The Contingent Role of Conflict: Deliberative Interaction
and Disagreement in Shareholder Engagement

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SUPPLEMENTARY MATERIALS

Coding Deliberative Interaction and Issue Disagreement in Shareholder Engagement

We asked coders to code a set of investors' notes on private meetings, conversations, telephone calls, emails and letters exchanged with corporate executives, in the context of investors' ongoing shareholder engagement dialogues on environmental, social and governance (ESG) issues with target companies. Through engagement dialogues investors eventually attempt to change ESG corporate practices and policies. First, we asked the coders to code each investor note reporting on an interaction (either a meeting, a telephone call or an exchange of email or letters) as deliberative, mixed/neutral, or non-deliberative. Then, we asked them to code the number of issue agreements and disagreements per interaction.
We clarified that while coding, they should consider that parties may engage in deliberative interaction while disagreeing and, on the contrary, they may agree while being in a non-deliberative setting. In order to clarify doubts, we first coded a small random subset of the notes (20) and then, after discussing remaining doubts, we asked each coder to independently code the rest of the notes. Coding was done on an excel sheet where coders had the notes, and fields on deliberative interaction, number of issues, and number of issue agreements and disagreements.

Deliberative Interaction

The field deliberative interaction can take values 1, 0 or -1. The interaction is coded ad deliberative, and takes value 1, when it is primarily characterized by the following attributes:

- Corporate managers appear to be willing to engage in dialogue, share relevant information, discuss investors' concerns, and provide reasons for their positions;

- Both parties appear willing to listen to the other party, respect their views, use a proper tone for criticism, and change their minds.

Here is an example of deliberative interaction:

> *"For the second year, we have again submitted a shareholder resolution requesting that the roles of chair and CEO be separated. We negotiated*

important governance concessions last year, including amendments to [Company]*'s corporate governance principles and enhancements to the role of the Lead Director, and hope to make further steps this time around. We began our dialogue with the company on the resolution this quarter, both with executives and then with the two key non-executive directors with regard to the issues we are raising - the Lead Director, and the chair of the governance committee. We focused our discussions this time on our core aim: that the board agree to split the roles on the current chair/CEO's succession. We highlighted the benefits to having separate roles and the directors in turn questioned us, seemingly thoroughly engaged on the issue. We were pleased by the level of engagement and debate which was evident in the discussion and provided follow-up materials as per their requests to reinforce the points we made. We look forward to continuing this dialogue."*

The interaction is coded as mixed or neutral, and takes value 0, in one of the following cases:

1. Partners switch between an open and closed attitude, between listening and reasons giving and defensive or offensive behavior, as in this example:

   "*We met with the corporate secretary and other executives at its headquarters to discuss pay,* [and] *risk management…. While the company's say on pay vote passed at this year's AGM, we raised concerns regarding the almost x% opposition it received - which in our view stems from the lack of performance requirements attached to the restricted stock units under the bonus plan. The company argued defensively that most major shareholders seem happy with the bonus structure and declined to consider amendments despite our urging. We made it clear that this would ensure our continued opposition to future say on pay votes. We then discussed risk management and oversight and how* [Company] *seeks to avoid the recent misfortunes of certain of its peers. We were assured that key individuals' risk taking is reviewed on a regular basis by an executive committee formed by each individual's direct line managers as well as by senior risk and compliance executives who in turn report to the board's risk committee. We also discussed the risk-mapping and monitoring systems which seek constantly to analyze over x stress scenarios and which trigger alerts when risk concentrated environments are detected. We requested practical examples to illustrate the effectiveness of these systems and that shortly we should be able to talk through how any triggered alerts have been overseen and escalated. We then discussed the recent two-notch downgrade by* [Company]*, citing examples of peers where such downgrades have had costly effects. …We agreed to continue our discussion on these and other topics in a series of subsequent conversations throughout the rest of the year*."

2. It is impossible to determine partners' attitudes due to a lack of sufficient information about the interaction, as in the following example:

   "*We spoke with a member of the company's investor relations team to encourage* [Company] *to respond to the Forest Footprint Disclosure Project questionnaire. The XYZ Project was created to help investors identify how organizations' activities and supply chains contribute to deforestation, which is one of the main underlying causes of climate change. We believe that*

[Company] *has significant risk exposures through its supply chain in this area and participation in the XYZ Project would be a first step in it transparently managing that risk effectively*."

Finally, the interaction is coded as non-deliberative and takes value -1 when it is primarily characterized by the following attributes:

- Corporate managers appear unwilling to engage in dialogue, share relevant information, discuss investors' concerns, or provide reasons for their positions;

- Both parties jumped abruptly from one topic to another and/or challenged each other, appearing unwilling to listen to each other, show respect for the other party's views, use a proper tone for criticism, and be open to change their minds.

Here is an example of non-deliberative interaction:

> *"Following our recent uninspiring call with* [Company] *on strategy, we had a follow up discussion with members of the company secretariat to discuss board independence and remuneration. The executives were unable to provide a convincing rationale for the board not having separate chair and CEO roles, simply citing that this was the board's view and still the practice of the majority of Fortune 100 companies. We argued that this was particularly concerning given that at this year's AGM a proposal to appoint an independent chair received approximately x% support. They sought to impress on us the involvement of the presiding director in helping to set the board's agenda and organizing meetings of the independent directors but were unable to comment on how the relationship and dynamic of the two directors works in practice. We also raised concerns about the long-term incentive scheme beginning to pay out at well below median performance. The rationale given (which they report as being supported by other shareholders) was that such an approach reduces the likelihood of inappropriate risk-taking. We will seek a meeting with the presiding director as a next step."*

Agreement and Disagreement

After coding whether the interaction described in the investor note was deliberative, mixed or neutral or non-deliberative, we ask to code whether the note indicates agreement or disagreement between the parties in the specific interaction described. In any interaction investors and executives might discuss multiple issues. Investors' notes report all the issues discussed, while typically reporting both investors and managers stand and the unfolding of their on-going discussion on them as well. In the following example, investors and managers discuss four issues: company's business performance, board coziness and refreshment, and remuneration's policies.

> "*We met with the bank to continue our discussions around board composition, remuneration and <u>business performance</u>. It defended its recent poor levels of return on equity and loss of share in key markets as down to lowering the risks the bank is taking, arguing that performance in 2011 was both planned and expected.* [Company] *pushed back on the notion that the <u>board</u> was cozy,*

though the bank did accept that some <u>*refreshment*</u> *may be necessary among the non-executives. Indeed, since our meeting and following a shareholder proposal from XYZ to separate the chair and CEO roles, the board has replaced the presiding director with a newly appointed lead director.*
On <u>*remuneration*</u> *we agreed to disagree on the quantum of pay which we argued should come down and be more directly linked to performance*."

The identification of the different issues in each note was done by the first coder, and each issue was identified with underlined font. We ask to code the total number of agreements, the total number of disagreements, and the total number of undefined cases per interaction. For instance, if the number of issues discussed is seven, the total number of agreements, disagreements and undefined cases had to sum up to seven.

Agreement

We ask to count an agreement in one of the following cases:

1. Investors are satisfied with the steps the company has taken, either because:

   - the company adopts and implements a practice, a policy, a code that constitutes investors' final objective of the engagement, or

   - the company undertakes an intermediate step towards the final objective that was previously advised to take by the investor, or

   - the company undertakes an intermediate step towards the final objective different from the one the investor had advocated for but which the investor agrees on considering the arguments made by the company;

2. Investors cannot see any action undertaken by the company in the desired direction, but the parties agree on the next steps the company will have to take.

In the previous example of a meeting where investors and managers discussed four issues, the following sentence might signal agreement:

> *"The bank did accept that some* <u>*refreshment*</u> *may be necessary among the non-executives. Indeed, since our meeting and following a shareholder proposal from XYZ to separate the chair and CEO roles, the board has replaced the presiding director with a newly appointed lead director."*

Disagreement

We ask to count a disagreement in one of the following cases:

1. Investors are not satisfied with the steps the company has taken;
2. The company defends its positions with arguments that result unconvincing to the investor or delays the topic to future meetings as a way of getting away with discussion;
3. Parties do not agree on next steps the company will have to take.

In the previous example, the following three sentences might signal disagreement:

"…business performance. It defended its recent poor levels of return on equity and loss of share in key markets as down to lowering the risks the bank is taking, arguing that performance in 2011 was both planned and expected."

"[Company] *pushed back on the notion that the board was cozy."*

"On remuneration we agreed to disagree on the quantum of pay which we argued should come down and be more directly linked to performance."

No info

We ask to count a "No info" for a given issue, when it was not possible to determine agreement or disagreement due to a lack of sufficient information or evidence in the investor notes, as in the following example:

"We pressed for clarity on their ability and willingness to renegotiate residential mortgages in order to stem the flow of foreclosures. It is increasingly being recognized that the crisis in the US will not end until residential foreclosures are put to a halt given the staggering prediction of three million in the next year. Some of the banks have publicly stated that they are renegotiating mortgages that they hold but whether or not they can at law renegotiate mortgages that they merely service is unclear (i.e., these are mortgages that have been bundled into structured products and sold on to investors). [Company] *discontinued the origination of residential mortgage loans in 2007 and its mortgage servicing business accounts for less than x% of total assets as of their last completed fiscal quarter."*