AFFIRMATIVE IMPACT

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Corporate Political Spending: the Transparency Gap

By James Griffitts

Corporate political spending, and corporate disclosures thereof, are issues of concern to an increasing number of investors.

Based on a recent report compiled by the Sustainable Investments Institute (Si2) and published by the Investor Responsibility Research Center (IRRC) Institute, election spending is largely transparent:

- 90% of companies in the S&P 500 have policies addressing disclosure of election contributions;
- Half the companies on the index require board oversight; and
- 75% even disclose which corporate officials oversee election spending.

By contrast, corporate spending on lobbying is largely kept undisclosed. Although companies that meet a quarterly spending threshold are required to report details on lobbying carried out at the federal level, disclosure of corporate spending via third parties such as trade associations and lobbying at the state level is rare. Only 12% of S&P 500 companies report how much they spend in total on lobbying.

The State Lobbying Transparency Gap

Some states, like California and New York, ensure transparency through robust disclosure requirements, but most have less comprehensive lobbying disclosure laws: 22 states require no disclosure of corporate political spending.

Companies that do disclose generally do so only at the federal level. While many companies actively lobby at the state level, only 5% even identify in which states their lobbying efforts occur: just 2% report on aggregate spending on state

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lobbying, and only two companies from the S&P 500 are fully transparent.

Federal lobbying spending has leveled out; however, spending at state level continues to rise. The Washington Post found that $2.2 billion was spent on state lobbying from 2013-2014 in the 28 states where data was available.

Spending on state lobbying is concentrated mostly among a few large corporations, which tend to be more transparent in their reporting than smaller companies. The biggest aggregate corporate spenders by sector at the state level were health care, consumer staples, and telecoms, with financials and energy not far behind.

Shareholder proposals addressing lobbying proposals on average receive ~25% support from shareholders. Given that fully 77% of lobbying proposals since 2010 have exceeded 20% support from shareholders, there is clear shareholder interest in lobbying disclosure. Five resolutions even garnered more than 50% of the vote from shareholders and 18 more exceeded 40%. Companies engaged in lobbying should take careful note of this trend.

Investors Seek Disclosure of Corporate Spending

Investors are increasingly demanding greater transparency of all corporate political spending. Since 2010, investors have filed 313 shareholder proposals on political lobbying. In 2016 alone, 99 shareholder resolutions were filed on the subject of political spending disclosure. Though some interest groups, most notably the U.S. Chamber of Commerce, argue that transparency and disclosure hinders a company's free speech rights, at First Affirmative we have argued that disclosing secret corporate spending does not hinder free speech, and secret political spending can actually undermine long-term value. A Harvard study found that in most industries secret political spending "correlates negatively with measures of shareholder power, positively with signs of managerial agency costs, and negatively with shareholder value." In fact, many companies engaged in secret political spending, whether to influence elections or legislation, do so through third party lobbyists and trade associations who do not necessarily share or observe company values. Trade associations can engage in political spending with no accountability to shareholders, even when they lobby in favor of controversial issues at odds with established company policy. This exposes companies to blowback from shareholders should this spending come to light. In the age of hacking and leaks, transparency is the best defense companies have against these risks.

Indeed, the Supreme Court's controversial Citizens United ruling was premised on the idea that increased political spending would be matched by greater transparency. Justice Kennedy, writing for the majority: *"With the advent of the internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations accountable for their positions and supporters. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits, and citizens can see whether elected officials are 'in the pocket' of so-called moneyed interests."*

Clearly, the court ruled in favor of unlimited political spending by corporations with the expectation that shareholders could evaluate it and take it into account when making investment decisions.

Based on the clear and growing investor demand for transparency, companies and shareholders have reached agreements resulting in proposals being withdrawn in exchange for a change in corporate policy 108 times since 2010. Though only 25% of S&P 500 companies have a board-level lobbying policy, that number is up from just 16% in 2013, and likely to grow further in the coming years.

The growth in investor demand for transparency on all political spending is only likely to increase in the near future, and through advocacy shareholders have shown a willingness to hold corporations accountable for their lack of transparency. While many companies are making progress on disclosure of political spending, state lobbying remains an area where transparency is lacking. Companies that proactively disclose their spending on lobbying at both the federal and state level will be best positioned to attract investors in a future where transparency is increasingly valued.

The RE100: 100 Companies Strong and Growing

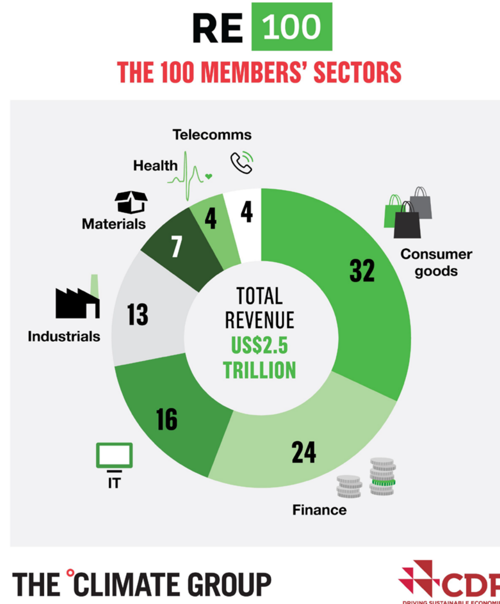
By Holly Testa

The RE100 – a global initiative launched in September 2014 by the CDP and Climate Group - has quickly reached critical mass.

RE100 galvanizes corporations to commit to a time-bound goal to power the entirety of their operations with renewable

energy, and offers technical and educational assistance. Over 100 global companies with a combined $2.5 trillion in revenue, with the help and encouragement of an investor group that includes First Affirmative, have made the commitment.

Participating companies are leading by example not only because of the compelling business case, but also to collectively increase demand for renewable energy, thus encouraging utilities to provide it.



The Business Case

RE100's 2017 annual report shares insights from member companies that demonstrate how renewable energy enhances corporate performance through cost savings and risk reduction, while meeting greenhouse gas reduction goals:

- General Motors reports savings of $5 million annually and anticipates that this will increase as planned projects come online.
- Tata Motors saved $2.5 million by installing wind power at a single plant in India and removing the need to pay grid electricity charges.
- Apple has commitments from eight suppliers to produce products and components using 100% renewable electricity.
- Steve Howard of IKEA envisions turning energy expense into income: "Electricity and energy are essentially just costs to your business, until you start generating your own when you can turn a cost into a profit center."

Multiple companies cite reduced business risk from lowering exposure to volatile fossil fuel prices, increased long-term cost control and improved energy security. Others point to how their commitments will help them avoid the worst of the systemic risks inherent in climate change.

Leveraging Demand to Transform the Energy Economy

End consumers of energy seem to be way ahead of the traditional power suppliers—utilities. Much of the increased renewable energy capacity has come from a variety of non-traditional sources, including privately owned large-scale wind and solar farms and direct company-owned installations. While progress has been impressive, a full transition to renewable energy requires utility participation and capital investment in renewable generation that can power the grid.

RE100 and other initiatives like the Corporate Renewable Energy Buyers Principles are exerting pressure to create this shift in how the grid is powered. The Principles, developed by large energy buyers including many members of the 100, provide guidance to utilities and other power providers as to what they need, and expect, when they buy renewable energy from the grid:

- Greater choice in procurement options
- More access to competitive cost options
- Longer and variable term contracts
- Access to new projects
- Increased access to third-party financing vehicles and standardized, simplified processes, contracts and financing for renewable energy projects
- Opportunities to work with utilities and regulators to expand our choices for buying renewable energy

Utilities have a clear signal from major buyers of their product and these principles provide a common sense blueprint for action.

And, those major buyers are also getting a clear signal from investors. First Affirmative, among other investor participants, has signed on to letters requesting that portfolio companies GlaxoSmithKline, Prudential, Sage Group, Shire, Netflix and Hargreaves Lansdown join the RE100. We are also planning engagement with other portfolio companies this coming proxy season, to include filing shareholder resolutions if necessary.

The Future Is Now

Some companies have already achieved the 100% renewable energy goal, and others are tantalizingly close. We are pleased to note that 37 of our portfolio companies have joined the RE100.

First Affirmative is also in direct dialogue with banks to discuss transitioning to renewables for their own operations. Perhaps more importantly, we are prompting banks to aggressively expand their financing of renewable energy projects while curtailing financing of the most carbon intensive fossil fuels.

The Equifax Breach and ESG

By James Griffitts

On September 7, 2017, Equifax issued a press release stating that on July 29, 2017, it discovered it had suffered "a cybersecurity incident potentially impacting approximately 143 million U.S. consumers" along with thousands of U.K. and Canadian residents.

The breach occurred due to a weakness in an open source software package and while the developer of the software released a patch in early March, it was never applied to Equifax's software. The breached data includes names, birthdays, addresses, social security numbers, and in some cases even credit card information.

Equifax's delay in disclosing the breach left customers unaware and vulnerable. Even after disclosure the company failed to protect its customers by posting several Tweets that directed customers to a fake website which could have exposed them even further.

In the time between the discovery and the announcement, executives at the company unloaded nearly $2 million in company stock, prompting a Justice Department probe into whether three senior executives are guilty of insider trading.

The breach, both of Equifax's data security and of their customers' trust, along with the behavior of the company following its discovery underlines the importance of considering environmental, social and governance (ESG) factors—particularly governance in this instance—when making investment decisions.

Indeed, there were signs that a serious issue could be looming. MSCI's ESG research analysts released a report in July 2017 rating Equifax at CCC, the lowest possible rating. The report cites weak data security and privacy measures as a major concern: *"Equifax is vulnerable to data theft and security breaches, as is evident from the 2016 breach of 431,000 employees' salary and tax data of one of its largest customers, Kroger grocery chain. The company's data and privacy policies are limited in scope and Equifax shows no evidence of data breach plans or regular audits of its information security policies and systems."*

MSCI was not alone in its assessment. Sustainalytics rated Equifax in the lowest decile of research and consulting firms, also citing data vulnerability and lack of reporting on breaches or improved security measures.

Despite ESG analysts rating the company so low, some ESG funds still held the stock in their most recently released reports. The stock, which had reached a high of 142.72 on September 7, 2017, had dropped to 92.98 by September 15, and was valued at 108.70 at the close on October 16.

This story is both an example of the value of ESG integration in identifying risks that traditional financial analysis may not pick up, as well as a call to action to the industry to pay closer attention to issues of data privacy and security. Data breaches are a growing problem in our increasingly digital world and too many companies are not sufficiently valuing the privacy and security of consumer data. The SRI industry has a role to play in ensuring a high value is placed on the protection of our personal information.

Honored to be Named "Best for the World"

First Affirmative is honored to have been recognized among certified B Corps as a Best for the World company. We ranked in the "Best for Customers" category. First Affirmative is proud to be a certified B Corp since 2011.

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