoff into nearby water sources.[17]
The desire to maximize short-term profits has squeezed thousands of animals into ever-smaller living spaces, increasing the risk of illness that comes with close confinement. A 2007 report by the U.N. Food and Agriculture Organization warned that increasing industrialization of pig and poultry production could lead to a higher risk of disease transmission from animals to humans.[18] The report cites the examples of Nipah, SARS and highly pathogenic avian influenza. After the report was issued, the H1N1 "swine flu" pandemic swept the globe.

To offset the risk of disease that comes with close confinement of animals, low-levels of antibiotics are used as a feed additive. Use of antibiotics in animal feed has been scientifically linked to the rise in antibiotic-resistant bacteria in humans.[19] Bacterial resistance is a significant health concern. According to the Centers for Disease Control and Prevention, more people in the U.S. die from resistant bacterial infections than from AIDS.[20]

The non-therapeutic use of antibiotics is facing increasing scrutiny on many fronts:

- Research by Tyson Foods show that 91% of consumers say they prefer antibiotic-free chicken.[21]
- More than 300 hospitals have signed the "Healthy Foods Pledge" and are purchasing meat grown without routine use of antibiotics.
- Companies such as McDonalds, Chipotle and Bon Appetit have adopted policies restricting the non-therapeutic use of antibiotics by their suppliers.
- The Preservation of Antibiotics for Medical Treatment Act (PAMTA), which would ban the use of certain antibiotics in animal feed, has more than 100 co-sponsors and has been endorsed by more than 300 public organizations, including the American Medical Association, American Public Health Association, the World Health Association and Johns Hopkins University.
- Outside of the U.S., the practice has been banned in the European Union since 2006 and is often cited by countries such as Russia as the reason meat imports are rejected.

A review of publicly available documents indicates the large meat companies are not prepared for (or have not disclosed) the potential impact a restriction on antibiotics would have on their business.

Seed Crops

Genetically modified organisms (GMOs) are organisms whose genetic structures have been altered by the introduction of nonrelated genetic material. This cross-species genetic manipulation is meant to enhance or improve the original organism. For instance, in the case of agricultural products, crops can be genetically modified to improve crop yield, improve taste, increase nutrients, resist traditional pests and/or tolerate the application of herbicides.

GMOs represent an ever-growing segment of all U.S. agricultural production. According to GMO Compass (www.gmo-compass.org), a website funded by the European Union, the U.S. is the world's largest producer of genetically modified crops. In 2009, genetically modified seeds in the U.S. accounted for:

- 91% of all soybeans
- 85% of all maize
- 88% of all cotton

Supporters of the use of GMOs claim they can help eradicate world hunger, make more efficient use of farm land, reduce pollution hazards and raise nutritional levels. Opponents, however, point out that food containing genetically modified crops has not been adequately tested for safety and may cause as-yet-unknown allergic reactions. In addition, they claim that cross-pollination of crops can contaminate fields planted with heirloom seeds. Indeed, a report by the Union of Concerned Scientists found that "Seeds of traditional varieties of corn, soybeans, and canola are pervasively contaminated with low levels of DNA sequences derived from transgenic varieties."[22]

Incidents have been recorded of GMO crops used improperly. In 2000 StarLink corn was found in more than 300 products even though it was not approved for human use. As a result, the products were recalled, mills closed, and exports were halted. In 2006, GMO varieties of rice contaminated the U.S. rice supply, causing Japan to ban imports and resulting in losses of more than $1 billion.[23]

Concerns also have been raised over the excessive amount of pesticides on crops. While U.S. farmers are trending toward lower-use patterns, growers outside the U.S. continue using older, higher-risk pesticides. Imported fruits and vegetables account for about one-third of U.S. consumption of these products.

United Methodist Instruction

The Social Principles of the Church state, "All creation is the Lord's, and we are responsible for the ways in which we use and abuse it." Resources that are valuable to us — water, air, soil, minerals, etc. — "are to be valued because they are God's creation and not solely because they are useful to human beings."

The United Methodist commitment to good environmental stewardship is also supported in *The Book of Resolutions*. Resolution 1023, *Environmental Justice for a Sustainable Future*, acknowledges that "humankind is destroying the global ecological balance that provides the life-support systems for the planet," and calls upon our organization to "evaluate its securities on adherence to high standards of environmental accountability…"

The bishops of The United Methodist Church elaborated on the concept of stewardship in a 2009 pastoral letter that called upon all United Methodists to "practice social and environmental holiness" by "caring for God's people and God's planet and by challenging those whose policies and practices neglect the poor, exploit the weak, hasten global warming, and produce more weapons."

Climate Change

In 2008, General Conference added a new section to the Social Principles on global climate stewardship. Resolution 1031 specifically voices support for "mandatory reductions in greenhouse gas emissions…" while calling on United Methodists to "reduce human-related outputs of greenhouse gases" and "educate others outside their church communities on the need to take action on this issue."

These statements augment long-standing concerns for environmental justice and sustainability. Resolution 1026, *Environmental Stewardship*, first adopted in 1984, declares, "As stewards of the natural environment we are called to preserve and restore the air, water, and land on which life depends…We must give special attention to the long-term effects of air pollution, such as the depletion of the ozone layer, global warming, and acid rain; we support international and bilateral efforts to eliminate the cause of these problems."

Water

Resolution 1029, *Protection of Water*, declares that water "is an integral part of God's radical expression of God's love to all humanity. Water cannot be monopolized or privatized. It is to be shared like air, light, and earth. It is God's elemental provision for survival for all God's children together on this planet." Furthermore, United Methodists "shall encourage and commit to good water management by all entities, corporations, and communities" and "push companies that pollute to provide funds and services to clean waters that they pollute."

Resolution 1026, *Environmental Stewardship*, affirms "water is a gift from God that needs to be kept clean. We advocate measures that will address polluted runoff...; protection of waters for future generations; wetlands preservation…; the public's right to know that their water is safe for drinking, swimming, and fishing; and effective enforcement against illegal pollution."

Food Safety

United Methodists have voiced important concerns about the food we eat. The Social Principles call for "policies that protect the food supply and that ensure the public's right to know the content of the foods they are eating (¶160G)." They support more rigorous inspection of foods, independent testing for chemical residues, clear labeling of processed or altered foods, and no weakening of organic foods standards. In ¶162Q, the Social Principles affirm support for “a sustainable agricultural system that requires a global evaluation of the impact of agriculture on food and raw material production.” In addition, the Principles “call upon our churches to do all in their power to speak prophetically to the matters of food supply…The concentration of the food supply for the many into the hands of the few raises global questions of justice that cry out for vigilance and action (¶163H).”

Resolution 1026, *Environmental Stewardship*, recommends “that industry, consumer groups, and governmental agencies aggressively investigate and study the long-range effects of chemicals used for the processing and preservation of food products, since many of these chemicals are harmful to animals and humans.”

III. Social

Introduction

For purposes of this document social issues encompass the areas of employee relations, human rights and supply chain management. There is clearly a strong moral case for corporations to have policies that cover these areas of operation; however, there is also a compelling business case. Social issues can be difficult to quantify, but there is no doubt that their relationship to a corporation’s reputation and stakeholder support can affect the bottom line.

Employee relations are typically under the purview of the human resources department, whereas the human rights and supply chain mandates are generally found in the corporate code of conduct. Wespath believes a strong code of conduct:

- Is based on international guidelines (see Appendix II*)*
- Clearly articulates corporate values
- Sets social performance expectations for suppliers
- Incorporates mechanisms for compliance monitoring
- Demonstrates accountability through public reporting and transparency

Transnational corporations commonly utilize global supply chains, which can be both efficient and cost-effective. To successfully capitalize on the benefits of this structure, corporate executives must be adept at managing different cultures, languages, legal systems and regulatory frameworks. Lapses in policies or procedures anywhere within the supply chain can have consequences that range from fines and lawsuits to losing the license to operate.

As a result, the risk of non-compliance with ethical social values can be material to a company and its stakeholders, with exposure to legal, financial and reputational impact. On the other hand, proper management of social issues can lead to cost savings and in turn, financial benefit.

The Investor Perspective

A study by University of Pennsylvania Wharton School Professor Alex Edmans examined the relationship between employee satisfaction and stock returns. He constructed a portfolio of stocks from Fortune’s “100 Best Companies to Work for in America” that were purchased one month after the list was published. From 1998-2005, these companies averaged 14% return per year, versus 6% for the broader market. Edmans found that these companies also had more positive earnings surprises. In part, these results reflect the shift from a manufacturing economy to a knowledge economy, where employers are relying on innovation and seeking value added from employees rather than from machinery.[24]

For a closer look at how social issues can impact the corporate balance sheet, consider the following examples.

Apparel Manufacturing

In the early days of globalization, supply chain management often meant developing a code of conduct and posting it on the factory wall (which may or may not have been written in the local language). Inadequate monitoring and a "hands off" approach resulted in several high-profile corporate missteps: The Gap, Levi Strauss and most notably, Nike.

After it was revealed that Nike products were, in some cases, being manufactured under unsafe and abusive labor conditions, universities and consumers across the U.S. boycotted the company's products. Nike's brand suffered and sales declined. As reported in the *San Francisco Chronicle* on April 17, 1999, "Last year, Nike and Reebok saw their profits fall 37 percent and 65 percent, respectively. Company executives blame the drop mainly on the overall slump in U.S. athletic footwear sales, which fell an estimated 9 percent, but also on negative publicity from the sweatshop controversy." Then-CEO Phil Knight said, "The Nike product has become synonymous with slave wages, forced overtime and arbitrary abuse."[25]

We had a leading role in conversations with Nike. Over the course of several years, staff evaluated the company's supply chain programs, provided constructive feedback and urged the adoption of best practices. Nike responded aggressively, undergoing a wholesale review of its supply chain. The company improved worker health and safety by switching to non-toxic materials, began auditing its supplier factories, and initiated a product re-design that led to drastic waste reduction and $700 million savings in raw material costs. The company also learned the benefits of transparency. In 2005 Nike was the first in its industry to disclose the names and locations of its factories — information that is often described as competitive and proprietary. Nike also publishes the results of factory audits, allowing stakeholders to analyze the data even though the results are modest. By acknowledging the challenges of a sustainable supply chain and being transparent about the progress it has made, Nike has largely neutralized the negative press that plagued it for so many years.

The results are impressive. In addition to being the industry leader in terms of market capitalization, Nike is the #1 apparel manufacturer on *Fortune Magazine's* 2010 list of World's Most Admired Companies and received a "1" rating for social responsibility.

Gap Inc. Senior Vice President for Global Responsibility and Human Resources Dan Henkle echoed this sentiment when he said that "Good supplier compliance is good for business." Mr. Henkle described Gap's belief in the correlation between working conditions and product quality, saying that when it comes to lowering the defect rate, "It doesn't take much to be (financially) meaningful."[26]

Food Production-Meat Processing

In meat-processing plants, workers perform dangerous jobs under difficult conditions. Common injuries include repetitive stress injuries, cuts, and adverse reactions to gases and chemicals. These risks can be exacerbated — or mitigated — through management of line speed, climate control, staffing levels, job rotation and other factors. In early 2005, Human Rights Watch released a report entitled "Blood, Sweat, and Fear: Workers' Rights in U.S. Meat and Poultry Plants," which concluded that the working conditions in America's meat-packing plants were so hazardous they violated basic human and worker rights. This was the first time the human rights organization had criticized a U.S. industry.[27]

The Forms 10-K of several large meat companies disclose fines, lawsuits and settlements reaching into the tens of millions of dollars, mostly related to processing plant operations.

Resource Extraction

Much of the world's mineral and fuel resources are located in remote areas that are inhabited by indigenous communities. Embracing best practices in environmental management and the precept of "Free Prior and Informed Consent" [28] are key elements to obtaining the local community's support of corporate operations. By securing a social license to operate, companies can avoid:

- Cost overruns caused by project delays
- The cost to implement corrective or counter measures
- Risk to brand and reputation

In the Philippines, Shell Philippines Exploration (a subsidiary of Royal Dutch Shell) embarked on a joint venture to develop the Malampaya Deep Water Gas-to-Power Project, designed to supply approximately 30% of the Philippines' electric power needs. By employing the principles of Free Prior Informed Consent, Shell reported no project delays and approximate savings of $50 to $72 million. According to Shell, only 0.13% of project costs were needed to secure community consent, and the cost of maintaining community consent is 0.43% of net project revenues.[29]

Conversely, Vedanta Resources did not appear to work collaboratively to address the local community's concerns over its plans to mine bauxite in Orissa, India, with significant adverse results. There were prolonged protests and divestment by some institutional shareholders. Despite assurances from the company that the project would go forward, a March 2010 evaluation report conducted by India's Ministry of Environment and Forests found the company had not given adequate consideration to the project's impact on the Dongria Kondh people and was violating environmental guidelines. As a result, the company was denied permission to begin mining.[30] The company's stock price was affected, declining 28% during the three-week period of August 9 through August 27, 2010. Furthermore, Vedanta's newly-constructed aluminum refinery in Orissa, costing $5.4 billion and built in anticipation of sourcing the local bauxite, is operating at approximately 25% of capacity, and "further expansion has been put on hold" according to an October 7, 2010 Vedanta press release.

Areas of Conflict/Repressive Regimes

Operating in areas of conflict (Sudan, Eastern Democratic Republic of Congo, the Middle East) or in countries that are ruled by an oppressive regime (Burma) is particularly challenging and can expose companies to allegations of corruption and/or that their products are being used to abuse human rights. Companies will frequently respond by allocating resources above and beyond normal project costs in an attempt to circumvent reputational damage and legal liability. For example, companies may fund the construction of schools, hospitals and homes, or provide electric power to a remote village. To be truly useful, there must also be teachers, doctors and nurses, and the company should be responding to a desire for these services.

The Prince of Wales International Business Leaders Forum argues that a business case for human rights can be formed around eight strategic opportunities. By mitigating risks of human rights, companies can:

1. Safeguard reputation and brand image
2. Gain competitive advantage
3. Improve recruitment, retention and staff loyalty
4. Foster greater productivity
5. Secure and maintain a license to operate
6. Reduce cost burdens
7. Ensure active stakeholder engagement
8. Meet investor expectations[31]

Workplace Discrimination

Costs associated with workplace discrimination are often avoidable and can place an unnecessary burden on stakeholders. In a study of the reputational costs of race and gender discrimination, it was found that "Upon the announcement of a race or gender discrimination lawsuit, the average two-day loss in the equity market value of the 163 firms in our sample was $168.5 million (per company)."[32] Companies that sell to consumers or government were found to have higher reputational risk than companies that sell to other businesses.

The study goes on to say, "The average loss in [firm] value is over 40 times the estimated legal damages ($4.2 million average) of the litigation. The estimated reputational costs for the 163 firms in the sample averaged $164.3 million."

Within the United States, many companies have faced large discrimination lawsuits. For example, Wal-Mart has paid tens of millions of dollars to settle numerous labor-related lawsuits, including a 2009 payment of $17.5 million to settle a racial-discrimination lawsuit filed by African-American truck drivers.[33]

Wal-Mart is not alone.

- In 2004, Abercrombie & Fitch, Boeing and Morgan Stanley each paid more than $50 million to settle discrimination lawsuits.
- In 1977, Texaco paid $176 million to settle a racial discrimination lawsuit.
- In 2000, Coca-Cola paid over $475 million to settle a racial discrimination lawsuit.

Ultimately, these costs are borne by shareholders, employees and consumers.

Another study examined the effect of management gender diversity on corporate performance. Starting with the Fortune 500 and adjusting for mergers and acquisitions, and eliminating those with less than four years of historical data, a total of 353 companies were analyzed. The study found that companies with the highest representation of women on their top management teams experienced better financial performance than companies with the lowest women's representation. Return on equity was determined to be 35% higher, and total return to shareholders was 34% higher.[34]

Conclusion

Increasingly, companies are recognizing that their approach to social issues can affect their bottom line. Providing a non-discriminatory work environment and comprehensive management of supply chains are complex activities whose benefits are evolving away from the category of "risk avoidance" and into "competitive opportunity." To capitalize on the available opportunities, leading corporations are developing close relationships with suppliers, working with auditors and/or local non-governmental organizations, and building operational capacity while respecting human rights.

United Methodist Instruction

John Wesley firmly believed that the person of faith must be involved in his or her community. Consequently, Methodists always have been active in social issues. In a strikingly modern statement on social problems adopted by the General Conference of 1908, the Methodist Episcopal Church recognized "the gravity of the social situation and the responsibility of the Church collectively, and of its members severally, for bringing about better conditions, through the application of the ethics of the New Testament."

Significantly, the 1908 statement called for:

- Equal rights and complete justice for all men in all stations of life…
- The protection of the worker from dangerous machinery, occupational diseases, injuries, and mortality
- The abolition of child labor
- A living wage in every industry

Today's Social Principles (¶162) echo this early statement: "We affirm all persons as equally valuable in the sight of God. We therefore work toward societies in which each person's value is recognized, maintained, and strengthened. We support the basic rights of all persons… Our respect for the inherent dignity of all persons leads us to call for the recognition, protection, and implementation of the principles of *The Universal Declaration of Human Rights* so that communities and individuals may claim and enjoy their universal, indivisible, and inalienable rights."

The Social Principles also discuss the rights of workers. Paragraph 163C asserts that "every person has the right to a job at a living wage" and that workers have the right "to refuse to work in situations that endanger health and/or life without jeopardy to their jobs."

Resolution 4052, *Economic Justice for a New Millennium*, recognizes that "the increasing ability of large corporations to shift their resources around the globe has contributed to an erosion of worker rights everywhere." The resolution calls upon the whole Church to address the issues of "jobs with livable wages and benefits, debt, plant closing and relocation, public education, homelessness, affordable housing, and meeting sanitation, clean water and energy needs" through advocacy and economic development.

Resolution 4135, *Rights of Workers*, recalls that "through public policy work, shareholder advocacy, and consumer power, the church and its members have sought to influence political and corporate decisions affecting working conditions around the world." In keeping with this historical aspiration, we are encouraged "to invest in companies that set high standards for treatment of workers throughout the world and to file or join shareholder resolutions that encourage such high standards." The Church also extends its support for "the conventions of the International Labor Organizations that advance safety in the workplace; freedom from bonded or forced labor; the elimination of discrimination in respect to employment and occupation; effective abolition of child labor; fair compensation; just supervision; and the right of collective action for employment in all nations."

IV. Corporate Governance

Introduction

For many years, socially responsible investors have engaged companies in dialogue on the importance of good corporate governance measures. The topic gained widespread support, however, after accounting irregularities and lax oversight resulted in the failure of several well-known corporations in 2000 and 2001.

In response, the New York Stock Exchange (NYSE) and NASDAQ stock exchanges revised their listing standards to require new levels of governance and oversight. In addition, Congress passed the Sarbanes-Oxley Act in 2002 which addressed such issues as director responsibility, auditor oversight, internal controls and enhanced financial disclosure to investors. The financial crisis in 2008-2009 resulted in the failure of more large companies, which led to passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010.

Today, prudent investors understand that corporate governance is an indicator of the quality of management. It is an investment risk that can and should be managed. Through advocacy and proxy voting, Wespath supports best practices in corporate governance, including executive compensation that is tied to performance, appointment of an independent board chairperson, and a diverse board of directors that is elected annually by a majority vote of shareholders.

The Investor Perspective

Several studies have examined the effect of corporate governance practices on financial performance:

The "CalPERS Effect" on Targeted Company Share Prices, Wilshire Associates Incorporated, 2010. This analysis evaluated CalPERS' corporate governance effectiveness by measuring stock performance of the 142 companies engaged by CalPERS from 1987-2008. For the five years prior to CalPERS' engagement, the companies averaged returns 83% below their respective benchmarks (-30% annualized). For the five years after the initial engagement, the companies averaged returns nearly 13% above their benchmarks (2.4% annualized).

Did New Regulations Target the Relevant Corporate Governance Attributes? Reena Aggarwal, Rohan Williamson, Georgetown University, 2006. This study examined a set of 64 governance attributes for more than 5,200 firms during 2001-2005, which covers the period before and after Sarbanes-Oxley and other regulatory changes. After controlling for size and industry, the study found a positive and significant relationship between governance and firm value, and also found that new regulations were associated with higher firm value in firms that adopted the regulations prior to them being mandated. The authors described the results as "statistically and economically significant." The study also revealed that, prior to the adoption of new regulations, the markets were already rewarding firms that had better governance.

Corporate Governance and Equity Prices, Paul Gompers, Joy Ishii and Andrew Metrick, National Bureau of Economic Research, 2001. This study demonstrated that firms with corporate governance practices favoring management tend to have lower price-to-book ratios, and that firms with corporate governance ratings in the bottom quartile had significantly below-average risk-adjusted returns during the 1990-1999 time period.

The following provides a closer look at a select number of corporate governance measures.

Separation of Chairperson and CEO

Wespath believes that, among the largest U.S. companies based on market value, shareholders' interests are best served when the board of directors is led by a non-executive chairperson. Such a structure has been supported by many corporate governance experts and advisors including The Corporate Library, Glass Lewis & Co. and Vanguard founder John Bogle.

We believe a non-executive chairperson brings added value to the company:

Corporate management in a global marketplace requires the full attention of the CEO and his/her management team. Given the time and effort that are required to effectively run the company, we believe it is neither wise nor prudent to dilute the focus of the CEO by also requiring him/her to serve as board chairperson.

Regulatory changes such as the enactment of Sarbanes-Oxley in 2002 and the 2003 revised New York Stock Exchange and NASDAQ listing requirements have significantly enhanced directors' responsibilities. As a result, the role of the board has shifted from "advisory" to "monitoring" and today's boards need a chairperson who can lead the directors in providing independent oversight of management goals and performance.

In the 2008 Public Company Governance Survey of the U.S. National Association of Corporate Directors (NACD), 72.8% of directors serving on boards with an independent chairperson stated that companies greatly benefit from an independent chairperson, while only 6.7% said that companies do not.

Many shareholders prefer an independent, non-executive chairperson to oversee their interests. RiskMetrics (now MSCI) reports that in 2008, shareholder proposals seeking to separate the roles of chairperson and CEO received on average 31% of votes cast — a meaningful result for proposals that are opposed by management. RiskMetrics predicted this issue will continue to receive a considerable amount of investor attention in the coming years.

A recent report by Chairmen's Forum cofounder Harry Pearce (through a collaboration with the Millstein Center for Corporate Governance and Performance at the Yale School of Management) recommended that corporate directors appoint a non-executive chairperson whenever a current combined chair/CEO vacates the position.

The SEC requires companies without an independent chairperson to explain in their proxy statement how their leadership structure provides sufficient management oversight and shareholder safeguards.

Advisory Vote on Executive Compensation, or "Say on Pay"

For many years, investors expressed concern about rising executive compensation, especially when it was not sufficiently linked to corporate performance. Unfortunately, avenues to communicate this dissatisfaction were limited. Shareholders had the option of engaging in direct dialogue with the company or "withholding" their vote from board members that comprised the compensation committee.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act mandated that an advisory vote on executive compensation be held every one, two or three years. To implement the law, companies must hold an advisory vote on executive compensation in 2011. They are also required to set forth a management proposal to decide if future votes will be held every one, two or three years.

In general, Wespath supports an annual vote on executive compensation. However, in cases where compensation is negotiated on a bi-annual cycle, a vote every two years may be considered.

Dedicated Communication Channel

Say on pay establishes a dedicated channel for shareholders to register their views on executive compensation. Rather than casting a vote on compensation committee members and hoping the board of directors correctly interprets the meaning of the vote, the results of an annual advisory vote provides the board and management with clear and useful information about shareholder approval of the company's senior executive compensation.

Say on pay is an important corporate governance measure. In a speech delivered on Wall Street on April 22, 2010, President Obama demonstrated his support by saying, "Say on pay will improve directors' accountability to owners of the company by giving shareholders a way to express their views on executive compensation, and will allow boards and shareholders to work together to design compensation that gives executives strong incentives to maximize long-term firm value."[35]

Concerns that shareholders would reflexively vote against management compensation plans have proven unfounded. The majority of shareholders have voted against pay packages in only limited circumstances.

Research

Say on pay is a relatively new issue; therefore, only limited research is available that examines its effect on shareholder value. However, in 2005, Moody's Investor Service published a study which investigated "the empirical relationship between executive compensation and credit risk." Examining non-financial corporations in the United States with senior unsecured bond ratings of B3 or higher, from 1993 through 2003, Moody's found a link between the compensation paid to chief executive officers and overall credit risk. Specifically, Moody's found that firms in the top 10% with respect to "high unexplained bonuses" and "high unexplained option grants" experienced "dramatically higher default rates and dramatically higher downgrade rates than did the middle 70% of the distribution." For example, in the case of "high unexplained bonuses," the default rate for the top 10% of companies was 1.8%, compared to only 0.1% for corporations which fell in the middle 20%.[36] It is reasonable to expect say on pay to offer shareholders a countermeasure against such enhanced risk.

Say on pay is broadly viewed as a method to enhance the transparency and accountability of the board's compensation committee, and to ultimately link pay to performance. An analysis by Stephen Davis of Yale's Millstein Center for Corporate Governance concluded that, in the United Kingdom (where advisory votes have been mandatory since 2003), the measure has resulted in "a marked rise in dialogue between corporate boards and management, on the one hand, and institutional investors on the other. This transformed the way compensation policies are constructed." Furthermore, "while top executive pay in the U.K. continues to outpace inflation and average workforce wage increases, advisory votes are widely seen as having been an important contributing factor in taming the rate of increase, curbing opportunities for 'pay for failure' and linking compensation dramatically closer to performance."[37]

Summary

Say on pay addresses executive compensation — an area of corporate governance that was previously untouched. As an investor who has actively sought say on pay access with several corporations, Wespath supports the inclusion of the issue in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Board Inclusiveness

Wespath is a strong advocate for gender and ethnic diversity on corporate boards of directors. We believe a diverse board offers a wider range of experiences, is an indicator of best practices in corporate governance, and can strengthen a company's financial results.

Each day, businesses interact with a wide variety of stakeholders. Customers, employees, investors, suppliers, media, the local community — these are only a few of the groups that maintain corporate relationships. Leveraging the diverse opinions and experiences of such groups can lead to competitive advantage. Consider that more than 80% of purchasing decisions for the home are made by women, yet women are poorly represented on corporate boards.[38]

Statistics on Board Diversity

Diversity is often lacking at top levels of a corporation. An examination of corporate boards reveals that many corporations fail to employ diversity criteria when hiring executives or nominating members for the board of directors. In 2006, women held 14.8% of Fortune 500 board seats, and people of color held 12.6%.[39] To place these figures in context, 2009 statistics from the U.S. Department of Labor show that 48.6% of the labor force were women and 29% were ethnic persons.

More recent data regarding the number of women on boards shows little improvement. In 2009, 15.2% of Fortune 500 board seats were held by women.[40]

Research

Does board diversity affect firm value? This question was addressed in a 2003 study by researchers at Oklahoma State University who examined the relationship between these factors at Fortune 1000 firms. After controlling for size, industry and other corporate governance measures, the study found significant, positive relationships between the percentage of women or ethnic persons on the board and firm value.[41]

Data published by Catalyst in 2007 supports this finding. An analysis of the S&P 500 based upon the number of women directors and four-year average performance figures showed a correlation between key performance indicators (as described in the following chart) and board gender diversity:[42]

Board Gender Diversity

	Bottom Quartile	Top Quartile
Return on Equity	9.1%	13.9%
Return on Sales	9.7%	13.7%
Return on Invested Capital	4.7%	7.7%

It can be difficult to determine how board diversity affects performance. Outside of an academic environment, it is reasonable to conclude that well-managed corporations understand the value of a diverse board and have capitalized on the opportunity it presents. Therefore, when conducting financial analysis, board diversity can be viewed as an indicator of the quality of management.

United Methodist Instruction

The Social Principles address corporate governance in a broad sense, stating that “corporations are responsible not only to their stockholders, but also to other stakeholders: their workers, suppliers, vendors, customers, the communities in which they do business, and for the earth, which supports them.” Additionally, acknowledgement is given to the importance of corporate policies and procedures by commending “corporations that voluntarily comply with standards that promote human well-being and protect the environment” (¶163I).

Resolution 4071, *Investment Ethics*, states “The Church also continues to advocate on such issues as…best corporate governance practices…” whereas Resolution 4052, *Economic Justice for a New Millennium*, recognizes that “corporations have become increasingly anonymous and unaccountable to their employees, to the communities in which they operate, and to governments.” This resolution directs the General Board of Pension and Health Benefits “to work with the Interfaith Center on Corporate Responsibility and support its *Principles for Global Corporate Responsibility*…”

According to these Principles, a company’s board of directors should be “characterized by independence …diversity of membership, transparency of decision making and accountability.” Compensation and bonus packages are to be “tied to financial, social and environmental performance…” Above all, a company’s governance structure should be “based on ethical values, including inclusivity, integrity, honesty, justice, transparency and responsiveness to shareowners and stakeholders.”

V. Health

Introduction

Governments have the primary responsibility for upholding human rights and providing health care to citizens. With regard to HIV/AIDS, approximately half the funding for research and treatment programs is government-sponsored. However, businesses also have a role, and many corporations find that caring for the health of their employees is good for the bottom line.

Many of Wespath's corporate dialogues regarding health have addressed efforts by pharmaceutical companies to distribute drugs to treat HIV/AIDS, tuberculosis, malaria and other neglected diseases in low- and middle-income countries. Other companies have been asked to assess the impact these diseases have on the company's business operations.

The Investor Perspective

According to the 2010 UNAIDS Report on Global AIDS, 33 million people are living with HIV. Fifteen million are in low- and middle-income countries, of which two-thirds do not have access to treatment. Globally, the number of infections has stabilized, partially due to better access to treatment and education. On a positive note, Sub-Saharan Africa has seen overall decreases in infection rates, although this is offset by increases in other countries, including India, Russia and China.

Tuberculosis (TB) and malaria are additional concerns. Approximately 14 million people are infected with tuberculosis, and there are 247 million cases of malaria worldwide.[43] Companies with operations in Africa, Brazil, Russia, India and China are advised to perform risk assessments to determine if the correct balance of prevention and treatment programs is in place to meet the health needs of employees and protect against future costs to the business.

Risks to Business

HIV/AIDS, TB and malaria can have the following impact on business operations:

- Increased absenteeism
- Reduced productivity
- Increased turnover, recruitment and training costs with more inexperienced workers
- Low morale, as employees suffer the effects of discrimination or the stress of caring for sick family members
- Increased health care expenditures for the company, employees and dependents

The effect on human capital may be significant. As disease claims the lives of teachers, nurses and parents, there will be fewer adults to raise and teach the children. As education levels decline, the available pool of qualified workers will be reduced.

Mining company Xstrata estimated that the costs of absenteeism, medical and compassionate leave, and staff turnover equal 3-6% of its South Africa annual wage bill. Gold Fields, the world's fourth largest gold producer, estimated that AIDS-related labor turnover adds $4-10 to each ounce of gold it produces.[44]

Opportunities for Business

A 2005 report by F&C Asset Management and UBS offered the following recommendations for companies operating in Africa, Brazil, Russia, India and China:

- Assess HIV/AIDS prevalence and the host government's response to the disease in country risk assessments for new and existing investments.
- Determine actual and potential staff exposure through situation analysis, prevalence surveys, and voluntary counseling and testing.
- Evaluate the costs and benefits associated with intervention programs. The report states that traditional accounting frameworks fail to capture the positive effect of successful intervention, and instead proposes a net present value (NPV) approach to valuing the impact of HIV/AIDS.
- Implement, where relevant, prevention, education, awareness, wellness and treatment programs.
- Publish company-wide nondiscriminatory policies relating to employees' HIV status and ensure senior management is accountable for such policies to reduce secrecy and social stigma surrounding the disease.
- Report publicly to shareholders and stakeholders how HIV/AIDS is being managed.
- Press host governments, international donors, multilateral organizations and non-governmental organizations to implement education, prevention and treatment policies, so as to boost the effectiveness of corporate efforts.[45]

Education, prevention and early intervention treatment programs are key to staff retention and prevention of long-term costs. The World Economic Forum estimates the cost of prevention programs to be very low — less than 0.5% of local sales. Similarly, another study quantifies the cost of prevention programs at $10-$15 per employee annually while lowering the chance of infection by 50%.[46]

Pharmaceutical Companies

Pharmaceutical companies have the challenge of finding ways to distribute their life-saving medicines to patients in low- and middle-income countries who cannot afford to pay for them. Traditionally, this has been addressed through drug donations or steep price discounts supplemented with voluntary patent waivers in certain countries.

In recent years, new "pooled resource" models have emerged that may offer pharmaceutical companies a way to turn this type of philanthropy into a revenue stream. GlaxoSmithKline and Pfizer have teamed up to create ViiV Healthcare, a global specialist HIV company created to deliver treatment and community support for people living with HIV. ViiV is now servicing nearly 20% of the worldwide HIV market.[47] In 2002, Johnson & Johnson acquired Virco and Tibotec Pharmaceuticals (now operating as Tibotec), which specializes in treatment and diagnostics for infectious diseases such as HIV and TB.

In October 2010, the National Institutes of Health became the first research organization to share HIV/AIDS drug patents with the UNITAID Medicines Patent Pool. Launched at the 2006 General Assembly of the United Nations, UNITAID's mission is to "contribute to scaling up access to treatment for HIV/AIDS, malaria and tuberculosis, primarily for people in low-income countries, by leveraging price reductions for quality diagnostics and medicines and accelerating the pace at which these are made available."[48] The UNITAID model, which has the ability to offer royalties to participating companies, is under consideration by several large pharmaceutical companies.

Institutional investors should continue to encourage pharmaceutical companies to explore operational models that will allow them to bring this part of the operations onto the balance sheet and generate revenue.

United Methodist Instruction

John Wesley was deeply concerned with the issue of health. During his lifetime, his book of health remedies, *Primitive Physic* or *An Easy and Natural Method of Curing Most Diseases*, went through more than 20 editions. In his famous sermon, *The Use of Money*, he cautioned that “we ought not to gain money at the expense of life, nor at the expense of our health.”

Methodist concern for health resulted in the founding of a number of hospitals throughout the U.S. Currently, the Social Principles declare “health care is a basic human right.” (¶162V).

The Church has adopted several resolutions on issues relating to health. Resolution 3202, *Health and Wholeness*, encourages “United Methodists around the world to accept responsibility for modeling health in all its dimensions,” and to “work for programs and policies that eliminate inequities around the world that keep people from achieving quality health.”

In 2007, the Council of Bishops, the Connectional Table and the General Secretaries’ Table recognized the eradication of the killer diseases of poverty (such as HIV/AIDS, malaria and tuberculosis) as one of the Church’s four areas of focus. Since then, the Church has embraced a global health initiative that “will mobilize United Methodists to action, strengthen health-care infrastructure, and advocate for health policies and global approaches that promote health for all.”

The Council of Bishops in 2009 issued a pastoral letter recognizing pandemic poverty and disease as a threat to the world. The bishops remind us that “God’s vision encompasses complete well-being.” They call us to challenge those policies that “neglect the poor” and “exploit the weak.”

The Council of Bishops’ letter reflects the concern of our Social Principles that countries facing a public health crisis must have “access to generic medicines and to patented medicines.” (¶162V.)

Appendix I: Shareholder Advocacy Implementation

Launched in 2011 as a division of the General Board of Pension and Health Benefits, Wespath continues our long history of successfully advocating for change. To achieve our advocacy objectives, we have implemented a structured process that creates a diversified and robust shareholder advocacy program.

Annually, the management of Wespath identifies the primary advocacy issues it will address. In deciding which issues to pursue, we give consideration to the concerns of Church constituencies, our internal resources and the advocacy priorities of our strategic partners (*Statement of Administrative Investment Policy III E).* To illustrate, we will:

- Review United Methodist Church Social Principles for Church positions on environmental, social and governance matters
- Research and evaluate ESG issues with regard to evolving issues
- Consult with other faith-based and socially responsible coalitions (other United Methodist agencies and entities, Interfaith Center of Corporate Responsibility, Ceres, Social Investment Forum, United Nations Principles for Responsible Investment, and the Council of Institutional Investors) to identify collaborative opportunities
- Annually develop a proposal for primary advocacy issues
- Annually present the advocacy issue proposal to the senior leadership team (SLT) and the board of directors UMC Principles Committee for review, input and approval.

Company Selection

The following are some of the factors that influence how Wespath identifies companies for engagement:

- Research and determine companies that are leaders within their respective industries.
- Evaluate portfolio holdings for companies in which we have large investment positions.
- Seek opportunities to engage companies in various regions of the world, recognizing that location in the Chicago metropolitan area offers opportunity to demonstrate stewardship of staff time and financial resources.
- Identify and document the advocacy priority that the engagement supports and develop an initial goal statement for the engagement.
- Seek opportunities to cooperate with strategic partners or other like-minded institutional investors on selective companies.

Corporate Engagement Strategy

Wespath utilizes many communication tools in the administration of our advocacy program, including:

- Letter-writing
- In-person meetings
- Filing shareholder resolutions
- Voting proxies
- Speaking at shareholder meetings

It is Wespath's practice to first send a written communication of commendation or concern to corporate management in the form of a letter or e-mail seeking the company's position on the specifically identified ESG issue and to request a meeting or conference call. It is Wespath's experience that conversations with management are the most constructive communication avenue.

If the company fails to respond to the written communication, a follow-up letter or telephone call will be placed seeking a reply.

If no meaningful information is received from the follow-up communication, then Wespath management may elect to research and draft a formal shareholder resolution and solicit other investors to co-sponsor the resolution.

Historically, the filing of a shareholder resolution may motivate company management to seek a meeting with investors in an effort to negotiate a withdrawal of the resolution prior to the printing of the proxy statement. Informative in-person meetings between investors and company representatives often result in withdrawal in exchange for management taking an action to develop a public report or to engage in ongoing conversations with investors.

Reporting

Many advocacy initiatives are publicly reported on our website at **wespath.com**. Wespath also publishes two bi-monthly e-newsletters, the *SRI Connection* and *On Your Behalf*, which serve to inform our clients about Wespath's corporate engagements and other key industry developments.

Advocacy Strategic Partners

Wespath's guidelines for strategic partnerships are contained in the *Statement of Administrative Investment Policy*. Currently, Wespath has identified five strategic partners for purposes of shareholder advocacy:

1. United Nations Principles for Responsible Investment (UNPRI)
2. Interfaith Center on Corporate Responsibility (ICCR)
3. Ceres
4. Social Investment Forum (SIF)
5. Council of Institutional Investors

Appendix II: International Guides Provide Framework for Social Policy

- The United Nations. In 1948 the "Universal Declaration of Human Rights" set forth many human rights sought for the workplace, including freedom from discrimination, just remuneration, and reasonable time off.

  1. In June 2008, the U.N.'s Human Rights Council embraced the "Protect, Respect, Remedy" framework for business and human rights, which is based on three pillars: 1) the state duty to protect against human rights abuses by third parties, including business, 2) the corporate responsibility to respect human rights, and 3) greater access by victims to effective remedy, judicial and non-judicial. The Council is now endeavoring to operationalize these pillars.

  2. The United Nations Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with10 universally accepted principles in the areas of human rights, labor, environment and anti-corruption. More than 5,300 businesses in 130 countries have joined the Global Compact. http://www.unglobalcompact.org.

- The International Labor Organization brings governments, employers and workers together to develop policies and programs designed to protect human rights in the workplace.

- The International Finance Corporation (IFC) has developed a "Guide to Human Rights Impact Assessment and Management" to assist companies in performing supply-chain due diligence. Prefacing the guide, the IFC states, "The business case for human rights is an increasingly important part of the human rights and development dialogues, the understanding of business risk for firms, and the mainstreaming of environment, social and governance factors in investment analysis and firm valuation." http://www.ifc.org/ifcext/sustainability.nsf/Content/Publications_Handbook_HRIA.

References

[1] Asset Management Working Group. Show Me the Money: Linking Environmental, Social and Governance Issues to Company Value, UNEP FI, Switzerland, 2006.
[2] The Business of Sustainability, MIT Sloan Management Review Special Report, http://www.mitsmr-ezine.com/busofsustainability/2009?#pg1, 2009.
[3] Brokerage House Analysts, CEO Briefing: The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing, UNEP FI, 2004.
[4] Marc Orlitsky, Frank Schmidt, and Sarah Rynes (2003). Corporate Social and Financial Performance: A meta-analysis. Organization Studies, 24 (3), 403-441.
[5] "Universal Ownership: Why Environmental Externalities Matter to Institutional Investors," p. 4, PRI Association and UNEP Finance Initiative, October 2010. http://www.unepfi.org/fileadmin/documents/universal_ownership.pdf.
[6] GS Sustain, Change is Coming: A Framework for Climate Change — A Defining Issue of the 21st Century, May 21, 2009, p. 1.
[7] The Economics of Climate Change: The Stern Review, Nicholas Stern, Cambridge University Press, 2007
[8] http://www.usmayors.org/climateprotection/revised/
[9] http://www.epa.gov/climateleaders/casestudies/index.html
[10] The Carbon Management Strategic Priority, Carbon Disclosure Project, 2010, p 3.
[11] "Water Scarcity & Climate Change: Growing Risks for Business & Investors" p. 4-5, Ceres, 2009.
[12] The Corporate Examiner, Vol 36, No. 8-10. Liquid Assets: Responsible Investment in Water Services, p. 20. Published by Interfaith Center on Corporate Responsibility, New York, NY. 2009
[13] Ceres, Murky Waters: Corporate Reporting on Water Risk, February 2010, p.7
[14] "Water Scarcity & Climate Change: Growing Risks for Businesses & Investors," p. 15, Ceres, 2009.
[15] Ibid, p. 16.
[16] The Corporate Examiner, Vol 36, No. 8-10. Liquid Assets: Responsible Investment in Water Services, p. 34. Published by Interfaith Center on Corporate Responsibility, New York, NY. 2009

[17] Duhigg, C. "Health Ills Abound as Farm Runoff Fouls Wells, The New York Times, 17 September 2009. http://www.nytimes.com/2009/09/18/us/18dairy.html?scp=1&sq=farm%20runoff%20fouls%20wells&st=cse. See Hodne, C.J. Concentrating on Clean Water: The Challenge of Concentrated Animal Feeding Operations, The Iowa Policy Project, 2005.
[18] J. Otte, D. Roland-Holst, D. Pfeiffer, R. Soares-Magalhaes, J. Rushton, J. Graham, E. Silbergeld. Industrial Livestock Production and Global Health Risks, Food and Agricultural Organization of the United Nations, June 2007.
[19] Testimony of Dr. Joshua Sharfstein, Principal Deputy Commissioner of Food and Drugs of the Food and Drug Administration, before the Committee on Rules of the House of Representatives held a hearing on H.R. 1549, 13 July 2009, www.rules.house.gov/111/oj/hr5419/statements/sharfstein. See, also, Testimony of Dr. Margaret Mellon, www.rules.house.gov/111/oj/hr5419/statements/mellon; and Robert Martin, www.rules.house.gov/111/oj/hr5419/statements/martin
[20] Boyles, Salynn. More US Deaths from MRSA than AIDS, WebMD Health News, October 16, 2007.
[21] "Tyson Goes Antibiotic-Free", Matthew Enis. June, 20, 2007, found at http://supermarketnews.com/fresh_market/tyson_antibiotic_free/
[22] "Gone to Seed: Transgenic Contaminants in the Traditional Seed Supply" Union of Concerned Scientists, 2004.
[23] Madill, Gillian and Illuminato, Ian. "GMO Crops: A Growing Concern," Business Week, December 2007, as found at http://www.businessweek.com/debateroom/archives/2007/12/gmo_crops_a_growing_concern.html.
[24] Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices, Alex Edmans, University of Pennsylvania — The Wharton School, June 2010
[25] Quoted in Bob Herbert, Nike Blinks, New York Times, May 21, 1998
[26] Remarks made in a November 2010 webinar, "Toward a Just, Safe Workplace: Apparel Supply Chain Compliance Programs Webinar"
[27] "Meatpacking in the US: Still a 'Jungle' Out There?", PBS, December 15, 2006, found at http://www.pbs.org/now/shows/250/meat-packing.html
[28] Free, Prior, and Informed Consent recognizes indigenous peoples' inherent and prior rights to their lands and resources, and respects their legitimate authority to require that third parties enter into an equal and respectful relationship with them. It is based on the principle of informed consent. As such, it encompasses 1) information and consultation on any proposed initiative and its likely impacts on the indigenous people's lands, culture and livelihood, and 2) meaningful engagement and participation of indigenous peoples in the negotiations (based on a compilation of United Nations papers).
[29] http://www.sarpn.org/documents/d0002569/7-WRI_Community_dev_May2007.pdf (p.25)
[30] http://timesofindia.indiatimes.com/India/AG-tells-ministry-it-can-refuse-forest-clearance-for-Vedanta-project/articleshow/6202075.cms
[31] Lucy Amis, Peter Brew and Caroline Ersmarker, Human Rights: It Is Your Business, IBLF 2005
[32] William Bradford, Discrimination, Legal Costs and Reputational Costs, University of Washington, 2005.
[33] http://walmartwatch.com/issues/discrimination/
[34] The Bottom Line: Connecting Corporate Performance and Gender Diversity, Catalyst Organization, 2004
[35] Remarks of President Barack Obama, Wall Street Reform at Cooper Union, April 22, 2010, New York, NY.
[36] Jay W. Eisenhofer and Gregg S. Levin, "Does Corporate Governance Matter to Investment Returns?" Corporate Accountability Report, Vol. 3, No. 37 (Sept. 23, 2005). The Bureau of National Affairs, Inc.
[37] "Does 'Say on Pay' Work? Lessons on Making CEO Compensation Accountable" Policy Briefing, Millstein Center for Corporate Governance and Performance, Yale School of Management, 2007.
[38] Pallavi Gogio, "I Am Woman, Hear Me Shop," Business Week, Feb 14, 2005.
[39] Board of Directors: Statistics, Diversity, Inc., www.diversityinc.com/content/1757/article/288/
[40] Catalyst Census: Fortune 500 Women Board Directors, http://www.catalyst.org/publication/132/us-women-in-business
[41] David Carter, Betty Simkins and W. Gary Simpson, "Corporate Governance, Board Diversity and Firm Value", The Financial Review, 2003, vol. 38, issue 1, p. 33-53.
[42] Lois Joy, Nancy Carter, Harvey Wagner and Sriram Narayanan, "The Bottom Line: Corporate Performance and Women's Representation on Boards," Catalyst, 2007.
[43] The Henry J Kaiser Family Foundation, www.globalhealthfacts.org, 2010.
[44] http://www.fandc.com/uploadfiles/co_gsri_hivaids_report_may_05.pdf, p.55.
[45] http://www.fandc.com/uploadfiles/co_gsri_hivaids_report_may_05.pdf
[46] Sydney Rosen et al, "AIDS is Your Business," Harvard Business Review, February 2003, https://www.bu.edu/ghi/documents/HBR%20article%20reprint.pdf
[47] www.viivhealthcare.com
[48] http://unitaid.eu/

Wespath

1901 Chestnut Avenue
Glenview, Illinois 60025
847.866.4100
wespath.com

a division of the General Board
of Pension and Health Benefits
of The United Methodist Church

4275/081011