Ceres Guidance

PROXY VOTING FOR SUSTAINABILITY

Proxy voting sustainability principles, voting guidance, sample proxy guideline language, an index of sustainability issues and an analysis of 2010 key sustainability votes.

By Kirsten Snow Spalding and Jackie Cook

Summer 2011

Ceres leads a national coalition of investors, environmental groups and other public interest organizations working with companies to address sustainability challenges such as global climate change. Ceres directs The Investor Network on Climate Risk (INCR), a group of 100 institutional investors with assets of approximately $10 trillion that addresses the financial risks and investment opportunities associated with climate change.

Kirsten Snow Spalding, Esq. is Ceres California Director and leads Ceres' work on investment practices. Her previous publications for Ceres include *Investors Analyze Climate Risks and Opportunities: A Survey of Asset Managers' Practices*, Ceres, January 2010 and *Energy Efficiency and Real Estate: Opportunities for Investors*, Ceres, December 2009. Prior to her work at Ceres, Ms. Spalding served as Chief Deputy Treasurer for the State of California and Executive Director of California's Pollution Control Financing Authority and the California Alternative Energy and Advanced Transportation Financing Authority. She taught at Boalt Hall, University of California Berkeley School of Law and practiced labor and ERISA law representing unions and Taft-Hartley pension funds in the San Francisco Bay Area.

Jackie Cook is founder of Fund Votes, an independent project started in 2004 that tracks mutual fund proxy voting in the US and Canada. She holds degrees in Research Psychology and Economics and Management. After graduating from Oxford in 1998 on a Rhodes Scholarship, Jackie worked as a Junior Research Fellow for Cambridge University's Centre for Business Research and then as a Senior Research Associate for The Corporate Library. Research specialties include mutuality and corporate governance, director interlocks and shareholder advocacy on environmental and social issues. She is co-inventor of the Corporate Library's Interlocks Tool and has worked on research projects for a number of organisations, including UNCTAD's International Standards of Accounting Auditing and Reporting Group, The World Bank's Private Sector Development Group, The UK Department of Trade and Industry, The UK Building Societies Association, Shareholder Association for Research and Development (SHARE) and The American Federation of State, County and Municipal Employees (AFSCME). Ceres and Fund Votes produce an annual review of mutual fund voting on climate resolutions.

ACKNOWLEDGEMENTS

The opinions expressed in this report are those of the authors and do not necessarily reflect the views of Ceres' sponsors.

The authors would like to thank Ceres Board of Directors members Dr. Neva Goodwin and Dr. Julie Gorte and Ceres staff Rob Berridge, Peyton Fleming, Meg Wilcox, Amy Augustine and Andrea Moffat for their valuable insights and editing suggestions.

Patricia Robinson designed and produced the final report.

FOR MORE INFORMATION, CONTACT:

Kirsten Snow Spalding
Ceres
spalding@ceres.org
99 Chauncy Street
Boston, MA 02111
www.ceres.org

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The guide was written for asset owners and asset managers with fiduciary responsibilities that include voting the proxy. It includes a set of Proxy Voting Sustainability Principles *(Principles, App. A)* to help investors address sustainability issues that arise through shareholder resolutions. Investors who adopt Ceres' Proxy Voting Sustainability Principles will be better positioned to vote consistently and responsibly on these resolutions. Investors can adopt these principles as a policy to guide their proxy voting consultants, or as a supplement to other proxy guidelines. For investors who are developing proxy guidelines for the first time, these Principles can be adopted as part of a comprehensive set of corporate governance guidelines.

This guide provides a list of the most common resolutions, including both sustainability and broader governance related resolutions, filed in recent proxy voting seasons, including percentage voting support that these resolutions received in the 2010 proxy season *(Shareholder Resolutions Examples, App. B)*. The resolutions are categorized so that investors can determine whether their existing proxy voting guidelines are sufficiently specific to create consistent voting outcomes on these resolutions. The list of common resolutions can also be used as a checklist for investors who want to ensure that their existing or new proxy guidelines will comprehensively cover sustainability and governance issues that arise in the future. The vote percentages achieved in the 2010 season on particular sustainability resolutions suggest trends for particular resolutions in upcoming proxy seasons.

Lastly, and perhaps most importantly, this guide includes more than 75 leading examples of proxy guidelines that asset owners and asset managers can consider as they re-visit their own guidelines and policies. The sample language, from public pension funds, asset managers, socially responsible investment funds, labor unions and foundations, cover key sustainability topics such as climate change, water availability, broad environmental risks, ESG-driven executive compensation and board of director governance *(Proxy Guideline Examples, App. C)*.

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This guide includes more than 75 best practice examples of proxy guidelines that asset owners and asset managers can consider as they re-visit their own guidelines and policies.

Introduction

Ceres leads a national coalition of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change and water scarcity.

Throughout its history, Ceres has worked with corporate leaders to define and advance sustainability best practices by public and private companies. *The 21st Century Corporation: The Ceres Roadmap for Sustainability* is now being used by dozens of corporations to develop a robust sustainability business strategy and improve public disclosure, governance practices, stakeholder engagement and overall sustainability performance. Investors are also using the Roadmap in their engagements and dialogues with companies. For the past decade, Ceres has been in the forefront of working with investors and the companies they own to address sustainability issues through shareholder resolutions, corporate dialogues and stakeholder engagements. Ceres has coordinated and supported governance initiatives of institutional investors on climate change and other sustainability challenges. Ceres has also worked closely with the Securities and Exchange Commission (SEC) to develop interpretive guidance on the materiality of climate change and other sustainability issues, and how those issues should be dealt with in US corporate filings.

This document sets out Ceres' case for responsible proxy voting on specific corporate governance and sustainability issues considered crucial to good governance and long-term value creation. It provides Principles *(see Principles, App. A)* and specific guidance on how to vote on particular sustainability resolutions in accordance with the Principles. The guidance has been compiled from a comprehensive review of resolutions that have been sponsored by shareholders and put to a shareholder vote at large publicly traded US companies over the past five years *(see Shareholder Resolutions Examples, App. B)*, as well as from a first-of-its-kind compilation and review of available best practice proxy voting guidelines offered by a number of different types of institutions, including large asset managers, socially responsible investment funds, public pension funds, labor unions, foundations and trusts *(see Proxy Guideline Examples, App.C)*. The list of the guideline documents reviewed is included for reference *(Proxy Guideline Sources, App. D)*.

The concept of "Sustainable Governance," which reflects a recognition that sustainability cannot be achieved without sound checks and balances addressing a wide range of relevant risk factors, applies at the level of both national governance by policymakers and corporate governance by companies and investors. In years past, corporate governance and sustainability were typically dealt with as distinct, perhaps even competing issues—shareholders vs. stakeholders. Today, corporate governance, sustainable business, reputational capital, long-term strategic considerations and stakeholder engagement are recognized as interlinked drivers of good business practice. The collection of practices, structures and considerations once separately referred to as either 'corporate governance' or 'corporate social responsibility' are now often collectively referred to as 'environmental, social and governance' (ESG) factors that define and inform sustainable business.

Today, corporate governance, sustainable business, reputational capital, long-term strategic considerations and stakeholder engagement are recognized as interlinked drivers of good business practice.

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Various models of corporate governance now explicitly incorporate reference to sustainability. The new *King III Report on Corporate Governance* in South Africa (2010) makes 'stakeholder relationship governance' and sustainability reporting the responsibility of boards of directors. In the preamble to the *King III Report*, Prof. Mervin King, the King Committee Chairman, states:

> *"Sustainability is the primary moral and economic imperative of the 21st century. It is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that should be understood by decision-makers. Most importantly, current incremental changes towards sustainability are not sufficient—we need a fundamental shift in the way companies and directors act and organize themselves."*

Indeed, some of the most widely accepted definitions of good corporate governance rest on the notion of sustainability:

> *"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined." (OECD Principles of Corporate Governance, 2004)*[1]

> *"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources." (Sir Adrian Cadbury in a foreword to the World Bank publication "Corporate Governance: A Framework for Implementation", 2000)*[2]

Even at the level of international public policy, sustainable governance is recognized as crucial to long-term value creation:

> *"Corporate governance is one of the pillars of IFC's focus on sustainability together with environmental and social sustainability. A company that is well governed is one that is accountable and transparent to its shareholders and other stakeholders such as employees, creditors, customers and society at large. Better corporate governance allows companies to recognize and act to fulfill their environmental and social responsibilities. Accordingly, it contributes long-term, sustainable growth" (International Finance Corporation, "Making the Business Case for Better Corporate Governance").*[3]

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1 http://www.oecd.org/dataoecd/32/18/31557724.pdf
2 http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2000/09/08/000094946_00082605593465/Rendered/PDF/multi_page.pdf
3 http://www.ifc.org/ifcext/corporategovernance.nsf/attachmentsbytitle/cg-brochure-e.pdf/$file/cg-brochure-e.pdf

What do we mean by 'sustainability'?

> *"When Ceres talks about sustainability, we are referring to how environmental, social and economic considerations are integrated into corporate strategy and capital markets for the long-term."*[4]

A focus on corporate sustainability requires consideration of both the risks and the opportunities that companies face. Climate change, industrial pollution and natural resource scarcity are forcing companies to attend to a whole new set of risk exposures—potential liabilities—yet also present opportunities to companies seeking competitive advantage over their less-responsive peers. For instance, innovations that enhance efficiency in water use or energy consumption, or that effectively utilize alternatives to fossil-fuel generated energy, will help decide corporate winners and losers in the years ahead.

In a recent *Harvard Business Review* article, Lubin and Esty argue convincingly that "sustainability is an emerging megatrend," fundamentally changing the way businesses compete. Changing geopolitics; globalized workforces; growing public concern over business impacts on environment and public health; the realization that what were once considered 'environmental externalities' are increasingly impacting the bottom-line; and the multifaceted challenges presented by climate change are some of the powerful drivers of the sustainability megatrend. They argue that the recent financial crisis accelerates the imperative for change and therefore strengthens the sustainability 'megatrend'.[5]

■ In a recent *Harvard Business Review* article, Lubin and Esty argue convincingly that "sustainability is an emerging megatrend," fundamentally changing the way businesses compete.

Internationally, reporting standards and regulations are evolving to capture performance metrics and indicators at the heart of corporate sustainability. A growing number of business and other organizations are adopting the Global Reporting Initiative's Sustainability Reporting Guidelines, which set out the "principles and performance indicators that organizations can use to measure and report their economic, environmental, and social performance". Accounting bodies are assisting with the task of describing sustainability in quantitative, measurable terms, as are multilateral initiatives such as the Carbon Disclosure Project. In 2010 the SEC issued new guidance requiring public corporations to assess and disclose financial risks relating to the physical impacts, legal implications and other material aspects of climate change.

At the same time, investors are recognizing that ESG performance can have a significant impact on shareholder value. There has been a proliferation of investment funds focused on various aspects of sustainability in recent years. Large asset managers such as Legg Mason, Vanguard, Wells Fargo, Dreyfus, DWS, Neuberger Berman, Dimensional and TIAA-CREF offer mutual funds that screen or select investments based on performance-linked sustainability criteria. A number of new indexes track stocks that are screened based on sustainability criteria—the Dow Jones Sustainability Indexes launched in 1999, the FTSE4Good Index Series launched in 2001, the HSBC Climate Change Index family

4 21st Century Corporation: The Ceres Roadmap to Sustainability, 7. http://www.ceres.org/resources/reports/ceres-roadmap-to-sustainability-2010

5 David A. Lubin and Daniel C. Esty (2010) The Sustainability Megatrend, Harvard Business Review, May 2010.

launched in 2007 and the S&P Carbon and ESG indexes, to name a few. The Principles for Responsible Investment[6], a set of voluntary guidelines by which mainstream investors can incorporate ESG considerations into their investment decision making, is being supported by more than 800 investment institutions from 45 countries. Ceres' US based Investor Network on Climate Risk (INCR) supports more than 100 institutional investors with assets exceeding $10 trillion by identifying the financial opportunities and risks of climate change and by tackling the policy and governance issues relevant to the realization of sustainable capital markets.

Why do we care about corporate governance?

In a recent article in the *Cambridge Journal of Economics*, Konzelman and co-authors note that

> *"The form taken by governance is important for sustainability—of organisations and of the broader socio-economic system of which they form a part. At both levels, sustainability depends upon the existence of an effective framework for establishing strategic objectives, determining the most appropriate and effective means of achieving them and monitoring performance."*[7]

Loyalty, accountability, competence and transparency are key governance expectations for companies, starting at the board level and extending down through senior executives to the rest of the organization. *The 21st Century Corporation: The Ceres Roadmap for Sustainability* states that, "as sustainability has risen up the corporate, investor and public policy agendas, it has become more fully integrated into these governance expectations".[8] Sustainability therefore has to be endorsed and driven by the board of directors.

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For a board to function effectively, it needs to have in place a solid set of corporate governance practices and structures. Key tasks of the board of directors of a corporation are setting strategic direction and designing and monitoring the framework for risk management. If sustainability is to be a core principle it should be embedded into both of these processes.

The recent global financial crisis highlighted a number of ways in which existing governance structures and practices do not function effectively. The ongoing economic crisis, a consequence of the financial crisis, shows just how crucial strong governance is to the prosperity and well-being of people around the world, and is putting new pressure on companies to manage exposure to risk and re-think 'business as usual'.

6 www.unpri.org

7 Sue Konzelmann, Frank Wilkinson, Marc Fovargue-Davies and Duncan Sankey (2010), 'Governance, regulation and financial market instability: the implications for policy', Cambridge Journal of Economics, 2010, 34, 929–954. See: http://cje.oxfordjournals.org/content/34/5/929.full.pdf+html

8 21st Century Corporation: The Ceres Roadmap to Sustainability, 15. http://www.ceres.org/resources/reports/ceres-roadmap-to-sustainability-2010

Sustainability is a measure of sound governance. It provides a framework within which companies will create long-term value for their shareowners. Sustainability considerations need to be integrated into the structures and practices that ensure that boards exercise stewardship on behalf of stakeholders; that material issues are effectively managed; that the management team is accountable to the board; that the board is competent in carrying out its duties; and that relevant information is available to shareholders and other stakeholders.

What is the role of proxy voting?

Shareholders express their views to boards by directly engaging corporate management, proposing resolutions to be voted on by other shareholders at general shareholder meetings, and by actually casting votes on an annual ballot of resolutions. Some of these resolutions include a slate of director nominees and other management-sponsored proposals. Resolutions put forward by shareholders, proposing measures that management usually does not endorse, may also appear on the 'proxy ballot,' often in cases where shareholder engagement with management fails. In addition to filing the majority of proxy resolutions, institutional investors own the majority of shares in public corporations in the US. Mutual funds alone hold over 25% of corporate securities in the US and thereby substantially control the proxy votes.

Investment companies are required to publish their proxy voting guidelines, which outline how the institution votes on various issues that arise, or are likely to arise, on companies' proxy ballots. Our review of proxy voting guidelines of large asset managers in the US shows that the guidelines of many institutions are not detailed enough or comprehensive enough to guide voting on specific sustainability and broader governance issues considered crucial to long-term value creation.

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What is needed from investors on integrating sustainability in proxy guidelines?

Our review of current proxy voting guideline practices and actual votes cast by many of the largest asset managers in the US shows that, although there has been much progress in support for both governance and sustainability resolutions put forward by shareholders since institutions first started publishing their voting records in 2004, the largest asset managers often fail to take advantage of this opportunity to promote key governance and sustainability reforms at large public companies, including the types of reforms that may have averted the recent financial crisis.

■ Asset managers have a fiduciary responsibility to incorporate sustainable governance considerations into the principles that guide their proxy voting.

Investors can no longer responsibly ignore or 'abstain' from taking a position on sustainable governance. With the realization of the business case for sustainability and with growing pressures for institutional investors to exercise stewardship, asset managers have a fiduciary responsibility to incorporate sustainable governance considerations into the principles that guide their proxy voting.

This document puts forward a concise set of Principles to guide proxy voting on specific corporate governance and sustainability issues that are voted on by shareholder bodies of large US corporations from year to year. *(see Principles, App. A)*

Click the following links to read the Appendices

Proxy Voting Sustainability Principles

Appendix A

Issues Raised By Shareholder-Sponsored Resolutions

Shareholder Resolutions Examples, App. B contains a checklist of the broad range of sustainability and broader governance issues that have arisen in resolutions filed over the past five years. The checklist does not purport to be comprehensive (i.e. it cannot cover every single resolution that has been filed or will be filed in the next few years), but is designed as a tool to help investors review their existing proxy voting policies or proposed new proxy voting policies. If a proxy voting policy or set of proxy voting guidelines does not specifically address the majority of these issues, then the voting fiduciary will not have the guidance necessary to address the significant environmental, social and governance issues that will arise in upcoming proxy seasons.

Proxy campaigns waged by shareholders tend to be evolutionary, adapting to changing business conditions, incorporating new insights about the effectiveness of certain governance or other arrangements, responding to new evidence of corporate impacts and externalities or of questionable corporate actions, and fine-tuning strategies for engaging corporate leadership. Resolutions seen last year may take a new form, raise new areas of concern or propose new management actions when they are presented this year or next. This evolutionary nature of shareowner resolutions means that proxy-voting policies must continuously be reviewed and amended to address new issues and the contexts in which they arise. But most of the issues on this list are longstanding areas of concern for shareowners and have been vetted thoroughly by the SEC as valid issues for the proxy.

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We have organized Shareholder Resolutions Examples, App. B into 13 categories, and topic areas. These categories and topic areas can be used as a checklist of issues that every investor's proxy voting policy or proxy voting guidelines should cover. In the Principles, App. A and the guidance accompanying the Principles which follows herein, Ceres offers advice to the voting fiduciary on how to vote on the core sustainability topic areas from the checklist. While there are many model guidelines that cover all of the issues on the checklist, Ceres' areas of particular expertise and concern fall into the sustainability areas of governance resolutions, general sustainability resolutions and specific environmental resolutions as well as human rights and public health. Ceres recommends that voting fiduciaries adopt the Principles as an amendment to their existing proxy voting policies or that they amend their detailed proxy voting guidelines to reflect the principles and the advice that follows below.

Proxy Voting Sustainability Principles And Voting Guidance

Institutional investors may either adopt these Principles and their accompanying guidance for their fiduciaries who will be casting the votes, or may use the Principles as a benchmark against which to evaluate existing or proposed proxy voting guidelines on these issues. An investor who adopts these Principles and their accompanying guidance will be guiding, but not determining how the fiduciary should vote on a particular resolution. Unlike more prescriptive guidelines, these Principles are designed to provide a framework for fiduciaries, but not to pre-determine or decide for the fiduciary how to vote on each resolution that they will encounter. However, if the investor's proxy voting policy or guideline on a sustainability issue is inconsistent with the following Principles, then it is unlikely that the voting fiduciary will vote consistently in accordance with Ceres' vision of sustainable business practices in the emerging sustainable global economy. Such votes may not consistently reinforce the investor's interests in prioritizing long-term shareowner value over short-term profits or blind support for management decisions. If an investor's proxy voting policy or guideline is silent with respect to these core sustainability Principles, then it is likely that the voting fiduciary will either vote contrary to these Principles on sustainability issues, or will vote on a case-by-case basis, leading to an inconsistent voting record.

For additional guidance as to how to apply these Principles in the absence of more prescriptive proxy voting guidelines, Appendix B correlates the Principles to the types of resolutions that have been filed over the past few years and indicates the vote that would follow from the application of the principle to the resolution. Fiduciaries can seek advice on specific resolutions from Ceres and other investor groups as specific resolutions arise each proxy season. Voting fiduciaries will, over time, develop a track record of voting on resolutions that can be evaluated by asset owners. Asset owners should amend or adopt more prescriptive guidance if they find inconsistent voting records or that the fiduciary's votes do not reflect a commitment to ESG performance.

We believe, therefore, that the following set of Principles and their accompanying guidance constitutes a simple yet valuable contribution to institutional investors' task of establishing proxy voting policies, reviewing existing proxy voting guidelines or compiling new proxy voting guidelines on key governance and sustainability issues. For investors seeking further depth on our expectations of companies, refer to *The 21st Century Corporation: The Ceres Roadmap for Sustainability*, http://www.ceres.org/resources/reports/ceres-roadmap-to-sustainability-2010.

1 GOVERNANCE PRINCIPLES

In order to create value, we believe that companies must be managed according to four main principles of sustainable governance: **loyalty, accountability, competence, and transparency.**

A number of the specific issues identified in Shareholder Resolutions Examples, App. B and Proxy Guideline Examples, App. C relative to corporate governance have, since the 2010 proxy season, been addressed in the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) and ruled on by the SEC, such as the 'advisory vote on executive compensation' ("say on pay"). In some cases, the SEC's final rules on how to implement the Act's provisions, such as those relating to 'proxy access', are facing ongoing legal challenges, and in some cases companies' responses to the SEC's recently released rules, such as those requiring increased disclosures, will likely shape future shareholder campaigns. Therefore we recognize that some governance-related voting guidance offered below may need updating following the 2011 proxy season.

1.A. Loyalty

The primary duty of the board of directors is to oversee management on behalf of, and in the interest of, shareowners. Shareowners elect directors to guide and monitor the company's management, to assure that the company is being managed in such a way as to safeguard the interests and assets of its owners, rather than in the managers' own interest. This is the duty of loyalty.

In applying this principle we would, therefore, recommend a vote 'FOR' resolutions that align the interests of board members more closely with those of shareholders. Ensuring that board members truly represent shareholders requires certain changes to the director nomination and election process such as declassifying boards, allowing shareholders to nominate candidates using the corporation's proxy card[9], nominating more than one director for each position or electing directors by a majority of votes cast in uncontested elections—all measures that can bring some competition to the market for corporate directors. Independent boards and key committees are less beholden to management and therefore more likely to represent shareholder interests, as are boards chaired by an independent director. Director pay practices should align directors' economic interests with those of shareholders through stock retention guidelines and through some shareholder say on director pay.

See 'Board Governance' and 'Proxy and Oversight Mechanism' in Appendices B and C. . . . . ▶

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Board Governance

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Proxy and Oversight Mechanism

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9 The Dodd–Frank Wall Street Reform and Consumer Protection Act (2010) mandated the SEC to consider proxy access rules, including the terms and conditions under which shareholders could access the corporate proxy. The SEC's final ruling applies to the 2011 proxy season and sets the ownership and holding period requirements for shareholders seeking to nominate board candidates using the corporate proxy card. This may, therefore, be a less relevant consideration in coming proxy seasons.

1.B. Accountability

Accountability is central to the effective functioning of a governance structure. At well-governed companies, the board is accountable to shareowners for its stewardship and oversight of management. Management is accountable to directors and shareowners. Each of these parties is also accountable to the company's internal and external stakeholders. We believe that full accountability is necessary for the creation of sustainable value. Accountability should be built into the major governing structures of all corporations and their boards. No management team or board of directors can anticipate every issue or design a fool-proof strategy. For directors to exercise loyalty and for management to be accountable there must be reasonable provisions for shareowners to express their views and preferences with directors, at a minimum, and preferably with management as well. Similarly, the board should be responsive to shareowner sentiment and take action when shareholder-sponsored proposals receive significant support.

In applying this principle we support resolutions that aim to enhance board responsiveness to shareholders, such as those calling for boards to set up procedures for engaging with shareholder proponents of resolutions that achieve a threshold level of support as well as reimbursing shareholder proponents for their proxy solicitation expenses where resolutions achieve significant support. Eliminating share structures with disparate voting rights so that each share carries a single vote, removing supermajority voting requirements and redeeming poison pill provisions that entrench the interests of boards and management are measures that ensure that boards remain accountable to all shareholders.

See 'Proxy and Oversight Mechanism' in Appendices B and C. . . . . ▶

A key mechanism through which shareholders are able to express their opinion on executive compensation practices is an advisory vote on the compensation of named executive officers of the corporation. The strength of support for a board's compensation practices provides a general measure of shareholder confidence in the board's management of the company. Until the SEC has issued a final ruling on whether and how frequently non-financial companies should be providing shareholders with a 'say-on-pay', thereby implementing Section 951 of the Dodd-Frank Act, we recommend votes in favor of shareholder resolutions that continue to advocate for annual advisory votes on executive compensation.

See 'advisory votes' under 'Executive Compensation' in Appendices B and C. . . . . ▶

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Proxy and Oversight Mechanism

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'Advisory Votes'
Executive Compensation

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1.C. Competency

Directors and corporate management should be held to a high standard of skill and expertise measured against their peers. Without measurable standards of excellence at the director and manager levels, shareholders will not be able to realize the benefits of long-term value creation that accrue from strong sustainable governance policies and consistent management implementation strategies.

☒ In applying this principle we would therefore vote 'FOR' resolutions aimed at improving the qualifications of directors (particularly resolutions proposing director qualifications that include training, expertise and experience in ESG issues), improving board diversity where boards are overly homogenous, and at limiting the total number of directorships held by individual board members to a number considered appropriate for the commitment required for board service. In order to ensure a continuation of leadership, boards should adopt and disclose detailed succession plans; we therefore recommend voting 'FOR' resolutions proposing such measures.

See 'Board Governance' in Appendices B and C. . . . . ▶

1.D. Transparency

There can be no accountability without transparency. Shareowner trust in directors and managers must be built on a foundation of information required and vetted by a well-developed regulatory framework and complemented by a management culture of openness and honesty. Transparency between management and shareowners requires verifiable accounting procedures and clearly understandable disclosures of material issues in financial filings, annual reports and sustainability reports.

☒ In applying this principle we recommend voting 'FOR' shareholder proposals aimed at enhancing auditor independence by limiting fees paid for non-audit services or requiring auditor rotation in order to ensure the audit integrity. These resolutions aim to limit conflicts of interest that may otherwise jeopardize the integrity of corporate reporting. We also recommend voting 'FOR' resolutions calling for disclosure of compensation consultants and any fees paid for services other than advice on compensation matters.

☒ In the interest of transparency we also recommend voting 'FOR' shareholder resolutions that call for all components of executive compensation to be reported on in detail, yet in a clearly understandable way, including the monetary value of benefits from deferred compensation, severance and post-retirement packages.

See 'Proxy and Oversight Mechanism' and 'Executive Compensation' in Appendices B and C. . . . . ▶

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Executive Compensation

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2 SOCIAL PRINCIPLES

2.A. Adherence to Internationally Recognized Labor and Human Rights Standards

We believe that it is the responsibility of businesses to protect and uphold labor and human rights in their own operations and throughout their supply chain. Management practices that reflect adherence to the highest level of labor and human rights standards will build long-term value in the company by maintaining high levels of workforce productivity, engaging workers and community stakeholders in innovation and new business strategies and enhancing the corporate reputation for good corporate citizenship. Adherence to these standards will minimize the risk of disruption of operations due to labor or human rights disputes.

☒ We therefore generally recommend voting 'FOR' resolutions that call for implementation and independent compliance monitoring of ILO and United Nations standards and MacBride principles. We expect that the Board will oversee labor and human rights practices and report to shareholders on such practices, including worker health and safety practices, compensation practices, non-discrimination and workplace diversity practices. We therefore recommend voting 'FOR' resolutions making such requests.

See 'Labor and Human Rights' in Appendices B and C.

2.B. Transparency around Corporate Practices Involving Weapons and Repressive Governments

Good corporate citizens will take steps to counter repression and to demonstrate that they are not implicitly acquiescing in governments' or other parties' repressive practices. We believe that shareowners need full and accurate information about the company's development of products and services or corporate practices that contribute to the insecurity of governments worldwide and/or an acceleration of the arms race. These products and services may create hidden risks for the company and its investors, including reputational risks, litigation risks and physical risks from disruptions of production. We expect that the Board of Directors will provide oversight and accountability for corporate products and services or corporate practices that contribute to militarism and state aggression.

☒ We therefore generally recommend voting 'FOR' resolutions that call for Board Committees, reports or other accountability measures to assist investors in understanding the risks of corporate products and strategies related to weapons and militarism. We also recommend voting 'FOR' resolutions that call for commitment to ethical criteria written into corporate codes of conduct that seek to limit the risk of acquiescence in repressive practices.

See 'Militarism and State Aggression' in Appendices B and C.

Click the following links to read the Appendices

Labor and Human Rights

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Militarism and State Aggression

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2.C. Corporate Practices Involving Public Health and Product Safety

High corporate standards and transparency around public health issues and product safety issues will enhance a company's long-term value. Consumer concerns, regulatory frameworks and standards of ethical business practices relating to public health and product safety will impact corporate risks and opportunities. We expect that the Board of Directors will provide oversight and accountability for products and services that impact public health or raise concerns about public safety.

☒ We generally recommend votes 'FOR' shareholder proposals asking for reports on the financial, legal and operational risks posed by the use of products and services that may impact public health or product safety. We generally recommend voting 'FOR' shareholder proposals asking for the adoption of product safety policies and 'FOR' resolutions calling for the study, adoption or implementation of product safety programs in the company's supply chain. We generally recommend a case-by-case analysis of proposals that call for specific pricing or business strategies factoring established and recognized standards for public health and product safety into the considerations of the business risks and opportunities proposed in a specific resolution.

See 'Public Health and Product Safety' in Appendices B and C. . . . . ▶

2.D. Lobbying and Political Contributions

We believe that a company's lobbying and political activities should be aligned with its corporate strategy to ensure that the political and regulatory frameworks within which the corporation operates will support the creation of long-term value for all stakeholders. Clear company guidelines and accountability for political activities including direct and grassroots lobbying and political contributions are the responsibility of the Board of Directors.

☒ We generally recommend voting 'FOR' proposals asking for disclosure on company guidelines and practices regarding political activities, including political contributions, political lobbying and trade association spending.

See 'Political Influence' in Appendices B and C. . . . . ▶

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3 GENERAL SUSTAINABILITY PRINCIPLES

3.A. Board Oversight of Sustainability Strategies and Performance

As long-term investors, we believe that management practices that address sustainability provide the best foundation on which to build long-term financial value. We expect that the Board of Directors will provide oversight and accountability for corporate sustainability strategy and performance.

☒ We therefore generally recommend voting 'FOR' resolutions that call for the establishment of a committee of the board that will assume specific responsibility for sustainability oversight within its charter. Such a committee would be responsible for considering long-term strategic planning and risk management addressing sustainability issues, such as global climate change and water scarcity. It would also consider the impact of its operations on political instability, environmental contamination, toxicity of materials, worker health and safety, resource shortages and biodiversity loss.

It is increasingly apparent that boards require specific expertise in order to perform key oversight functions. One such area highlighted by the financial crisis is the need for financial expertise. The challenge of becoming more sustainable, a key business imperative in coming years, requires environmental expertise at the board level as well. We therefore recommend voting 'FOR' resolutions calling for boards to nominate an independent board candidate with a high level of expertise and experience in environmental and other sustainability matters.

See 'Environmental, Social and Ethical' in Appendices B and C. . . . . ▶

3.B. Management Accountability for Sustainability Goals

We believe that once sustainability strategies have been articulated by the Board, responsibility for achieving specific sustainability goals must rest firmly with the CEO and senior corporate management for these strategies to produce the long-term value that they promise.

Executive compensation packages and incentive plans are a critical measure of a company's commitment to a particular strategy. We believe that sustainability performance results should be a core component of compensation packages and incentive plans for all executives.

☒ We therefore recommend voting 'FOR' resolutions that call for incorporating social and environmental criteria, alongside financial criteria, into formulas used for determining executive compensation.

See 'Environmental, Social and Ethical' and 'Environmental Stewardship' in Appendices B and C. . . . . ▶

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3.C. Internal and Public Policies to Reflect Sustainability Goals

We believe that a company's values and strategies should inform the policies that govern their operations and the public policies that they support through lobbying and contributions to trade associations who will lobby on their behalf. Companies must embed sustainability considerations into their corporate policies and risk management systems to guide day-to-day decision-making. Companies should clearly state their position on relevant sustainability public policy issues. Any lobbying should be done transparently and in a manner consistent with sustainability commitments and strategies. See, *Principle 2.D. herein and Principles, App. A.*

We believe that companies must track, report on and manage the environmental, social and ethical impacts of their business, including significant upstream and downstream impacts through their customers and suppliers, to ensure that they are leading their industry in sustainability solutions, maintaining their reputation and addressing significant sustainability risks.

☒ We recommend voting 'FOR' resolutions that call for commitment to policies or codes that are designed to enhance the sustainability of a company as well as its suppliers and vendors and 'AGAINST' resolutions that would require companies to justify their sustainability policies with scientific or economic analysis or would require companies to quantify their expenditures under such policies.

See 'Environmental, Social and Ethical Principles', 'Climate Change' and 'Political Influence' in Appendices B and C. . . . . ▶

3.D. Stakeholder Engagement around Sustainability Policies, Plans and Performance

Companies will benefit from ongoing and systematic engagement with a range of stakeholders. These stakeholders can provide diverse perspectives on, and support for, corporate sustainability initiatives. Stakeholders should regularly engage with corporate management and when necessary with Boards on sustainability risks and opportunities, including materiality analysis.

For investors to participate in corporate value creation (through their investment and corporate governance functions) they must be informed about the relevant sustainability risks as well as strategic opportunities. Companies must proactively address specific sustainability risks and opportunities during annual meetings, analyst calls and other investor communications. When investors request dialogues and commitments around sustainability issues, these requests should be promptly honored and the outcomes of these dialogues openly disclosed.

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Consistent with this principle, we recommend voting 'FOR' resolutions that request reports on how companies are accountable for the impact of their operations on the communities in which they operate. Relevant disclosures include emissions, environmental and health impacts, community consultation, integration of community environmental accountability into the company's code of conduct and the extent to which company actions have a negative impact on the health of those living in poor communities.

See 'Environmental, Social and Ethical Principles' and 'Environmental Stewardship' in Appendices B and C. . . . . . ▶

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3.E. Sustainability Disclosure

In addition to a general principle of transparency, companies that make particular disclosures about sustainability commitments, programs, performance and impacts to their stakeholders will not only create long-term value through higher-quality management information systems and internal controls, but will also allow investors to discriminate between corporations on the basis of their long-term sustainability policies, practices and performance.

Where sustainability issues have material impacts on corporate strategy, risks, opportunities or performance, these issues should be disclosed in financial filings.

In addition, companies should disclose all relevant sustainability information using the Global Reporting Initiative (GRI) Guidelines as well as additional sector-relevant indicators. These disclosures should include significant performance data and targets relating to their global direct operations, as well as the operations of subsidiaries, joint ventures and supply chain. Disclosure should be balanced, covering challenges as well as positive impacts.

We recommend voting 'FOR' resolutions calling for sustainability reports describing the company's ESG performance and goals in line with GRI guidelines. In addition, we also recommend voting 'FOR' resolutions requesting specific information on sustainability issues such as greenhouse gas emissions and management plans for their reduction, sustainable water management, sustainable forestry practices and FSC certification of wood and wood fiber products, operations in ecologically sensitive areas such as the Arctic National Wildlife Refuge and the impact of tar sands oil extraction, the cleanup of toxic sites caused by environmental contamination and strategies for the recovery and recycling of beverage containers.

We recommend voting 'AGAINST' resolutions sponsored by climate skeptics designed to obfuscate sustainability risks and opportunities.

See 'Environmental, Social and Ethical' and 'Climate Change' in Appendices B and C. . . . . ▶

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4 ENVIRONMENTAL PERFORMANCE PRINCIPLES

4.A. Adoption of Specific Environmental Policies

Quantitative measurements of sustainability are necessary for investors to compare corporate securities. One measure of a company's commitment to a long-term value creation strategy is the company's adoption of universally recognized global environmental and human rights policies and principles. Companies should reference principles that they have adopted and how they are applying them in their day-to-day decision-making.

Where shareholder resolutions make a request for adoption of universally recognized environmental policies, we recommend a 'FOR' vote. Examples where we would recommend votes 'FOR' resolutions include requests that the board adopt specific policies on global warming, FSC certified wood and paper fiber purchasing, and sustainable access to water of local communities in which companies operate, particularly resource extraction companies using water for oilfield injection or mineral processing.

See 'Environmental Stewardship' and 'Climate Change' in Appendices B and C.

4.B. Adoption of Specific Environmental Performance Goals and Measurements

Long-term value depends not only on the strategic direction of the company, but also on the day-to-day performance goals and measurements used by the company. Companies should adopt goals and relevant benchmarks to address environmental performance issues including:

- Green building and smart growth strategies
- Greenhouse gas emissions and energy efficiency
- Water use and wastewater discharge
- Manufacturing and business processes causing toxic air emissions and hazardous and non-hazardous waste
- Environmental impacts of corporate logistics and transportation of personnel and products

We therefore recommend voting 'FOR' resolutions that request boards to set greenhouse gas reduction targets and to measure and disclose emissions.

See 'Climate Change' in Appendices B and C.

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4.C. Corporate Investments in Sustainability

The corporation's investment strategy should align with its sustainability principles and its sustainability and environmental performance goals. Companies should adopt investment principles, goals and performance benchmarks to address sustainability issues in the following areas:

- Companies should use sustainability as a filter through which all R&D and capital investments are made. Companies should set a percentage goal for R&D investments focused on developing sustainability solutions.
- Companies should approach all product development and product management decisions with full consideration of the social and environmental impacts of a product throughout its life cycle. Companies should set targets and benchmarks for reducing the environmental impacts of products and services.
- Companies should align their marketing practices and product revenue targets with their sustainability goals, and market their designed-for sustainability products and services with at least the same effort as their marketing of other products.[10]

☒ We therefore recommend voting 'FOR' proposals asking companies to increase their investment in renewable energy research, development and sourcing and in research and product development aimed at energy waste reduction improvements and other sustainability solutions.

See 'Climate Change in Appendices B and C. . . . . ▶

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10 See *21st Century Corporation: The Ceres Roadmap to Sustainability*, 13. http://www.ceres.org/resources/reports/ceres-roadmap-to-sustainability-2010

Conclusion

It is disillusioning that many of the nation's largest asset managers have little or nothing to say about how they intend to vote on shareholder-sponsored resolutions that address material topics such as climate change, water availability, environmental stewardship and other key sustainability trends. It is not logical, in fact it seems myopic, to refer to these resolutions collectively as 'special interest', 'non-routine' or as involving 'special circumstances,' as some of the nation's largest asset managers have in their current proxy voting guidelines.

To cite just one example, climate change is a material risk consideration for asset managers in at least four ways: regulatory risks, physical risks, legal risks and competitive and reputational risks. The balance of scientific evidence overwhelmingly shows that human-induced global warming is altering our global environment, and the rate at which this is happening is increasing dramatically.[11] In 2010 alone, more than 100 climate-related lawsuits were filed in the US, continuing an exponential trend of year-on-year increases in climate-related litigation activity.[12]

Released in January 2011, the World Economic Forum's *Global Risks 2011, Sixth Edition* finds climate change to be the #1 Global Risk when ranked by a combination of likelihood and impact.[13] The ranking draws on the insights of 580 expert respondents to the Forum's Global Risks Survey across stakeholder groups and regions. The survey measured the perception of risk likelihood, risk impact and risk interconnections from 2010 to 2020 for 37 global risks. Risks considered include, amongst others, food insecurity, terrorism, geopolitical conflict, fragile states, biodiversity loss, fiscal crises, water security, etc. In fact, many of the other 36 global risks are themselves very clearly linked to climate change. Of the four groups of respondents: governments, business, academia and international organizations, only business respondents failed to rank climate change as the most concerning global risk factor.

Cities and states in the US are pledging emission reductions where the federal government fails to provide leadership in this area. For instance, in the closing weeks of 2010 California regulators voted to implement a state-wide carbon trading program, the first in the US, and to cap the greenhouse gas (GHG) emissions of at least 600 large industrial plants in the state. US companies operating internationally are subject to a growing number of regulatory and market pressures to reduce emissions and improve the efficiency of their operations.

Finally, it is hard to imagine how investors can ignore the competitive and reputational capital risks attending the environmental impacts of the corporate operations of their portfolio companies following the BP Gulf oil spill, and the tsunami-induced nuclear power disaster in Japan.

It is disillusioning that many of the nation's largest asset managers have little or nothing to say about how they intend to vote on shareholder-sponsored resolutions that address material topics such as climate change, water availability and other key sustainability trends.

11 The Intergovernmental Panel on Climate Change, drawing on the voluntary efforts of thousands of scientists from all over the world, has been regularly assessing the available scientific evidence since 1988, with the fifth Assessment report due in 2011. See: http://www.ipcc.ch

12 See: Deutsche Bank Climate Change Advisors (DBCCA) (2010) 'Growth of U.S. Climate Change Litigation: Trends and Consequences' , 3 November: http://www.dbcca.com/dbcca/EN/_media/US_CC_Litigation.pdf

13 World Economic Forum (2011), Global Risks 2011, Sixth Edition, An initiative of the Risk Response Network http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2011.pdf

Resolutions requesting disclosures, policies or other actions relating to industrial contaminations and emissions, community social and environmental impacts, sustainable forestry, drilling and other operations in ecologically sensitive areas, water use, sustainability reporting, GHG emissions from operations, strategies for energy efficiency, corporate policy on climate change and quantitative goals for GHG emission reductions comprised more than 10% of the total number of shareholder-sponsored resolutions voted on at large US publicly traded corporations in the 2010 proxy season. Fully 66 resolutions dealt with environmental and sustainability issues out of a total of 619 resolutions that came to vote in 2010—this constitutes one of the largest categories of shareholder-sponsored resolutions.

Our message to asset managers, asset owners and voting fiduciaries that have yet to incorporate specific mention of the various sustainability issues into their proxy voting guidelines is this: "Now is the moment to act." You cannot defer to the opinion of specific management bodies in deciding how to vote on issues that will help determine business success or failure and significantly impact long-term value creation in the coming years. If you fail to specifically address these issues in your guidelines, you run a serious risk of breaching your fiduciary duty by voting inconsistently or failing to vote on resolutions of critical importance to the companies you own and the shareholders or beneficiaries to whom you owe your fiduciary duty.