Engaging with Wellington Management Company

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Carolina San Msartin
Managing Director, Director of ESG Research
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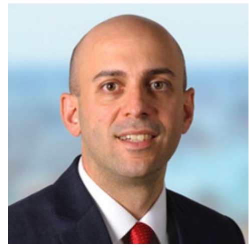
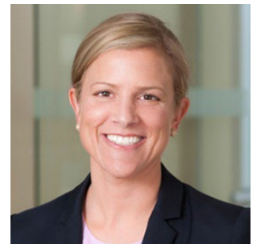


Chris Goolgasian
Managing Director, Director of Climate Research
Wellington Management Company



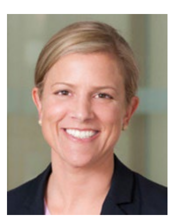
Hillary Flynn
Managing Director, Director of ESG, Private Investments
Wellington Management Company

Krystal: How is the ESG Research team structured within Wellington?

Carolina San Martin: At Wellington, we see ESG research as an investment research capability that can support better investment decisions and help us deliver on our firm's mission to exceed our clients' investment expectations. To do this, our ESG analysts work closely with our equity and credit analysts to bring the ESG issues we think matter most to bear on investment decisions and drive better outcomes. All of us sit together within our central Investment Research team, and we believe that collaboration across equity, credit, and ESG research can lead to a deeper understanding of the investment mosaic through expertise in each dimension. Our ESG Research team currently has 8 sector ESG experts focused on both research and stewardship – engagement and proxy voting – across public and private markets. We also have a dedicated Climate Research team that focuses on the potential impacts of climate change across the capital markets and on our clients' portfolios across sectors.

ESG Sector Research Team:

Carolina San Martin, CFA
Director, ESG Research
Managing Director
Energy

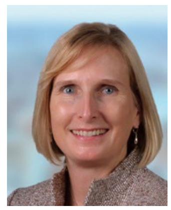


Hillary Flynn
Director, ESG, Private Investments
Managing Director

Jeff Barbieri
ESG Analyst
Vice President
Financials,
Information Technology

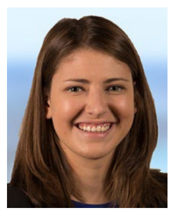
Sean Caplice, CFA
ESG Analyst
Vice President
Consumer

Natacha Dimitrijevic
ESG Analyst
Vice President
Internet, Media & Telecom



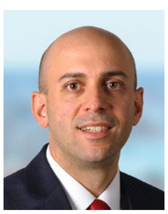
Jennifer Rynne, CFA
ESG Analyst
Managing Director
Utilities, Property, Transport

Michael Shavel, CFA
ESG Analyst
Vice President
Materials, Industrials

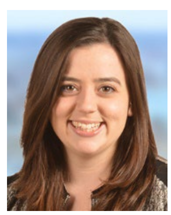


Jessica Fry
Research Associate
Health Care

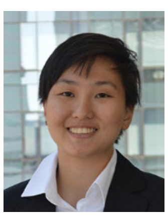
Climate Research Team:



Chris Goolgasian, CFA
CPA, CAIA
Director, Climate Research
Managing Director



Julie Delongchamp, CFA
Climate Transition Risk
Analyst



Jenny Xie
Research Associate

Krystal: How is ESG integrated into the investment process at Wellington?

Carolina: Our ESG integration philosophy comes down to two core beliefs that act as our North Star. First is a belief that *material* E, S, and G issues are strategic business issues that can impact performance. This is why we have a dedicated team of experts to identify them, analyze them, and bring insights to our portfolio managers (PMs) so they can be taken into account in investment decisions. Second is a belief that it doesn’t stop at the research – as our clients’ fiduciaries, we have a responsibility to give feedback to companies when they can improve, using the tools of voting and engagement, because when they perform better on ESG issues that are most relevant to financial outcomes, our clients should benefit.

We take an investment-led, bottom-up approach to ESG analysis, putting the issues in the context of the investment thesis, which leads to a holistic and truly integrated approach to assessing companies, all to drive better investment decisions for our clients.

As we've developed our team over the years, we've been deliberate about building it out as an investment research capability that is fully integrated in our firm's investment culture so we can drive ESG integration across the platform. That means that our ESG analysts are expected to be active contributors to the firm's investment dialogue along with our equity and credit analysts and all of our investment professionals. That starts with our daily morning meeting of investors across our platform, which you can see in action on our web site, and extends to sector team meetings and ongoing one-on-one dialogue with other investors about specific ESG issues that relate to holdings in client portfolios.

Krystal: How does the ESG Research team partner with Portfolio Managers?

Carolina: Just like other research analysts at Wellington, our ESG analysts bring research insights to our PMs so they can incorporate them into their own philosophy and processes and consider them in a manner that is consistent with their clients' investment objectives and approach. We rely heavily on our sector research counterparts in equity and fixed income as a resource to inform our work, and in turn, they benefit from our depth of expertise on ESG issues to inform their analysis and insights. In many cases, our analysts have been covering their companies for decades. This partnership works really well - we each bring something to the table to deepen our collective understanding of companies.

While we communicate our views to PMs in various forms in the natural course of our research, we also sit down with PM teams for more structured ESG portfolio reviews to support their ESG integration process. In these meetings, each ESG analyst talks about their sectors and highlights the most relevant ESG issues across their portfolio companies that we believe PMs should focus on.

Since we don't have a chief investment officer, we don't have a "house view." In our "community of boutiques" model, each PM employs his or her own unique philosophy and approach to meeting clients' investment objectives. Accordingly, there is no single, top-down-prescribed way that our PMs consider ESG issues in their investment decisions. For example, some of our PMs invest in "best-in-class" ESG performers while others may invest in companies whose ESG performance has lagged but is at a positive inflection point and they believe this is a tailwind behind the investment thesis. However they go about it, each of our PMs has their own approach to ESG integration that is intrinsic to their investment philosophy and process.

Krystal: Your Investment Stewardship Committee is a cross-functional, firm-wide oversight body that includes PMs and analysts. Can you give us some insight into how that Committee functions and what companies should understand about how it guides policy developments?

Carolina: Our 15-member Investment Stewardship Committee (ISC) is comprised of colleagues across multiple functions and regions. The ISC oversees and monitors stewardship activities, including engagement, letter writing, and proxy voting and is responsible for establishing our proxy voting and engagement policies, which can be found on our web site. Senior-level and experienced professionals from portfolio management, investment research, relationship management, and legal and compliance sit on the ISC.

Krystal: Can you give us some more color on voting practices in general – who holds the vote and how does the ESG team get involved?

Carolina: While the ISC has created best practice guidance on how to approach specific issues that come up in the voting process, ultimately, each PM owns the final voting decision for their client portfolios. Given the ESG Research team's depth of expertise on issues that come up at companies' AGMs, we help PMs fulfill this responsibility by contributing our research and recommendations on specific voting matters.

Krystal: What is typically driving a split vote on a ballot item?

Carolina: Split votes can certainly happen and it's consistent with our community of boutiques model. Accordingly, PMs occasionally arrive at different voting conclusions for their clients, resulting in a split decision for the same security. Split votes are the result of a robust deliberation process where PMs make the final decision in the context of their own philosophy and process to achieve their clients' objectives. We believe this process is aligned with our role as active owners and fiduciaries for our clients.

Krystal: Have there been any changes to your voting guidelines in the last year?

Carolina: Ahead of the 2020 voting season, the ISC approved a change to our approach to shareholder proposals. We continue to evaluate shareholder proposals related to environmental and social issues on a case-by-case basis, but we are increasingly looking for ways to align our voting with our engagement activities to encourage continuous improvement among portfolio companies on issues we deem most relevant to their long-term success.

We consider the spirit of the proposal, not just the letter, and generally support proposals addressing material issues even when management has been responsive to our engagement on the issue. In this way, we seek to align our voting with our engagement activities. If our views differ from any specific suggestions in the proposals, we provide clarification via direct engagement.

Krystal: Let's talk a little bit about the data you're using. When you're evaluating sustainability and governance practices of portfolio companies, are you bringing in raw data and putting it into a model or are you taking the third-party ratings and using your own methodology?

Carolina: We do both. We use third-party ESG rating providers, but primarily as a *starting point* for our work. Third-party ESG ratings provide broad coverage and scale so we have a consistent starting point for further research. However, we often find that the methodologies used don't align squarely with our own ESG research philosophy. We've found biases in the third-party ratings as well. For example, most are disclosure based which means they are inherently backward looking and give credit for disclosure even when business practices themselves are lagging.

We are investing with a forward-looking view in mind and want to really understand the practices that could signal a future competitive advantage or emerging risk for a company. And while we certainly advocate for improved disclosure, when it's not there yet, we are able to fill in the gaps through engagement, which also helps us understand companies' future plans and potential for improvement.

For these reasons, we use the third-party raters as a way to identify outliers across a broad opportunity set, but ultimately our ESG analysts develop their own sector frameworks and do their own bottom-up work to assess companies. It's the insights from this work that we share and discuss with PMs to support their ESG integration process.

Krystal: Given what we've just talked about with how you use ESG data, in your view, how should companies think about their scores from ESG ratings providers?

Carolina: We acknowledge that there are a lot of mixed messages in the market about these ratings. Different providers have different methodologies and it can be quite confusing for companies. We advise portfolio companies to focus on improving ESG disclosures on the issues they think are most important for an investor audience, whether that's in the annual report, sustainability report, their web site, or an investor presentation.

Krystal: How do you encourage companies to move toward standard disclosure - is it framework related?

Carolina: The frameworks are a good starting point for looking at an industry for the first time and getting a baseline for materiality. In our experience, SASB is a very useful framework. We recognize that there may be some metrics that aren't as relevant to a company, but the framework provides a starting point that investors can appreciate. We encourage companies to adopt both SASB and TCFD (for climate-related disclosures) since they are investor-focused and emerging as global standards for disclosure. Ultimately we're most concerned with seeing more consistent disclosure of issues that will matter to long-term outcomes for each specific company.

Krystal: How should companies prepare to engage with you, particularly on environmental and social issues?

Carolina: Companies should come prepared to talk about the sustainability issues they believe are important to their business. If a company doesn't bring an issue up that we believe could be important, we will raise it. It all comes back to the tenets of our philosophy. Each member of the ESG Research team has a sector materiality framework which includes the issues we think are material for the industries we cover.

Krystal: Do you have a preference about who from a company you like to have join engagement meetings?

Carolina: We engage with people in various roles within a company depending on the topic, and we think having multiple touch points and seeing how the conversations fit together is useful in informing the mosaic. We are increasingly focused on board engagement in our process to understand directors' strategic thinking on those ESG issues that are material for long-term business success.

Krystal: What is the balance you seek in engagement in terms of your focus on environmental and social issues, governance issues or compensation?

Carolina: The 'G' is always present, and we're bringing in E & S issues into the conversation depending on who we're meeting with and what engagement priorities are coming up through our research. During voting season we will likely touch on issues coming up in the company's AGM. Both ESG analysts and other Wellington investors can host company meetings that touch on ESG issues. This is a reflection of our integrated philosophy and approach – when you engage with Wellington, it's not one person or one team that you're engaging with, it is likely several analysts representing perspectives from our equity, credit, and ESG teams as well as portfolio managers and their team analysts.

Krystal: How has COVID-19 influenced your engagement priorities? Are there other issues you will be focused on in your engagements this fall?

Carolina: The impact of the pandemic on companies and how companies are adapting has been a key focus of our engagements this year, and we expect that to continue into the fall. In our conversations we seek to understand how boards and management teams are interacting to manage through the crisis, what they are doing to bolster resilience, and how companies are responding to the needs of key stakeholders e.g. their employees, customers, and communities. We also look to understand what companies see as the potential longer-term impacts of the pandemic on their business and their plans to adapt accordingly. Finally, we have been spending time on the impact of COVID-19 on companies' compensation practices and believe this will be an area of increased focus in the 2021 voting season.

Diversity and inclusion has long been an engagement priority but we have also heightened our focus in this area given the most recent instances of racial inequity and injustice across the U.S. These events have prompted us to use the ESG lens to re-examine ourselves as a firm and further reflect our mission to be diverse, inclusive, equitable, and humanistic. We are diving deeper on our diversity practices, aiming to raise the bar for our firm and the companies we invest in on behalf of clients.

As we look ahead to the fall, we will use company engagements to better understand their response to racial inequity. This dialogue will form the basis of a practice-sharing document that we will draft and share publicly. We are also planning an internal consumer-sector-focused diversity panel that will feature company executives and may serve as a pilot for similar panels tailored for other sectors. Our goal is to gain deeper knowledge of the companies we invest in on behalf of our clients, enhance our diversity approach by learning from others, and facilitate practice sharing across a wide swath of companies. We expect that the lessons we learn in this process will change how we hold portfolio companies accountable, including via our proxy voting policies.

Krystal: Hillary – as Director of ESG for Wellington's Private Investments, can you describe how you engage with private companies?

Hillary Flynn: Over the past decade, ESG has become an increasingly important part of the investment process across all asset classes, and we believe private equity should be no exception. My goal as a member of our Private Investments team is to help ensure that ESG integration happens in a formal, systematic way. My prior areas of focus and coverage as a member of our ESG Research team were Consumer and Health Care-related, which aligns well with private company opportunities and positions me to share lots of best practices and lessons learned from the public market with our private companies.

The Private Investments team assesses companies' ESG profiles early on so we have a more holistic and relatively consistent message throughout the due diligence process. Post investment, we gather and track data on companies' ESG practices, which includes engaging with management teams to address potential ESG risks. Finally, for our portfolio companies considering an IPO, we can provide guidance on ESG topics as they map their path to the public market. We've seen examples when ESG issues such as lagging governance practices have significantly impacted the success of IPOs, so we think this is a great opportunity to leverage our public market experience and deep ESG expertise to help enhance returns for our LPs.

Krystal: I want to shift gears a little here and discuss Wellington's collaboration with CalPERS and the Woodwell Climate Research Center to analyze and better understand the physical effects of climate change – the Physical Risk of Climate Change (P-ROCC) framework. Chris, you are director of Climate Research here at Wellington and have led this effort. What should companies know about this initiative?

Chris Goolgasian: We announced the P-ROCC disclosure framework in September 2019 with really one primary goal - to help asset owners and investment managers better evaluate the ability of the companies they invest in to adapt to or mitigate the potential effects of the physical risk of climate change. That risk can relate to extreme heat, drought, wildfires, hurricanes, flooding or water access. We're working with CalPERS and sourcing our data from the Woodwell Climate Research Center, which is a globally renowned science-led organization that has been ranked as the top climate science think tank globally.

We're looking to help companies understand the 'how' of identifying, measuring and managing their exposure to physical risk of climate change. We're not saying to companies that they must comply with the framework; it's more about helping them think through disclosure that's useful to the markets.

Components of disclosure

Krystal: Why are you focused on physical risk?

Chris: We're trying to change the conversation so that companies begin to think about physical climate risk as an enterprise risk. Company management teams have legal, audit, compliance, cybersecurity teams, but relatively few are paying attention to the physical impacts of climate change on the horizon. Part of the reason for this is the market has been focused on transition risk, essentially the risks and opportunities arising from shifting to a low carbon economy. Of course that's important, but it's not the only climate risk that companies face. We want to help facilitate a broader discussion.

Krystal: Have you prioritized which companies you'll be assessing and planning to meet with to discuss their exposure to physical climate risk?

Chris: We're doing this now at the portfolio level. We created something called CPR – Climate Portfolio Review. We'll take an equity portfolio of stocks held by one of our PM teams and read each company's 10-K, their CDP disclosure, earnings transcripts and investor decks. We identify what the company says their risks are or what they don't say, we'll line that up with their geographic locations and our climate maps and we'll be able to identify risks that they may not be talking about.

We share this research with the PM and the next time a relevant company management team is in for a meeting, the PM has the research to ask about, for example, if a company's physical plants are in specific flood risk areas and the PM may explore how the company is thinking about that. We've started having conversations like this with companies and so far they have been really productive.

Krystal: What has the company reaction been when you've engaged with them on physical risk?

Chris: They've been positive, but we know it's going to take time for companies to fully embrace this concept, even if they are open minded about the issues. On the one hand, physical risk is actually a much more down-the-fairway business discussion than other ESG topics - where your plant and customers are located are both topics that companies are thinking about anyway. On the other hand, it can be easy for people to say that certain risks are unforeseeable or even that you can't fully plan for them. With the data we have, we feel that these climate change-based risks are now knowable, not with the precision of time but with probability over time.

Carolina: Our experience so far has been that if this issue is already on a company's radar, they are more apt to connect with us on this. Some companies are doing a lot around physical risk but are not referring to it as an effort to address climate risk per se. In any case, it's become a big engagement opportunity because we have the scientific research. We recognize that it still takes time, people and resources to think through these issues.

Krystal: Does any company not have an issue with physical risk?

Chris: The key question is materiality. Every company may have some level of physical climate risk but it may not always be material. When we review a portfolio we might find that 15-25% of the holdings have what we consider to be a material risk. Sometimes these are from obvious sectors like infrastructure, real estate, insurance, mining, but not always. Physical climate risk is all about location and concentration, and that combination could hit just about any industry or company in a material way.

Krystal: Where and how do you envision companies will disclose this information?

Chris: I believe that regulations will eventually compel companies to disclose more comprehensive assessments of physical climate risk. If companies believe that physical risk is an enterprise risk, it should be evaluated at the board level and disclosed alongside other risks in the 10-K and at least get a page in the investor deck.

Krystal: Shifting back to governance as we wrap up here, I want to touch on a topic where we've seen a lot of activity in recent years - asset manager disclosure of stewardship activities. Some of this new disclosure is market driven and some of it is driven by regulation. How is Wellington navigating these new demands?

Carolina: There have been a series of new market standards and regulations, across different markets, which have had an impact on how we think about transparency and disclosure. Examples include the UN Principles for Responsible Investment, which we signed in 2012, and the UK and Japan Stewardship Codes which have introduced requirements in those markets, and the EU-wide Shareholder Rights Directive (SRD). Recent amendments to the SRD and the UK Stewardship Code now require asset managers to disclose their stewardship activities across all asset classes, including both engagement and voting, with an emphasis on demonstrating the *outcomes* of those activities.

In our view, the spirit of these requirements is that investors across categories have a role to play in supporting the success of their portfolio companies. One way to do that is by giving feedback in a constructive way that drives change so that the company, investors, and other stakeholders fare better over the long term. As an active manager, this comes naturally to us because we are equity and debt holders by choice. We are rooting for the companies we invest in to be successful, and we strive to support them constructively through our stewardship efforts.

Krystal: Final question - a narrative we've seen in the market recently is that active managers, Wellington included, have become more willing to be public and vocal in advocating for their thoughts on company actions or M&A transactions. There are a number of reasons given why that's the case, but, we wanted your thoughts on whether you think that is a fair characterization

Carolina: We've always had the ability to be vocal and we are very active in our dialogue with our portfolio companies. Making a public statement has been and remains a tool we can use if we determine it's in the best interest of our clients. What drives our stewardship activities first and foremost, whatever form they take, is our fiduciary mindset. If a specific set of circumstances leads us to conclude that being vocal is the best path forward to serve our clients, then we will pursue it.

About PJT Camberview

PJT Camberview, the corporate governance and shareholder engagement practices group of PJT Partners LP ("PJT Partners"), is a leading provider of investor-led advice to public companies on engagement and shareholder relations, activism and contested situations, sustainability and complex corporate governance matters. PJT Camberview helps its clients succeed by providing unique insight into investors' perspectives on long-term value creation, interpreting the evolving governance landscape and creating proactive strategies to stay ahead of investor challenges.