PZENA Investment Management

THIRD QUARTER 2021 FINDING VALUE IN ESG

Executive compensation, energy transition, and succession planning were among the thorniest issues we dealt with during the 2021 proxy season. We use these examples to illustrate our engagement with managements and boards of directors, and the thought process behind our votes.

As active owners, we take our stewardship responsibilities seriously. Direct engagement and proxy voting are the two primary ways we can seek to influence management teams and steer companies in the direction of long-term shareholder value creation. That is why we do not outsource our engagement or proxy voting decisions; rather stewardship is led by the members of our research team most closely connected to the particular investment.

When it comes to proxy voting, there are always a handful of particularly complex and inevitably controversial votes that require significant discussion within the research team to arrive at a vote determination. We profile three such votes, below, from the recent 2021 proxy season, to illustrate our focus on maximizing long-term shareholder value and how that was manifested in our voting and engagement.

EXAMPLE 1: GENERAL ELECTRIC

CEO compensation has been a flash point at GE for some time because of the size of Larry Culp's pay package. It has been our view that GE needed to pay for the talent to run the company and execute on the much-needed turnaround. We would rather have the right person in the role, even if this commands a higher compensation package than might seem prudent (given the financial challenges the company is facing).

We did, however, take issue with the recent decision to re-price Larry Culp's compensation package in late 2020 when the stock was experiencing significant underperformance as a result of the global pandemic. Re-pricing equity-based compensation packages before they expire falls foul of our philosophy on executive compensation. To add insult to injury, repricing the package at the bottom of the market meant that it was most advantageous for Larry Culp while being least advantageous for shareholders. We engaged extensively on this issue with GE's lawyers, the heads of Human Relations and Investor Relations, and members of the board.

After much deliberation, we made the decision to vote against Larry Culp's pay package and abstained in votes for the compensation committee members. In our discussions with GE and Larry Culp specifically, we made it clear that this was not a vote against Larry (whom we still think very highly of) but rather a vote against the philosophy by which GE determined CEO pay, which we viewed as in direct conflict with the interests of shareholders. We remain confident in GE leadership specifically because it was our assessment that this decision was made by the compensation committee alone and therefore, while regrettable, did not implicate Larry Culp directly.

EXAMPLE 2: EXXONMOBIL

ExxonMobil (Exxon) had perhaps one of the most public and hotly contested board seat battles ahead of the 2021 AGM (annual general meeting). We had lengthy discussions with Exxon and Engine No.1 (the activist hedge fund proposing their own slate of directors who they felt were better placed to help Exxon manage the energy transition). Our concern in speaking with the Engine No.1 nominees was that, while we shared a lot of their concerns, they did not have ideas to solve the problems they raised. As such, we were not convinced that those nominees would do a better job on the board than the current directors as board disruption can bring its own set of problems. Instead of voting for the Engine No.1 nominees, we voted for the existing directors, while explicitly conveying to the board the areas where we expected Exxon to make significant progress: the quality of financial and operating metric disclosures; energy transition; and capital discipline, particularly as it relates to upstream energy assets.

We decided to vote in favor of the proposal requesting Exxon certify that its lobbying activities would be aligned with the Paris Agreement, contrary to management's recommendation. We judged that voting in favor of this resolution was warranted given Exxon's publicly-stated support for the Paris Agreement, contrary to management's recommendation. Certifying that lobbying efforts are aligned with the Paris Agreement could therefore be an effective way for the company to restore some credibility on the issue of climate change, aligning itself with European peers who have already made this certification and taking the lead on this issue among US peers. As we conveyed to Exxon directly, this commitment could go a long way in helping Exxon overcome its reputation of actively lobbying to deter climate regulation and basing its strategy on overly rosy scenarios for oil & gas demand. This reputation has damaged the company's credibility in the investor community and, in our view, legitimized the challenge from Engine No 1.

EXAMPLE 3: SCOR

Succession planning had always been on our agenda when engaging with SCOR (a French property, casualty and life reinsurance firm) because of the key man risk that comes along with the founder CEO/ Chairman Dennis Kessler. This issue came to a head in the 2021 proxy season because of the announcement that Dennis Kessler was stepping down as CEO earlier than planned and that the previously externally appointed successor CEO, Benoît Ribadeau-Dumas, (who had been in the process of shadowing Dennis Kessler) would also step down and be replaced by Laurent Rousseau, a company insider. This backtracking on succession plans conveyed a sense of disorganization or, potentially, a desire by Dennis Kessler to retain control of SCOR after stepping down as CEO by appointing an insider and retaining his role as chairman.

To express our dissatisfaction with how this succession process had been handled, we planned to abstain from votes related to the reappointment of the CEO/Chairman and two directors on the nomination committee, as well as voting against Dennis Kessler's compensation package. Prior to the vote, however, we engaged with both the board and Dennis Kessler directly, both to express our views as well as to better understand these decisions. As we voiced our concerns and investigated this issue, we learned that Kessler's decision to step down early was for personal reasons that ultimately drove the need for a successor CEO who was more intimately familiar with the business and could hit the ground running. On this basis, we decided to give Dennis Kessler and the nominating committee the benefit of the doubt on the motive behind the change in succession plans. In our discussions with company management, we made it clear that the communication to shareholders around succession planning should have been better handled. In light of that, while we decided to vote in favor of the board reappointments, we still voted against the compensation of Dennis Kessler to formally register our discontent with the succession planning process.

These three examples of our more significant proxy votes from the 2021 season hopefully highlight where the nuances of each decision had to be debated extensively, internally and with company management, to reach a final vote determination. Our focus on long-term shareholder value creation, ESG or otherwise, always guides our decision-making. We believe our focus on bottom-up company specific research makes us well placed to evaluate ESG issues in the normal course of investment diligence, all the way through to our ongoing stewardship activities.

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