ESG Insights: Active Proxy Voting

Promoting Accountability, Diversity and Sustainability to Create Shareholder Value and Benefit Stakeholders

COHO PARTNERS, LTD.
Where protection and participation meet®

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Executive summary

Coho Partners continues to take an active role in the proxy voting process through ESG analysis and engagement. We believe thoughtful and responsible voting promotes board and management behaviors which should, over the long term, minimize risks for our portfolio companies and translate into strong shareholder returns. We vote all proxies using our customized ESG proxy voting guidelines. We make decisions that we believe are in the best interest of shareholders and benefit stakeholders including employees, society, and the environment.

Our approach to proxy voting

At Coho, proxy voting is fully integrated into the investment process. In 2019, the Investment Team formally adopted customized ESG proxy voting guidelines which include best practices for governance and sustainability. We developed these based on in-depth research, years of experience voting proxies, and engagement with corporate officers, directors, and governance experts. The guidelines reflect our proprietary views and are used as a framework for decision making by portfolio managers when voting proxies. Proxy reviews performed for each of our portfolio companies include governance and sustainability research using a materiality lens and are supplemented by engagement with management. Engagement meetings help us influence and advocate for commitment to environmental and social responsibility, discuss corporate governance practices, and collect insights for proxy voting and sustainability research. We completed our first annual update of our guidelines at the end of 2020 to further reflect our proprietary corporate governance views, new proxy voting topics, and best practices.

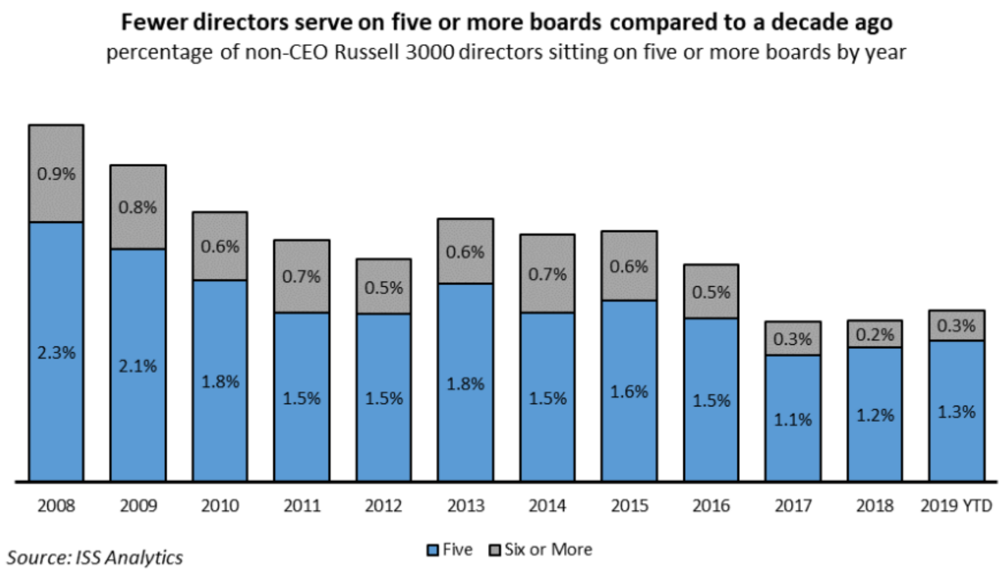
Our guidelines cover topics such as director elections, executive compensation, shareholder rights, and sustainability. These have all received increased attention from shareholders in recent years.

Director elections: increasing accountability for corporate results and improving board diversity

The board of directors is an important part of corporate governance for a company. Directors provide management oversight, offer strategic advice, establish corporate policies, and determine executive compensation. Boards focus on the long-term success and risks for an enterprise, well beyond an executive team's tenure. We believe directors should act in the best interests of shareholders and be held accountable for corporate results. We also believe that a diverse board of directors helps a company manage risks and consider the perspectives of all key constituencies, which have the potential to maximize shareholder value. We use proprietary research and a holistic approach to focus on multi-factor board diversity across gender, ethnicity, culture, industry, and academic experience. We look for variety across these elements to ensure cognitive diversity for better decision making through inclusion of independent views and different perspectives.

Serving as a director is a sizable time commitment and board responsibilities have been increasing in recent years. Research shows that directors now spend an average of over 200 hours per year on board matters. As a result, corporations and shareholders have begun focusing on limiting the number of directorships for individuals. As shown in Figure 1, this has led to a decrease in the number of directors who serve on many boards. To help directors and executives maintain focus and achieve strong corporate results, we believe it is in the best interests of shareholders to use strict criteria for director board commitments. Our guidelines include a three public company board limit for non-CEO directors and allow CEOs to serve on only one outside board. We encourage companies in our portfolio and investment universe to consider these factors in the board selection process, and we vote accordingly. During the 2019 proxy season, we voted against 51 directors who did not meet our requirements.

Figure 1 Director Board Commitments



Board diversity has become one of the most important governance topics for companies, investors, and stakeholders in recent years. Gender diversity has been the main focus, and this resulted in more female representation on boards. The percent of women directors has increased from 18.3% in 2015 to 27.4% in 2020 for the S&P 500[1]. Ethnic diversity has now taken center stage because there has been less progress here. The percent of ethnic minority directors has only increased from 13.6% in 2015 to 16.8% in 2020 for the S&P 500[2]. For the Coho Relative Value ESG portfolio, 22.1% of directors are ethnically diverse and 28.8% of directors are women.

We believe institutional investors can help improve board diversity through proxy voting and engagement. If investors continue to make diversity, equity, and inclusion a topic of discussion with management teams and directors, and incorporate diversity in proxy voting decisions, more progress is possible. Our proxy voting guidelines, research, and engagement efforts for director elections focus on skills, tenure, commitments, and multi-factor diversity. We have limits for the maximum number of director board commitments, as previously mentioned, and also have requirements for director tenure. These conditions provide two ways to open the door to improve diversity as directors are refreshed. Outside of investor efforts, U.S. states and market exchanges are advancing board diversity with specific requirements for public companies. For example, Nasdaq will now require boards to have at least one woman and one director who self-identifies as an underrepresented minority or L.G.B.T.Q. (those categories are not mutually exclusive).

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1 Source: Russell Reynolds.
2 Source: Russell Reynolds.

2020 ESG proxy voting guidelines update
For the first annual update of our guidelines, we introduced an additional threshold for a maximum average board tenure of 15 years, which could result in votes against individual directors with high tenure. This supplemented existing requirements for average board tenure, board refreshment, and director board commitments. We believe these criteria promote both board independence from management and board diversity, setting the stage for improved oversight and fresh, unbiased assessments of corporate results.

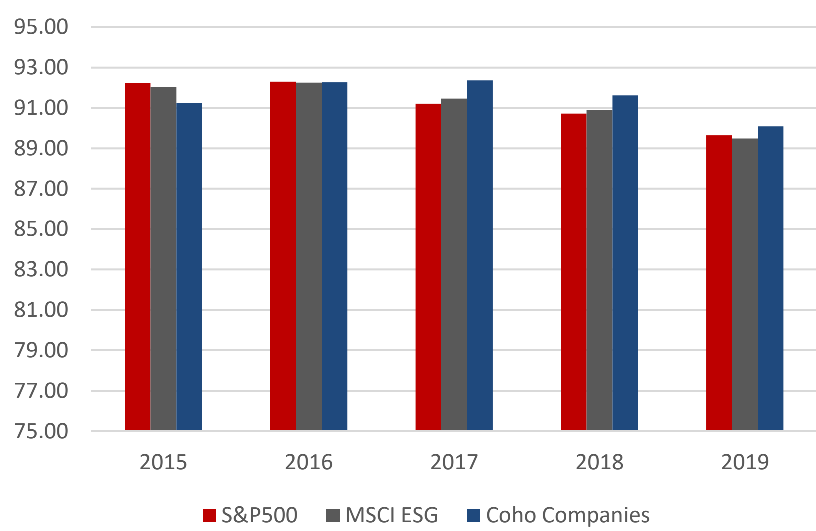
Executive compensation: aligning management interests with the creation of shareholder value

Strong pay practices properly align executive interests with the creation of long-term shareholder value while enabling a company to attract and retain talent. When evaluating compensation packages, Coho Partners believes there should be evidence of a clear and successful link between pay and performance.

A shareholder vote on executive compensation through a say-on-pay proposal was provided for all public companies in the United States as part of the Dodd-Frank Act on July 21, 2010. With the 10-year anniversary of this legislation, it is interesting to note that shareholder support for executive compensation has been declining in recent years as investors further scrutinize pay practices and apply more rigor to compensation analysis. When we evaluate say-on-pay proposals, we review financial and sustainability targets, and perform an analysis of compensation levels and performance compared to peers. Through management engagement and voting proxies on behalf of our clients, we focus on strengthening compensation practices. Our goal is to align executive interests with long-term shareholder value creation and sustainability advancement.

Figure 2 summarizes the average say-on-pay support level for our portfolio companies and compares this to the S&P 500 Index and the MSCI ESG Index[3]. In the last few years, Coho's portfolio company average support level has been consistently higher than the averages for these indexes.

Figure 2 Average Say-on-Pay Support Level Comparison



A high say-on-pay support rate reflects shareholder confidence in management's compensation practices and the view that appropriate incentives are provided for management to perform in the best interests of shareholders. Support rates also illustrate a report card on how investors rate management's execution of corporate strategy

[3] Sources: Bloomberg and Coho Partners. The data may not be fully representative of the entire index due to availability.

and ability to create shareholder value. In 2020, we started analyzing data to determine if companies with a high say-on-pay support rate tend to create higher shareholder returns than companies with a lower say-on-pay support rate over the subsequent year of the vote. Though we have reviewed only three years of historical data, we believe evidence of a correlation exists across Coho's portfolio companies, the S&P 500 Index, and MSCI ESG Index and we will continue to track and test this data.

As shown in Figure 3, we see outperformance of the high support group in seven of the nine periods tracked.[4] As Coho's portfolio company average support level has been above the averages for the indexes, we believe there is potential for this to have a positive impact on our portfolio.

Figure 3 Annual TSR Outperformance of High vs. Low Say-on-Pay Support Groups

	2017	2018	2019
Coho companies	Underperform	Outperform	Outperform
S&P 500	Outperform	Underperform	Outperform
MSCI ESG	Outperform	Outperform	Outperform

Figure 4 shows the percent of Coho's portfolio companies and S&P benchmark companies that include total shareholder return (TSR), return measures like return on invested capital (ROIC), and sustainability metrics in compensation plans. We believe these metrics are important because they align management compensation with shareholder value creation and help benefit stakeholders. Through engagement, we encourage companies in our portfolio and universe to incorporate these metrics into compensation plans. We also consider these metrics when voting on say-on-pay proposals.

Figure 4 Important Compensation Metrics to Shareholder Value Creation

	TSR	Return metric	Sustainability
Coho Companies	62%	46%	30%
S&P 500 Companies	63%	39%	26%

Sources: Bloomberg and Coho Partners. Holdings as of 12.31.20.

2020 ESG proxy-voting guidelines update

For the first annual update of our guidelines, we added additional reviews, including further scrutiny of negative pay practices into our compensation analysis to help promote a strong link between pay and performance.

Shareholder rights: promoting shareholder interests through the expansion of shareholder rights

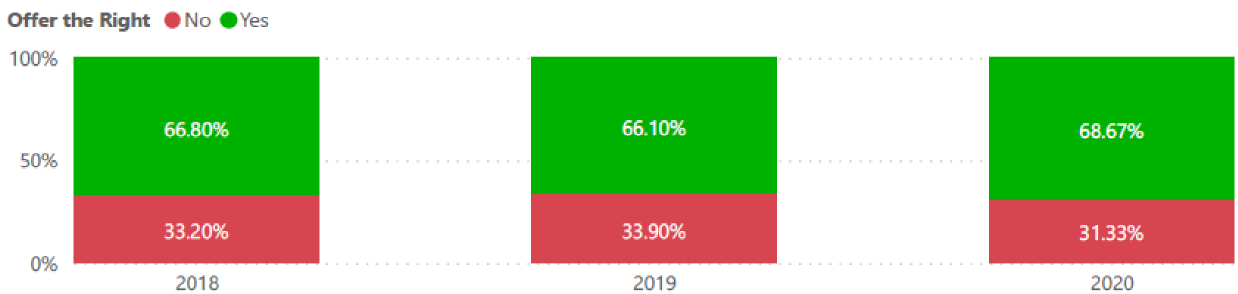
As part owners of a company, shareholders have voting rights that provide the ability to influence management and determine policies through director elections and approval of corporate matters. Coho believes the expansion of shareholder rights supports the interests of shareholders and strengthens corporate governance by providing additional management oversight.

[4] Sources: Bloomberg and Coho Partners. TSR is total return over the calendar year. High support group companies have 90% or higher support rate. Low support group companies have less than 90% support rate. The support rate for each company is the say-on-pay support rate for the year reported.

When evaluating shareholder proposals on shareholder rights, we consider existing rights offered to shareholders and potential outcomes, including decision making focused on maximizing short-term stock price performance at the expense of long-term shareholder value creation. Our guidelines generally support shareholder proposals asking companies to provide the right to call special shareholder meetings and to adopt proxy access, a process during which shareholders place a limited number of alternative board candidates on the company's proxy ballot. We also support shareholder proposals asking companies to provide the right to act by written consent in lieu of a shareholder meeting when the right to call a special meeting is not provided to shareholders.

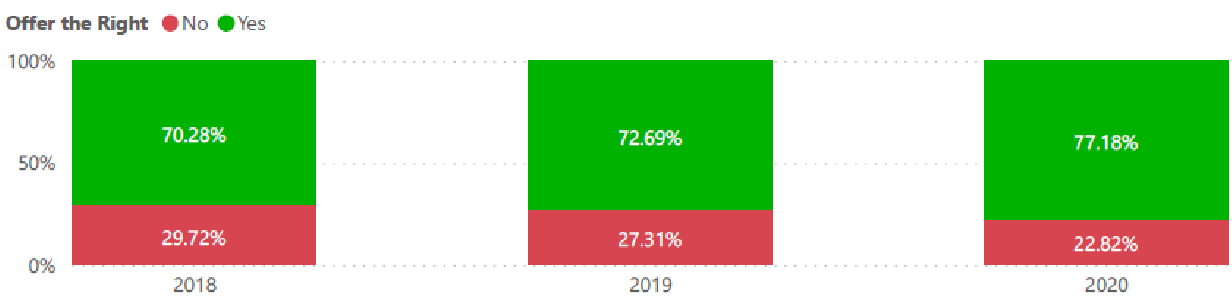
As shown in Figures 5-7, there has been an expansion of shareholder rights in recent years.[5] A majority of S&P 500 companies offer shareholders the right to call a special meeting and seek proxy access. Adoption of written consent has been less widely adopted.

Figure 5 Special Meeting Adoption



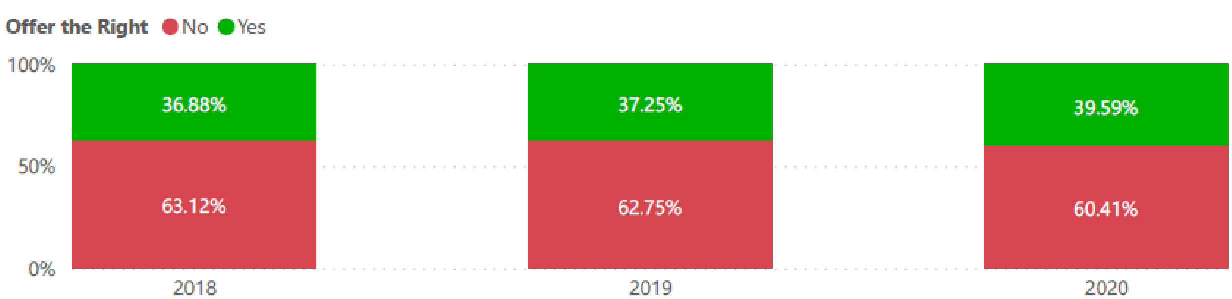
Source: Glass Lewis

Figure 6 Proxy Access Adoption



Source: Glass Lewis

Figure 7 Written Consent Adoption



Source: Glass Lewis

[5] Source: Glass Lewis

2020 ESG proxy voting guidelines update
For the first annual update of our guidelines, we included shareholder rights plans and supermajority vote standards. We will generally support shareholder proposals that request shareholder approval for new poison pills (defensive tactics used by a corporation's board of directors against a takeover) or for redemption of a current poison pill adopted without shareholder approval. We also generally support shareholder proposals that request companies eliminate a supermajority voting standard because this can limit shareholders' rights in decision making compared to a simple majority vote standard.

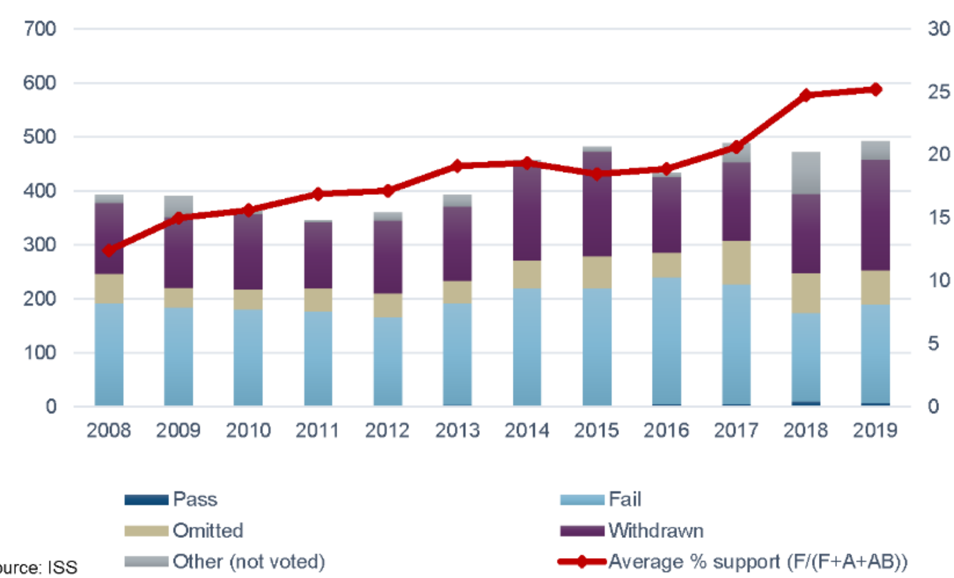
Sustainability: supporting environmental and social shareholder proposals to benefit stakeholders

Coho believes that management should incorporate sustainability into corporate strategy. In our view, a strong corporate sustainability program has the potential to benefit stakeholders, minimize costs, enhance growth, reduce business risks, and create shareholder value. Promoting diversity and inclusion is important for the management and sustainable growth of a company.

Our customized ESG proxy voting guidelines are generally supportive of shareholder proposals on sustainability. When evaluating these proposals, we consider the financial materiality of the information outlined in the proposal; the quality of existing disclosures, policies, and goals; potential costs of compliance; and any liabilities, fines or litigation experienced by the company receiving the proposal.

The number of environmental and social shareholder proposal filings has increased over the past decade. These now represent over half of all shareholder filings. Average support levels have also been increasing. As shown in Figure 8, for the 2019 proxy season, there was 25% support compared to only 15% percent in 2008. The rising support level reflects increased investor interest in sustainability risk management and less prescriptive shareholder proposals that focus more on disclosure and reporting. In the 2020 proxy season, we supported and voted for 84% of environmental and social shareholder proposals.

Figure 8 Number of Environmental & Social Shareholder Proposals Filed (LHS) and Average Voting Support (RHS)



Source: ISS

2020 ESG proxy voting guidelines update
For the first annual update of our guidelines, we included diversity and inclusion as part of our review of shareholder proposals. Coho will generally vote for shareholder proposals that request companies to provide disclosures, adopt policies, and establish goals related to human capital management, workforce diversity, and details concerning how companies are promoting diversity within their workforce.

Engagement: our approach to enacting positive change for corporate governance and sustainability

Active ownership and engagement are key parts of our ESG framework and investment process along with in-depth fundamental research. In 2020, the Coho Investment Team participated in 32 ESG-focused engagement meetings to influence and advocate for commitment to environmental and social responsibility, discuss corporate governance practices, and collect insights for proxy voting and sustainability research. For these meetings, we focus on financial and business model specific materiality. As it relates to corporate governance, we make recommendations to improve compensation practices and disclosure through the inclusion of specific financial and sustainability metrics and to increase director accountability and diversity. We also advocate for incorporating climate-related risks within long-term strategic planning and adopting shareholder proposals on sustainability.

The following are case studies to highlight our active voting and engagement with portfolio companies on corporate governance and sustainability.

CVS Health Corporation

Management proposal: "say-on-pay", a proposal to approve the company's executive compensation.

Following an engagement call with management, we voted against the company's compensation plan due to the company's decision to accelerate stock grants. The grants remained contingent on achieving an EPS peformance target which is an important factor we consider in our guidelines. We were concerned, however, by the decisions to acclerate grants prior to achieving the goal and to provide this for only two executives. We also found shortcomings during our analysis of the level and trend of executive pay relative to peers and performance metrics. We believe it is in the best interest of shareholders to maintain the scheduled stock grant delivery date to promote a strong link between pay and performance.

Chevron Corporation

Stockholder proposal: create a board committee on climate risk for the board of directors

Whether or not a security is owned within or outside of our ESG portfolio, at Coho Partners, we vote all proxies using our customized ESG proxy voting guidelines and make decisions we believe have the potential to enhance shareholder returns and benefit stakeholders. We voted in support of this proposal because climate risks are financially material for the oil and gas industry. A separate board committee would be able to perform a comprehensive review of the company's climate change strategy, including setting carbon reduction goals and making capital allocation decisions to help lead the transition of Chevron's business model.

Colgate-Palmolive Company

Stockholder proposal: adopt independent Chairman of the Board

We voted in support of this proposal because an independent Chairman introduces a stronger accountability culture for the board of directors. The separation of the Chairman and CEO positions provides further management oversight and more authority for the independent Chairman compared to a lead independent director.

State Street Corporation

Compensation discussion and sustainability advancement

We recommended that management introduce specific metrics for short-term compensation to further improve the link between pay and performance. We also discussed the company's environmental policies and goals. During 2020, State Street became our first portfolio holding to achieve carbon neutrality across Scope 1 and Scope 2 emissions.