

SHAREOWNER ADVOCACY AND IMPACT

MIXED SIGNALS

2017 was a year of contrasts. Our corporate engagement was full of productive dialogue resulting in significant progress: 47% of the 15 shareholder proposals we filed were withdrawn — often a positive indication that a company is receptive to investor concerns precluding a shareholder vote. This compares favorably to the overall estimate of 25% of shareholder proposals withdrawn in 2017, per the EY Center for Board Matters.

However, shareholder rights are now under intense legislative and administrative threats that may increase the number of proposals that get omitted from the ballot and even curtail our ability to file proposals at all. Ironically, these challenges coincide with the growing integration of environmental, social and governance (ESG) factors into investment decision-making. Support of shareholder proposals filed by mainstream institutional investors on climate, diversity and other ESG issues is also on the rise as proxy voting policies are enhanced.

This “ESG tipping point” is exemplified by a recent letter from Larry Fink, CEO of Blackrock, the world’s largest investment management firm. Remarkable even in its title, “A Sense of Purpose,” his letter drives home the role of the private sector in delivering solutions to the world’s biggest challenges by taking a broader stakeholder view underpinned by long-termism. He notes that “...investors’ increasing use of index funds is driving a transformation in BlackRock’s fiduciary responsibility and the wider landscape of corporate governance...” such that BlackRock must pursue a more aggressive corporate engagement strategy. We look forward to seeing how BlackRock’s stance influences other large asset managers.

PROPOSED LEGISLATION AND SEC RULEMAKING

The Financial Choice Act 2.0 passed the house in 2017. Section 844 of the Act would virtually eliminate shareholder proposals by:

- changing the holding requirement to 1%, from a \$2,000 ownership, to submit a proposal
- increasing the resubmission thresholds for re-filing the same resolution in subsequent years
- prohibiting proposals by proxy, thus preventing investors from delegating this task to their advisor.



The Corporate Governance Reform and Transparency Act also passed the house. If it becomes law it will jeopardize the independence of research and voting recommendations that we receive from our proxy voting service, Institutional Shareholder Services (ISS). The Act requires that recommendations be shared with companies for comment and potential revision, prior to release to investors. This is highly concerning for investors who require (and pay for) unbiased research!

The SEC also received a petition from the Corporate Governance Coalition for Investor Value, an organization under the U.S. Chamber of Commerce umbrella, asking for rulemaking that would increase resubmission thresholds (the level of support required for a proposal to be resubmitted again within a five-year period) from 3% to 6% in the first year, from 6% to 15% in the second year and from 10% to 30% in the third year. Higher thresholds would be a barrier to educating companies and shareholders on emerging or little understood issues. For example, the average support level for shareholder proposals asking for annual board of director elections in 1987 was less than 10%, but increased to 81% by 2012. Annual board elections are now accepted as good corporate governance.

The perceived problem that this petition addresses –the filing of the same low support proposal year-after-year– does not appear to exist. Since 2010, shareholders resubmitted proposals on environmental and social issues only 35 times and impacting only 26 companies, where votes fell under 20% for two or more years.



THE UNCERTAIN IMPACT OF SEC STAFF BULLETIN 14I

While the aforementioned threats linger, our immediate concern is SEC staff bulletin 14I released on November 1, 2017. Staff bulletins are intended to clarify how investors and companies can best comply with formal SEC rules that guide the shareholder proposal process, but the broad language of 14I invites interpretations that may tip the balance of power towards corporations.

Clients must now sign a separate authorization for each proposal filed, effectively reversing previous SEC guidance that allowed a client to designate an advisor to act on their behalf for all proposals. Although we believe that state law allows such delegation, we have amended our process to accommodate this inconvenience.

The longer-term impact is more concerning. There are two commonly used grounds for excluding a proposal from a company's proxy statement: the "ordinary business exception" (proposals addressing day to day operational aspects of a business enterprise,) and the "economic relevance exception" (proposals that address operations that account for less than 5% of assets, sales, or revenues.) These apply unless it is determined that a proposal relates to a significant policy issue that "transcends" ordinary business.

In addition, Corporate Boards may now include a formal opinion as part of a proposal challenge. The bulletin states that such opinions will inform decisions that "raise difficult judgment calls" and that a board knowledgeable of the company's business "...is better situated than the staff to determine whether a particular proposal is significantly related to the company's business." Previously, the SEC made such an assessment independent of Corporate Board input, deciding in favor of many proposals addressing compelling and publicly debated societal and economic issues. These SEC decisions served as guideposts for both investors and companies as to how the SEC would handle challenges from other companies on similar proposals.

We are now seeing proposal challenges that test the boundaries of both the "ordinary business" and "relevance" exceptions, with Corporate Board assessment being used to contest the kinds of proposals that have previously been filed in volume, passed SEC scrutiny, and received considerable shareholder support.

Apple was the first company to take advantage of 14I. It challenged four proposals that included Board opinions, with one, addressing human rights, surviving SEC scrutiny. The Board's opinions did not address the significance of the specific request within each proposal, as the bulletin requests, but argued that as the company currently addresses the broad issue regularly at its board the issue has become "ordinary business",

rendering it excludable. While the SEC sided with the filer of the human rights proposal, the comments behind its decision to exclude the greenhouse gas reduction proposal are of concern: "In our view, the Proposal seeks to micromanage the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." The complexity of an issue should have no bearing on the right of investors to engage on that issue as these issues can have tremendous impact on investor returns.

Many companies (including Travelers, where we filed a lobbying proposal) have challenged proposals based on "relevance" using an argument that we believe is irrelevant. Travelers redefined this relevance exclusion threshold to cover expense incurred, i.e. the proposal should be excludable because lobbying expenses account for less than 5% of assets, sales or revenue.

Will the SEC respond to proposal challenges generated by 14I according to their stated mission of investor protection or increasingly defer to the Company's assessment? It is still too soon to tell, but we know that SEC decisions in 2018 will set the tone for years to come.

As a result of these developments, First Affirmative has been ramping up its activity. Last year we mobilized advisors and clients to reach out to their congressional representatives as the Financial Choice Act was making its way through the House of Representatives, and we will continue to look for opportunities to influence the public policy agenda with the support of the broader community. We continue to collaborate with investor coalitions, including the Shareholder Rights Group, an association of investors formed in 2016 to respond to legislative and policy changes and to engage with public companies on governance and long-term value creation.

OUR 2017 ACTIVITY

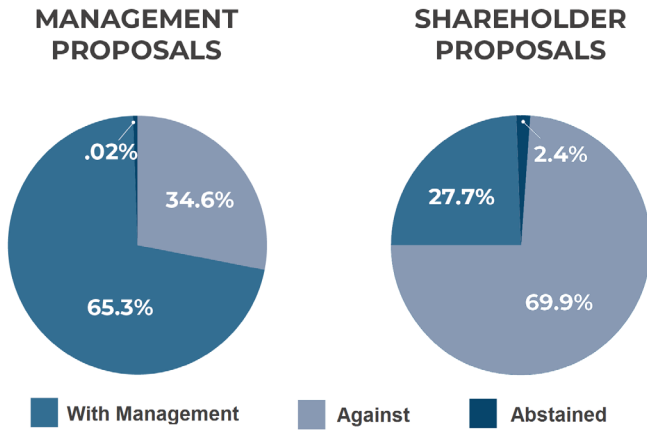
PROXY VOTING

Our stringent voting guidelines continue to generate atypical results. We voted against management recommendations on over 65% of executive compensation packages (compared to 7% of shareholders, overall, voting against). Average director support continues to hover at over 95%, while we voted against 27% of board members where there were fewer than 30% women on the board. We supported 69% of 486 shareholder proposals presented on ESG issues.

We made significant progress this year influencing significant changes to proxy voting policies at some of the biggest investment management firms, including BlackRock. Engaging with investment managers on this issue continues to be a priority.

SHAREHOLDER PROPOSALS

First Affirmative filed 15 proposals, serving as lead filer on proposals at Travelers, Kinder Morgan and co-leader at BlackRock.

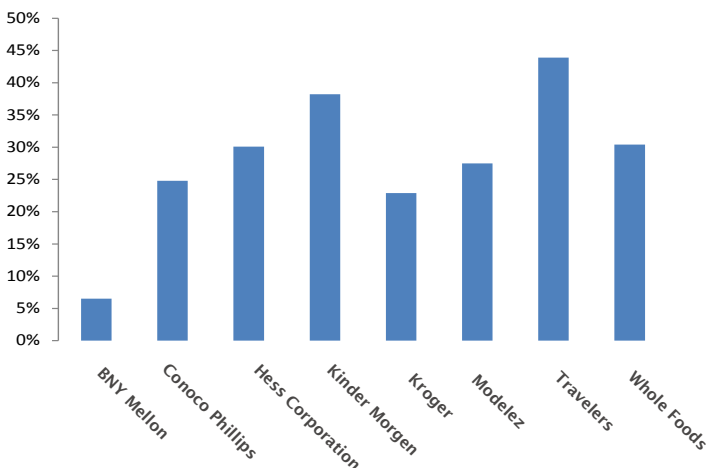


We continue to communicate with companies using a range of techniques, including dialogue and customized letters, as well as signing on to multi-investor letters that address issues of common concern.

DIALOGUE

Our four-year dialogue to address climate risk in lending and investment portfolios with Fifth Third Bank progressed rapidly over the past year. The company has formally established board oversight of climate issues, established an executive committee to specifically address climate risk management and clean energy product development, and convened an internal working group to evaluate disclosures and explore the implementation of the Task Force on Climate-related Financial Disclosures (TCFD). These accomplishments represent a substantial and welcome shift in governance practice that we believe will facilitate the changes necessary for the bank to effectively support, and benefit from, the transition to a low carbon economy.

2017 Resolution Support



We discussed chemical risk management and reporting with Ecolab, CVS and Costco. All three companies report progress, but CVS established itself as a leader by instituting a restricted substances list and implementing a phase out plan for all CVS branded products. They became the first major pharmacy chain to become a signatory of the Chemical Footprint Project, pledging to influence suppliers to respond to this annual survey that measures corporate progress to reduce use of chemicals of high concern and to integrate safe alternatives.

We discussed proxy voting policies as part of our engagement with Blackrock and J.P. Morgan, leading to substantial changes in policy and some change in voting behavior. Blackrock in particular has made emphatic public statements that indicate a strong commitment to corporate engagement, to include an aggressive engagement priorities plan implemented by an expanded Investment Stewardship team and more stringent proxy voting practices focused on key issues including climate, diversity and compensation.

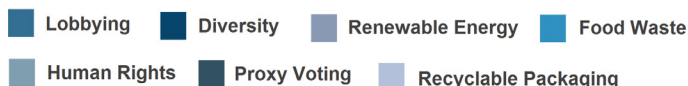
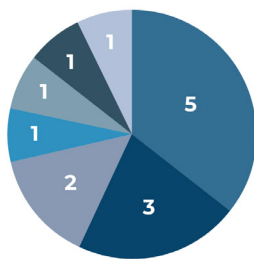
We sent letters to over 100 companies on issues including diversity, reporting according to the final recommendations of the TCFD, antibiotics in the food supply chain, human rights, renewable energy and chemical risk management.

PUBLIC POLICY

In addition to our support of shareholder rights, we weighed in on pressing public policy issues, including:

- Signing the “We Are Still In” Paris agreement statement
- Asking the G7 to support the Paris Agreement and to eliminate fossil fuel subsidies
- Opposing repeal of BLM methane emission standards
- Supporting existing Corporate Average Fuel Economy (CAFE) standards
- Supporting the Consumer Financial Protection Bureau
- Opposing Texas SB6 anti-LGBT legislation
- Supporting enforcement of Dodd Frank provisions: conflict minerals rule and median pay ratio rule

2018 Resolutions to Date



LOOKING FORWARD TO 2018

The stage is already set for 2018 as deadlines to file proposals for this year’s annual meetings fell primarily in the last quarter of 2017. Here is an overview of our advocacy priorities and activities for the coming year.

CLIMATE

We are focusing efforts on companies best positioned to take advantage of a renewable energy economy. In line with this, we joined the RE100 investor initiative which encourages companies to set time bound goals to achieve 100% renewable energy. A proposal filed at American Tower has already resulted in productive dialogue that led to a withdrawal as the company agreed to time bound goals, and to provide details in their upcoming, and first ever, sustainability report.

We continue to engage banks on climate, continuing our partnership with Boston Common Asset Management to focus specifically on pushing for widespread adoption of the TCFD recommendations.

DIVERSITY

With the unprecedented scrutiny of gender and race issues, investors have an incredible opportunity to advance diversity goals and social justice issues. In 2017, we sent letters to the few remaining companies in our major holdings with no women on their boards. Thus far, we have received encouraging responses from four companies that have taken action to increase board diversity.

We co-filed a resolution at Citrix Systems on integrating gender and racial diversity into executive compensation incentive plans, which was withdrawn after successful dialogue. We are also participating in a broader international multi-investor campaign on women’s empowerment led by Boston Common Asset Management.

CORPORATE LOBBYING

Corporate spending to influence elections and public policy, particularly corporate influence on climate policy, has been an engagement priority for years. Companies often direct some spending via third parties such as the Business Roundtable and the U. S. Chamber of Commerce, both of which are complicit in curtailing shareholder rights. To date, we have filed at five companies on this topic, including lead files at Travelers and Morgan Stanley. We withdrew the Travelers proposal as the company agreed to all disclosure requests save a disclosure of spending on trade association lobbying and we have agreed to continue discussions on this contentious issue.

ENGAGING OUR INVESTMENT MANAGERS

Many of the investment managers we work with already engage with their portfolio companies on ESG issues. However, some invest with ESG criteria but do not have proxy voting guidelines or advocacy agendas that align with their ESG practices. We recently met with two of our managers on this topic and will engage with more in the coming year.

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