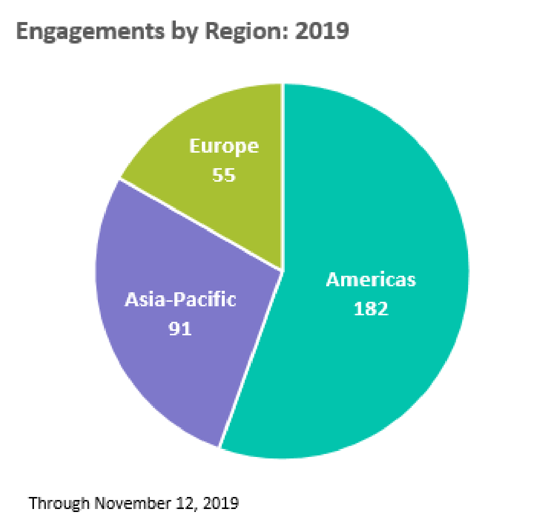
2019 Engagement Report

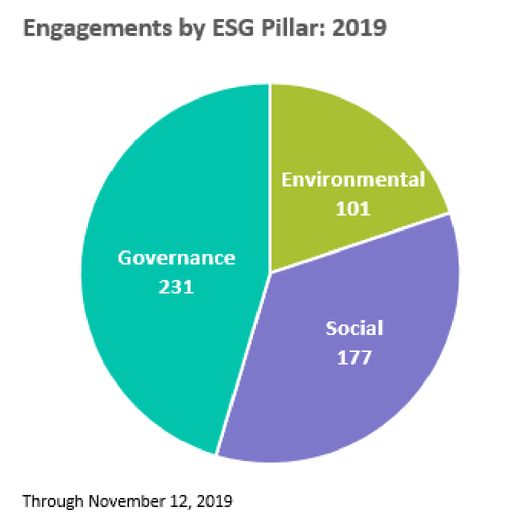
Engaging with issuers on environmental, social and governance (ESG) issues is a vital part of AB's fundamental research. Our analysts collaborate with responsible investment experts to better understand the impact of ESG considerations on company performance and—increasingly—to advocate for advancements in behavior and business practices.

Our analysts and portfolio managers share insights using proprietary research and collaboration tools. PRISM, a fixed-income credit rating and scoring system, includes ESG scores assigned to each issuer by AB analysts that are accessible to investment professionals in real time. Equity analysts use ESIGHT, a proprietary ESG research collaboration platform where AB analysts input their ESG assessments and results from company engagements, and house third-party research. Analysts also exchange perspectives across asset classes to gain a more complete picture of investments.

ESG considerations have long been integrated in our investment process, because they're critical to making informed risk/return assessments and investment conclusions. The methods of applying ESG considerations vary. Some teams directly incorporate ESG concerns into their discount rate; others include ESG insights in the information mosaic that shapes investment decisions.

In 2019, AB's analysts—often collaborating with our responsible investing specialists—conducted 328 ESG-focused engagements with issuers. It was a global effort, addressing issues across the ESG spectrum: 45% of engagements were on governance, 35% on social issues and 20% on environmental. Often, these engagements cover multiple topics. We expect engagement on social and environmental issues to increase over time.





The engagement examples in the following pages are intended to be a representative sample of our engagements on environmental, social and governance issues with firms in diverse industries and geographies. Collectively, we believe they provide perspective on how we're engaging companies on ESG issues.

Environmental Engagement

Reckitt Benckiser (Household Products)

We had multiple engagements with this UK-based multinational consumer goods company in 2019 on the management of its product carbon footprint, climate change risks, greenhouse gas emissions and social impact on communities. These issues provide Reckitt Benckiser with opportunities to improve operational performance and enhance its position with consumers who are increasingly supporting brands with strong environmental focus on sustainable production and packaging.

The company had set several ambitious environmental goals for 2020 including a 40% reduction in greenhouse gas emissions stemming from manufacturing, a 35% reduction in energy consumption and a 33% reduction in carbon footprint. At the time of our engagement with Reckitt Benckiser in May 2019, the company had reduced emissions by 35.2% and energy consumption by 22.6%, but its carbon footprint was only 4% smaller. The company had also targeted a transition to 100% renewable energy by 2030, which is ambitious given that the renewable sourcing for manufacturing sites was 30%.

Reckitt Benckiser uses carbon lifecycle modeling to understand and manage its climate change risks and impacts throughout the value chain. To improve its environmental profile and achieve its goals, the company is implementing energy-efficient production processes, investing in purchased and on-site renewable energy, and advancing its sustainable innovation program.

Despite these efforts, our ongoing engagement with Reckitt Benckiser revealed that the company is not adequately focused on executing its environmental strategy, as observed in the underperformance towards its own stated 2020 environmental targets. During meetings with company management in the third quarter, we re-iterated our view that effectively managing emissions and energy consumption was critical to improving operational performance. However, we ultimately concluded that Reckitt Benckiser was not fully executing its high-profile environmental initiatives – presenting a potential long-term risk to the company's brand and reputation with consumers.

Although we are continuing to monitor the company's progress in these areas and plan to continue our engagements in 2020, we have lowered our price target due to the lack of tangible focus on the environmental risks identified and discussed.

Suzano (Paper Products)

Brazil-based Suzano is one of the largest paper and eucalyptus pulp producers in the world, with businesses including forestry, cellulose, paper, biotechnology, Eucafluff, tissue and lignin. The company produces hardwood pulp from eucalyptus and oversees eucalyptus and other planted forests surrounding the Amazon.

In the third quarter of 2019, Brazil received intense, negative global press because of large fires in the Amazon rainforest, which were widely attributed to deforestation and land clearing for agriculture. More frequent fires intensified international concern about the fate of the Amazon rainforest, a critical absorber of greenhouse gas that plays a significant role in mitigating global warming. The fires also occurred as Brazil undergoes a political shift that reflects weaker environmental regulation and controls.

AB reached out to Suzano in early August 2019 to better understand the company's environmental position given the significant increase in fires. As the largest forestry company in Brazil, Suzano owns significant amounts of land adjacent to the Amazon.

Suzano told us that it has set aside approximately 40% of its land for forest conservation and is protecting more land than mandated by law. It focuses specifically on areas with positive social and environmental attributes such as biodiversity, and those that extend well-preserved forest fragments and protect rare or threatened ecosystems.

Suzano also communicated its commitment to the non-commercialization of timber or products containing wood fibers from natural forests converted into commercial forests. Suzano's forest restoration program spans three regions: the Amazon, the Atlantic Rainforest and the Cerrado. In 10 years, Suzano planted more than 11 million native seedlings, contributing to biodiversity. And in 2018, the company drew approximately 90% of its energy needs from renewable sources.

AB encouraged Suzano's Chief Financial Officer (CFO) to communicate the company's continued strong commitment to environmental and social concerns in the Amazon to the wider market, particularly given the negative publicity and intense media scrutiny related to the fires. In August 2019, the company issued a press release detailing Suzano's commitment to sustainable forest practices and the preservation of the Amazon.

In our view, this public statement continued Suzano's transparency and commitment to embedding ESG considerations in its corporate and environmental practices. It also offered a significant counterpoint to 2019's Amazon deforestation and land burning, as well as the Brazilian government's shift toward weaker environmental policy.

AB met with Suzano's CFO again in September 2019, when he explained that the company was using drones to improve its forest fire surveillance, and that it was advocating tougher environmental laws to protect the Amazon and reduce illegal wood supply. These practices signal Suzano as an exemplary corporate leader in environmental performance and management.

Social Engagement

CBRE (Real Estate Services)

Based in the United States, CBRE is the largest commercial real estate services and investment firm in the world. To provide feedback on how CBRE can improve its sustainability and corporate responsibility programs ahead of its next reporting cycle, we spoke with several of its senior leaders, including the senior vice president of the corporate responsibility program, the investor relations team, the director of corporate responsibility and the executive assistant of the Global Assurance & Advisory division. Representatives from the company's sustainability consultant, EY, also attended.

We believe the firm can improve its human capital development, how it addresses the physical and transitional risks associated with climate change, and the connection between sustainability and corporate responsibility and the company's long-term financial performance and viability.

CBRE has a high turnover rate (22% in 2018). Much of the company's growth is through M&A, and the service orientation of the business is highly customer-facing, so this issue can have a material impact on the business. The firm must be able to effectively integrate and maintain talent, a risk it rightly cites in its 10-K. CBRE also reports in several places that it's seeing more growth in contractual revenue versus fee revenue, which suggests that long-term relationship development and maintenance between clients and employees are imperative.

The company indicated that it's well aware of the turnover challenge and continues to put significant resources toward addressing it. Management also mentioned that the company measures the cost of this turnover as well as the return on investment from employee training and development. It was clear to us that the company understood that greater transparency on this topic will enable investors to make more informed decisions. Management conveyed that it will review the current level of disclosure.

We also noted that CBRE received an AFL-CIO shareholder proposal relating to its arbitration on sexual harassment. The company's efforts on additional disclosures on this topic will be essential to us making an informed assessment on how we should vote on the proposal in CBRE's upcoming annual general meeting.

Regarding climate change vulnerability and carbon emissions, CBRE's sustainability report focuses on Scope 1 emissions (direct emissions from owned/controlled sources) and scope 2 emissions (indirect emissions from the generation of purchased energy). There's very little indication of how the firm approaches physical resiliency to environmental changes such as more frequent severe weather events and rising temperatures, but the company does disclose some information on potential physical risks in its CDP reporting. It also acknowledges physical risks (though not those stemming from climate change) throughout its discussion of risks in its 10-K.

About the potential physical impacts of climate change, the company acknowledged that it is considering physical risks, and pointed to an example of how it's managing transitional risk: the company has achieved savings by being more energy-efficient, which isn't currently reported. The team also noted that CBRE sees an opportunity to develop and grow its sustainability services.

We also discussed the company's Stakeholder Engagement and Materiality Assessment. Although the company has a robust qualitative description of its approach to stakeholder engagement, it is our view that there's room for improvement. For example, the company chooses materiality topics instead of hearing directly from stakeholders on what's material to them.

For clarity, and to ensure the company is measuring and managing what's important to stakeholders, we recommended making engagement more systematic and enabling stakeholders to self-identify material items rather than choose from predetermined options. For example, physical risk and transitional risk from climate change were not among topics the company presented for stakeholder feedback. The company also indicated that it was including suppliers in the stakeholder engagement process, although it excluded this group from its initial remarks.

The company is considering our feedback to expand disclosure on the explicit costs and benefits of its sustainability and corporate responsibility initiatives, including the opportunities and risks associated with climate-related mitigation. It's also speaking with other shareholders. We'll continue to monitor the company's materials for updates, and plan to follow up on board oversight as well as expertise in talent development and climate science.

WNS Global Services (Data Processing and Outsourced Services)

We engaged with the management of WNS, a leading global business-process management company, to explore how it mitigates the risks of managing a global workforce of 40,000 employees. We also wanted to understand WNS's policies and procedures for using and protecting data on individuals that it processes as part of its ongoing business operations.

WNS's outsourcing services including finance, accounting, customer relationship management and business administration services, and its success has been supported by leveraging lower-cost talent globally and its expertise in optimizing processes. Despite increased digitalization, WNS processes are still very labor intensive, and its lines of businesses tend to have high natural employee turnover. Because WNS's clients expect service cost to decline yearly, the firm must deliver productivity gains to protect profitability. We were curious to learn how WNS balances the need for productivity gains from its employees with the pressure to keep costs down and manage naturally high turnover rates.

As part of their regular line-of-business duties, WNS employees gain access to sensitive information on company clients. We wanted to better understand what WNS can do with that data, who is ultimately responsible for its security, and what processes and policies are in place to ensure data privacy. We regularly engage with WNS, holding discussions with senior-level finance executives who oversee investor relations.

During a recent conversation, we discussed WNS's talent management in detail, as well as its data-protection policies and procedures. We learned that entry-level recruiting and training is crucial for WNS to replenish its employee base in a cost-effective manner. The majority of its 40,000 employees are front-line employees, mainly recruited as entry-level positions for recent college graduates. WNS has very specific hiring criteria, and looks for people that possess the appropriate skill set and that are a cultural fit. WNS hires only one out of every 25 candidates it speaks with, and each hire must complete firm- and function-specific training, which usually lasts six weeks.

WNS manages natural attrition to control costs while retaining valuable talent. The corporate attrition rate is 30%, driven by 60% to 70% attrition in call centers, high-teens attrition in IT and attrition in business process outsourcing that's in line with peers, based on conversations we've had with some of those companies. We learned that most WNS turnover is through natural attrition—people leaving voluntarily—that's a necessary part of the business model.

WNS manages voluntary turnover through salary and performance reviews. Annual compensation increases are based on each person's ability to be more productive. Entry-level positions are paid in line with the industry average, and the best performers can expect a 10% to 12% salary increase in the first year. The average global wage increase for WNS is about 8%. WNS is using digital tools to help make employees more productive, and it's investing in training programs to help promising entry-level talent develop into middle management. Currently, half of the company's middle management rose from entry-level positions at the firm.

WNS has increased its focus on recruiting and advancing women globally through targeted recruitment campaigns. The company has also worked to overcome cultural biases about women in the workforce. As a result, WNS has seen a 41% increase in women hired over the past three years. In 2015, women represented 36% of WNS employees. That percentage had risen to 45% at the end of 2018.

In terms of data protection, we believe that WNS has low data-breach risk, because it's never in control of clients' data. The data WNS processes isn't stored on WNS systems; clients provide remote access to it. WNS's main data-protection vulnerability is its human workforce, and the company has taken several measures to mitigate this risk. WNS has processes to limit the sensitive information one employee can access. The firm invests in software to help identify potential data abuse by employees. To date, WNS has avoided material data breaches. In some cases, employees have abused their access to data, but WNS identified and fixed the problem in a timely manner.

Our discussion of talent management highlighted that WNS is aligned with industry best practices. Its ability to manage a complex talent pool in a high-attrition industry increased our conviction that WNS can continue to grow while maintaining its level of service and profitability. We encouraged management to publish a recurring sustainability report including workforce metrics, so we can continue tracking the company's performance in managing talent development, attrition and diversity. In terms of data privacy, we were convinced that WNS is investing in appropriate tools to mitigate risks.

Governance Engagement

Commvault Systems Inc. (Systems Software)

Commvault Systems is a provider of data management software applications and related services. Elliot Management, an activist fund, increased its ownership stake in Commvault Systems, Inc. to 10.3% in April 2018, which appears to have been a driver of Commvault's recent implementation of changes to both its board of directors and compensation program. AB engaged with Commvault at that time to assess the alignment of executive compensation, board refreshment and succession planning with shareholders' interests over the long run.

In August 2019, AB held a call with Commvault's Head of Human Resources Operations, an Investor Relations manager and a member of the compensation committee to review the four new directors who joined the board. This board shift appears to be a classic arrangement with Elliot, with Commvault meeting its demand to prevent a potential proxy contest, particularly with the market reacting positively to Elliot's increased stake.

In terms of compensation, AB was more concerned about the former CEO's pay, because the company modified its agreement with him on his retirement. Specifically, his stock options would be allowed to continue vesting—even the performance-based portion. The company also extended the timeframe during which the options will be exercisable to 10 years, versus 30 days after his last employment date.

These amendments effectively lead to Commvault paying two CEOs, which does fall short of market best practices. The pay structure for the current CEO also lacks certain structural aspects, as long-term incentives were based solely on three-year relative total shareholder return (TSR), with no absolute cap for negative TSR years. Short-term incentives also lack clarity in terms of threshold, target and maximum disclosure.

Commvault explained that the adjustments to the prior CEO's severance pay was to account for his help with an orderly transition for the new CEO. The outgoing CEO had served since 1998, so a traditional severance package would be substantial. A less expensive option was to take a USD $12 million non-cash charge by making several amendments to the severance pay, structuring the package as if he were still with the firm. Commvault responded positively to AB's comments to incorporate a per-share basis metric into its current CEO's pay structure and added that they would review internally.

The meeting clearly answered our questions on the context of board changes and pay structure for the retired CEO, addressing concerns that would have led to negative votes on the compensation committee chair and the say-on-pay proposal. At the 2019 annual general meeting, AB supported all director nominees and the compensation program based on the additional information we obtained. We plan to follow up in 2020 to discuss Commvault's overall board and executive succession plan, and to determine whether the firm has made any improvements to its compensation program for the current CEO.

Charles Schwab (Investment Banking & Brokerage)

Historically, we've engaged with the management of Charles Schwab, a US based bank and stock brokerage firm, because we were concerned that the structure and policies of its board of directors posed risks. The Schwab board did not have a mandatory retirement age for directors; at the time, five board members were over 75 years old with an average company tenure of 26 years.

Schwab had been an excellent performer both fundamentally and in the market, but we were concerned that this governance structure could lead to problems in the future. We raised this issue and expressed our concern with the company's CEO and CFO, who were in fact wrestling with the same issue. Our support and thoughts helped prompt management to refresh the board.

More recently, we engaged with Schwab management in May 2019 to discuss the defeat of a shareholder proposal to disclose equal employment opportunity data. We believe that interest in the disclosure of this type of information is increasing, so we wanted to better understand management's reluctance to implementing this shareholder suggestion.

As management explained, its concerns relate mostly to data relevance. However, the company hired a head of Diversity & Inclusion in 2018 who has been studying the issue. While Schwab management is confident that there is no gender pay gap issue, the proportion of diverse hires for its financial consultant role has not met the company's target, nor is it representative of Schwab's customer base. We believe that management must continue to work on this issue.

We also spoke with management about the company's board, which remains entrenched, with mostly older individuals despite three retirements in the past two years. Given that the company has three older board members whose terms will expire in 2020, we emphasized to management that it should continue to refresh the board. However, management pushed back, suggesting that some level of continuity added value. In our view, management was noncommittal in terms of how many of the three members with expiring terms would not stand for reelection.

Finally, we raised the issue of Schwab's universally poor environmental, social and governance scores among third party ESG rating providers. The CFO strenuously objected to these assessments, as he and other members of management view Schwab as having a mission-driven culture that has decreased the cost of investing and increased investing knowledge for millions of customers. While the scores are low, we believe Schwab is well positioned in environmental and social but has more work to do on governance. We encouraged management to engage with ESG ratings firms and disclose more information that will hopefully result in ratings that more accurately reflect management's practices. The CFO was open to this suggestion, and shared that the issue was discussed at the most recent board meeting.