

To Serve the Present Age: Socially Responsible Investing at Wespath Investment Management 2013 in Review

by *David Foster*

According to *The Book of Discipline of The United Methodist Church 2012*, the General Board of Pension and Health Benefits (General Board) is responsible for the “general supervision and administration of the support, relief, and assistance and pensioning” of United Methodist clergy and lay employees. In addition, it has been directed to “make a conscious effort to invest in institutions, companies, corporations, or funds whose practices are consistent with the goals outlined in the Social Principles...”

United Methodism’s Social Principles, dating from 1968, are a collection of position statements on a wide variety of environmental, social, economic and political concerns. They “speak to the human issues in the contemporary world from a sound biblical and theological foundation as historically demonstrated in United Methodist traditions.” Along with *The Book of Resolutions of The United Methodist Church* (published quadrennially by the Church’s top governing body), the Social Principles provide a foundation for the General Board’s socially responsible investing.

The General Board managed more than \$20 billion of investment assets by the end of 2013. Using sound fiduciary principles and a variety of advocacy tools, the General Board’s Wespath Investment Management division seeks to maximize shareholder value and attain high standards of corporate responsibility.

This White Paper details the General Board’s shareholder advocacy work for the year 2013.

Portfolio Screening

According to long-standing United Methodist values, Wespath does not invest in certain types of companies, specifically companies producing and distributing alcoholic beverages, cigarettes, pornography and weapons and those involved in gambling and the operation of correctional facilities.

Not investing in these companies reflects United Methodist concerns for human dignity, health and peace. These concerns are well-documented in the *Social Principles and The Book of Resolutions*.

Wespath has identified and maintains a list of companies ineligible for investment. This list is constructed based on screening guidelines adopted by the General Board’s board of directors. The list is reviewed monthly by a third-party research vendor and is updated as necessary. All Wespath investment managers have access to these monthly updates.

The Wespath ineligible list does not contain every ineligible company in the investment universe. Rather, it includes, only companies that Wespath has reviewed and judged ineligible for investment.

With few exceptions, Wespath’s ineligible list is comprised of publicly-traded companies. Privately-held companies offering fixed-income securities also may be screened, but separate lists of such companies are not maintained.



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David joined the General Board’s Wespath division Corporate Relations team in 2005, and previously was a senior writer in the Communications department. David shares responsibility for incorporating environmental, social and corporate governance (ESG) factors into Wespath’s investment process and monitors external investment managers’ securities purchases (within Wespath funds) to ensure compliance with Wespath screening guidelines. David received a B.A. degree in Political Science from Western Illinois University, an M.A. degree in Public Policy and Administration from the University of Wisconsin-Madison, and an M.A. degree in Religious Studies from the Chicago Theological Seminary.



Wespath screens are based on a percentage of revenue earned. Generally, companies must earn at least 10% of their total revenue from a screened activity before they are considered ineligible for investment. (The nuclear weapon screen is set at three percent.) Companies providing key components to ineligible companies or involved in the wholesale or retail distribution of screened goods also may be ineligible for investment.

Wespath revised its portfolio screening guidelines at the end of 2013 to address environmental and human rights concerns and to assess more accurately the “core business” of screened companies. The revised guidelines can be found at <http://www.gbophb.org/investments/funds/portfolio-screening-guidelines/>. All screening activity in 2013 followed the former guidelines.

2013 Screenings

Wespath had a total of 524 companies on its ineligible lists as of December 31, 2013. (U.S. and non-U.S. companies are listed separately.) During the course of the year, 61 companies were added to this list, while 118 companies were removed. Companies are removed for a variety of reasons, including:

- falling below the 10% revenue threshold
- purchase or dissolution
- deregistration of securities, etc.

The complete list of ineligible companies is available at <http://www.gbophb.org/sri/portfolio-screening/>.

The Balanced Social Values Plus Fund

All Wespath investment funds are subject to our portfolio screening practices described above. The Balanced Social Values Plus Fund, one of the funds available to participants in the United Methodist Personal Investment Plan (UMPIP), is subject to additional screening. This fund excludes all weapons-related companies on the U.S. Department of Defense’s top 100 contractors list. It also excludes most general obligations of the U.S. government (Treasury bills, notes or bonds.)

Corporate Engagement

Despite the importance of screening, most socially responsible investors seek to engage companies directly on ESG issues. These engagements usually involve face-to-face meetings or conference calls, but also may include writing letters or filing shareholder resolutions.

Letters

Letters are a common first step in the corporate engagement process. Their purpose usually is to draw attention to a particular issue and to secure a response from the company. If letters remain unanswered or if the answers received do not adequately address the issue of concern, Wespath may consider filing a shareholder resolution or pursuing other avenues of engagement.

Wespath sent more than 70 letters to companies and government agencies requesting information or encouraging direct action of some kind during 2013.

Worker Safety

More than 1,000 garment workers in Bangladesh lost their lives when the building in which they were working collapsed in April 2013.

Many apparel companies and retailers rely on low-cost manufacturing facilities in developing countries to satisfy consumer demand for clothing. Unfortunately, many of these facilities are overcrowded and unsafe. Though a number of companies have pledged to uphold international labor and safety standards in these supply chain factories, working conditions remain unsatisfactory for many workers.

In response to the tragic events in Bangladesh, Wespath co-signed a letter encouraging 27 companies to participate in the Accord on Fire and Building Safety in Bangladesh. The Accord details how industrial buildings can be made safer for workers. Signatories to the Accord commit to independent facility inspections and fire safety training. In addition, the Accord provides for the establishment of a governance committee, a remediation process and public reporting of results.

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Wespath co-signed a letter addressed to U.S. Secretary of State John Kerry in June 2013, asking that he “publicly support the Accord on Fire and Building Safety in Bangladesh.” The letter also calls “on U.S. brands and retailers to sign on [to the Accord] immediately.”

Conflict Minerals

The Securities and Exchange Commission (SEC)—as stipulated in the Dodd-Frank Wall Street Reform and Consumer Protection Act—issued a rule in August 2012 requiring companies to disclose the sourcing of “conflict minerals” for their products. Conflict minerals are mined in areas where armed conflicts and human rights abuses exist. The unrest surrounding the mining of conflict minerals in the eastern Democratic Republic of Congo has resulted in large numbers of deaths, displacements and human rights abuses. Conflict minerals continue to be found in many consumer products.

Following a legal challenge to the rule, Wespath sent the SEC a letter of support in May and pledged to “encourage companies in which we invest to comply with it fully.” (In July, the Federal District Court of the District of Columbia upheld the SEC’s final rule on conflict minerals.)

Power Plant Emission Standards

The Environmental Protection Agency (EPA) released proposed standards regulating new power plants emissions in September 2013.

According to the EPA, power plants, “...are the largest concentrated source of emissions in the United States... accounting for roughly one-third of all domestic greenhouse gas emissions.” The new standards set limits on the amount of carbon emissions that power plants may release into the atmosphere.

Wespath joined nearly 50 institutional investors in addressing a letter to President Obama supporting the new standards upon their release. According to the letter, “The need for such standards is urgent. Climate change could add as much as 10% to portfolio-wide risk in the next two decades, putting trillions of dollars of institutional investors’ assets at risk.”

Climate-Related Risk Assessments

Wespath, in cooperation with 70 global investors, wrote to 45 of the world’s major energy-related companies in September 2013, requesting they conduct climate-related risk assessments using two possible assumptions:

- No change in current business operations
- A low-carbon alternative based on the goal to reduce greenhouse gas emissions 80% by the year 2050

The investors are concerned that proven reserves (oil, gas and coal) of energy companies cannot be developed if the world’s governments enact regulations designed to reduce greenhouse gas emissions.

Shareholder Resolutions

A shareholder resolution is a proposal that calls upon a company or its board of directors to take a particular action. These proposals are submitted by shareholders—appearing in the company’s proxy materials—and voted on by shareholders.

The results of shareholder resolutions are not binding, but resolutions are central to the engagement process. Even resolutions with only minimal shareholder support may compel company management to engage in dialogue with concerned shareholders.

Wespath co-filed two resolutions in 2013 for consideration at 2014 annual meetings.





Emerson Electric Company

Wespath co-filed a resolution at Emerson Electric in July 2013 requesting that the company “issue a sustainability report describing the company’s environmental, social and governance (ESG) performance, including greenhouse gas (GHG) reduction targets and goals.” Wespath co-filed this resolution in part because Emerson Electric does not report on its sustainability efforts or efforts to manage greenhouse gas emissions. In the words of the resolution, “Not managing [ESG performance metrics] properly could pose significant regulatory, legal, reputational and financial risks.”

The resolution will be considered at Emerson Electric’s annual meeting in February 2014.

Tyson Foods, Inc.

Wespath co-filed a resolution in August 2013 at Tyson Foods asking the company to report on the use of gestation crates in its supply chain. These crates, which severely limit animal mobility, have been widely criticized as cruel and unnatural. Several states have banned their use and a number of food-related businesses have said they will not purchase pork sourced from farms using them.

The resolution requests the Tyson Foods prepare a report “detailing the possible risks and operational impacts associated with allowing the indefinite use of ‘gestation crates’...the report should detail—using peer-reviewed data, when possible—all potential risks and impacts, including those regarding brand reputation, customer relations, public perception, and regulatory compliance.”

Following Tyson’s announcement in early 2014 of new animal welfare guidelines, Wespath and the other co-filers withdrew the resolution. The new guidelines ask producers to improve the quantity and quality of space for gestating sows when building new barns or re-designing existing facilities.

Dialogues

Many companies willingly meet with shareholders in order to communicate information, listen to concerns, discover problems or anticipate shareholder actions. These meetings give shareholders the opportunity to promote ESG concerns in an open and collaborative setting.

Medicines Patent Pool and HIV/AIDS Drugs

Bristol-Myers Squibb announced in December 2013 it would be working with the Medicines Patent Pool to allow its HIV/AIDS drug Atazanavir to be produced by generics manufacturers anywhere in the world. Wespath, working with other faith-based investors, helped negotiate this agreement.

The Medicines Patent Pool is an initiative to help increase both the availability and affordability of life-saving drugs for vulnerable populations around the world.

Executive Compensation Recoupment Policies

Wespath helped create the Principal Elements of a Leading Recoupment Policy in cooperation with 13 other institutional investors. Directed towards pharmaceutical companies, this policy helps shareholders recover compensation paid to executives who have violated health care laws.

So-called ‘clawback’ provisions have become a common feature of executive compensation in recent years as shareholders react to pay packages that frequently are not aligned with company financial performance. Most efforts to reclaim compensation in the past occurred only after compensation had been paid and company financial statements were restated. The newly adopted Principal Elements, however, target compensation that has not yet been paid or vested.

Six major pharmaceutical companies have endorsed this corporate governance initiative.

Proxy Voting

Shareholders have the right to vote on official company business either directly, by attending the company's annual meeting, or indirectly, by submitting a proxy ballot. Generally, proxy voting is considered both a fiduciary responsibility and an opportunity to promote prudent governance practices. Wespath owns shares of stock in approximately 3,000 companies worldwide and endeavors to vote the proxy of each. Proxy votes are cast in accordance with Wespath's proxy voting guidelines, which have been approved by the General Board's board of directors. These guidelines endeavor to address environmental, social and corporate governance "best practices," as embraced by many of the world's leading socially responsible investors.

Wespath retains a proxy voting service to help in this process. The proxy voting service provides a computerized voting platform whereby votes are cast based on Wespath proxy voting guidelines. (Wespath's proxy voting guidelines are available at http://www.gbophb.org/assets/1/7/proxy_guide.pdf.) For issues not covered by specific Wespath guidelines, Wespath reviews the recommendations of the proxy voting service before casting a vote.

Wespath voted nearly 3,000 proxy ballots, containing more than 27,000 separate proposals during 2013. Our percentage of votes against management in these proposals totaled 34%.

Major 2013 Proxy Voting Issues

Diversity

Numerous studies suggest that companies whose boards have significant gender/racial diversity outperform those that do not. Accordingly, Wespath withholds votes from director candidates who serve on either the board nominating or governance committees when the respective board has less than 20% gender and/or racial/ethnic diversity and has not offered a valid reason explaining why.

Wespath withholds votes from many board candidates based on the above policy. When we have a significant share position, we occasionally write to companies explaining why we withhold our votes.

Wespath sent letters to 16 companies in 2013.

These letters not only provide the reason for our withhold votes, but encourage the company to consider diversity in future nomination discussions and to be transparent in board composition disclosure.



Executive Compensation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 provides shareholders the right to cast advisory votes on executive compensation packages at most companies. Occasionally, compensation packages strike investors as excessive when measured against financial performance. Wespath supports compensation packages that are tied to financial and social performance using clear and reasonable metrics.

Wespath voted against the executive compensation package at more than 400 companies in 2013.

Sustainability Reporting

Wespath believes that a company's policies for dealing with environmental, social and governance (ESG) issues may materially affect corporate financial performance. Consequently, we encourage companies in which we invest to report publicly on their ESG policies and practices. These reports are commonly called "Sustainability Reports" or "Corporate Social Responsibility" reports. A growing body of research supports Wespath's belief that sources of financial risk—and opportunity—may be found within the pages of corporate sustainability reports. The reporting process is often a catalyst to identify key sustainability challenges and opportunities. Companies preparing such reports frequently cite such benefits as lower costs, reduced waste, and increased productivity.

Concerned shareholders continue to file shareholder resolutions asking companies to prepare sustainability reports. Wespath supported 19 such resolutions in 2013.



Task Forces

Wespath has been an active participant in two United Methodist Task Forces convened in 2013.

Human Rights and Investment Ethics

The United Methodist Church’s General Conference 2012 adopted a resolution asking “all United Methodist general boards and agencies prayerfully consider advocating that all companies formally recognize and adopt into their Codes of Conduct the United Nations Guiding Principles on Business and Human Rights...and...prayerfully consider economic sanctions with companies that refuse to recognize and adopt the Principles.”

In response, the General Board and the General Board of Global Ministries convened the Task Force on Human Rights and Investment Ethics “to identify resources, principles and procedures that express our commitment to human rights taking into account fiduciary responsibility and ministry priorities consistent with the global mission of The United Methodist Church.” Bishop Ken Carter (Florida Episcopal Area) is chairing the Task Force and participants include the general boards of Pension and Health Benefits, Global Ministries and Church and Society, United Methodist Women, the Georgia United Methodist Foundation, and several United Methodist seminaries and conferences. The Carter Center (Atlanta, Georgia) and Boston Common Asset Management LLC, a leading socially responsible investment management firm, also are represented on the Task Force.

The Task force currently is in the process of gathering resources, principles and procedures on the subject of human rights and fiduciary duty.

Environmental Justice Working Group

Wespath, in cooperation with the General Board of Church and Society, initiated a conversation in early 2013 with concerned United Methodists on the issue of climate change. The resulting “working group” met occasionally throughout the year to consider the risks and opportunities of investing in companies involved in the exploration, mining, and production of fossil fuels. Fossil fuel companies are responsible for many of the greenhouse gas emissions that scientists have linked to climate change and some investors have questioned whether such investments are appropriate. The working group has provided an important forum to discuss these investments.

Partnerships

Whenever possible, Wespath works in partnership with other socially responsible investors and organizations. Notable partners in 2013 included:

- **Ceres** – Ceres is an association of investors, companies and public interest groups promoting sustainable business practices and a more healthy global economy. A Wespath staff member served on the Ceres board of directors until June 2013.
- **Council of Institutional Investors** – The Council of Institutional Investors is comprised of pension funds, endowments and foundations working for good corporate governance and shareholder rights.
- **Interfaith Center on Corporate Responsibility (ICCR)** – Wespath is an active member of this advocacy group of faith-based and other socially responsible investors dedicated to justice and sustainability in the corporate world. Besides being involved in several ICCR-led engagements, a Wespath staff member serves as chairperson of the ICCR board of directors.
- **Sustainability Accounting Standards Board** – The Sustainability Accounting Standards Board (SASB) advocates for the disclosure of material sustainability metrics and is in the process of establishing ESG (environmental, social, governance) standards for Securities and Exchange Commission (SEC) filings.
Wespath is represented on SASB’s Advisory Council and is active in SASB’s non-renewable resources and food working groups. These groups, along with groups focusing on other industry sectors, are helping to develop metrics that investors may use to compare companies on the management of their ESG risks and opportunities.

- **United Nations Principles for Responsible Investment** – The General Board helped draft and was an original signatory to the Principles for Responsible Investment. This initiative of asset owners, investment managers and service providers is dedicated to the incorporation of environmental, social and governance factors into investment decision-making.

Conclusion

The Book of Resolutions reminds us that “all resources are God-given and can be used to promote the reign of God on earth (#4071, Investment Ethics).” Wespath is committed to using its financial resources, through shareholder advocacy, to continue to work for high levels of corporate responsibility and to bring about positive change in the communities in which we work and invest.

“ To serve the present age,
My calling to fulfill;
O may it all my powers engage
To do my Master's will! ”
—Charles Wesley

Wespath provides UMC-affiliated institutional investors with access to well-managed investment programs that historically have delivered competitive performance while honoring United Methodist Social Principles. Wespath is the investments division of the General Board of Pension and Health Benefits of The United Methodist Church, a century-old institution with a well-regarded reputation for delivering returns aligned with values.

Wespath is an established investment manager with approximately \$20 billion in assets under management.

Our name honors John Wesley, the founder of Methodism and a leader in establishing social principles that outline the tenets of socially responsible business practices. Wespath reflects this heritage, along with the idea of putting clients on the right path to financial growth with a commitment to values-driven investing.



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