MFS® Case Study

December 2022

Stewardship at MFS in Practice

ExxonMobil Case Study

Sustainable Investing at MFS

Our purpose at MFS is to create long-term value responsibly. In order to achieve this, we integrate ESG factors into our investment process. Proxy voting and engagement also play a pivotal role.

Rather than simply divest or apply blanket exclusions, we believe it is in our clients' best interest for us to engage with companies on challenging issues. At times, we use our voting rights as shareholders to drive the change we believe is necessary. This approach is far more resource intensive than divestment, but we believe it drives long-term value for our clients, and often for broader society too.

This case study illustrates our collaborative, security-specific approach to proxy voting.

Active Ownership and Proxy Voting at MFS

Open communication with companies and issuers is a critical aspect of our ownership responsibilities. We believe that long-term-oriented asset managers who engage companies and issuers on ESG topics can positively influence business practices by encouraging executive teams to more fully appreciate the impact that these issues may have on companies' long-term value.

Shareholders have the right to vote on certain topics for the companies they own. MFS' stewardship team manages these votes on behalf of our clients who delegate us to vote for them. The team employs a collaborative approach in its decision-making, often incorporating information and perspectives from our global team of investment professionals, public disclosures, engagement discussions with our portfolio companies, and a variety of third-party research tools. This process facilitates well-rounded viewpoints on key issues, which we believe leads to well-informed, security-specific voting decisions.

Proxy Contests

A proxy contest occurs when one or more shareholders – referred to as the "dissident" – seek to create change by asking a company's shareholders to replace certain members of the board with individuals nominated by the dissident. MFS takes special care in evaluating proxy contests, as these contests have a substantial influence on a firm's governance and, often, strategic direction.

ExxonMobil case study – background

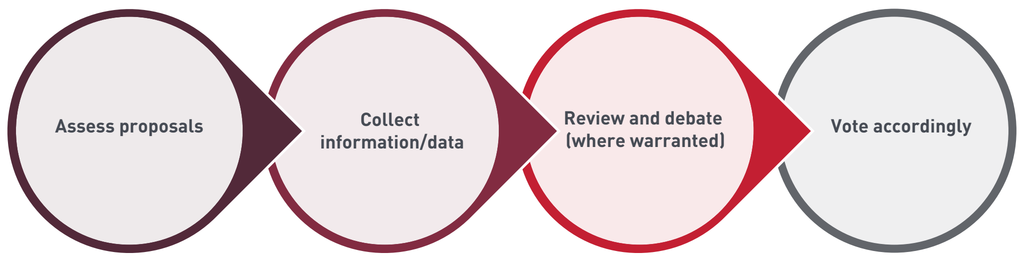
The proliferation of cheap fossil fuels has led to unparalleled economic progress. It has also made oil and gas companies highly valuable. In fact, ExxonMobil ("Exxon") was the world's most valuable company back in 2010.[1] And yet, the onset of climate change means that the use of fossil fuels must be scaled back globally. This represents an existential threat to companies such as Exxon.

Exxon has faced growing criticism, most recently from activist hedge fund Engine No.1, regarding its financial performance, strategy and board composition. More generally, the critique centers around poor capital allocation and a board unprepared for an energy transition. This is the highest profile case to date of activist investors putting forward a dissident slate of directors due to a company's lack of progress on the energy transition.

Engine No.1's proposal

Engine No.1's dissident card proposed four replacements to the twelve-member board of directors at ExxonMobil. These four replacements were believed to bring much needed expertise to aid the board's ability to understand and bring about the energy transition required. Three of the four nominees were ultimately elected to Exxon's board, in what can only be described as the most stunning climate-related contest to date.

Exhibit 1: Stewardship at MFS — An emphasis on collaboration



Assess proposals

The first step in our proxy voting process is to conduct a preliminary assessment of the proposals put forward at the companies we invest in. With respect to focused proxy contests or environmental shareholder proposals, our goal is not to simply vote in favor of the dissident slate or as many proposals as possible, but instead to identify those that will have the most meaningful impact on outcomes for companies and our clients. When warranted, such as in this case, we take a highly collaborative and in-depth approach that can require a meaningful amount of time from key personnel.

In this situation, we believed that the risks to our clients, should Exxon fail to transition, were viewed as significant and therefore warranted the investment of significant resources, in spite of our modest ownership of Exxon stock.

Collect information and data

We seek to gather the best information and data available to ensure we have a deep understanding of what is being proposed. We draw primarily on our own internal company research, but we also incorporate other sources, such as research and analysis from proxy advisory firms. This external research is often useful and is widely distributed within MFS via our centralized investment research database and platform.

MFS may consider environmental, social, and governance (ESG) factors in its fundamental investment analysis alongside more traditional economic factors where MFS believes such ESG factors could materially impact the economic value of an issuer. The extent to which any ESG factors are considered and whether they impact returns will depend on a number of variables, such as investment strategy, the types of asset classes, regional and geographic exposures, and an investment professional’s views and analysis of a specific ESG issue. ESG factors alone do not determine any investment decision. MFS may incorporate ESG factors into its engagement activities when communicating with issuers but these engagement activities will not necessarily result in changes to any issuer’s ESG-related practices.

Review, debate and decide

In the case of Exxon, the covering analyst, an ESG specialist, several portfolio managers, members of the stewardship team, and the head of sustainability and stewardship at MFS all met to discuss our voting options. The team thoughtfully debated the company's climate transition risks and recent actions taken by the executive team to improve the management of those risks. We had long viewed their actions in relation to this as insufficient, but we needed to understand which of several voting options and potential changes would produce the best outcome for the company and MFS' clients.

After much consideration, the team agreed that voting in favor of Engine No.1's nominees was necessary to increase the board's overall level of awareness of, and experience in, areas of renewable technologies and the transition more generally. Given the substantial potential change to the board that this vote would bring to the company, we chose to vote against a separate shareholder proposal that was seeking to separate the CEO and chair roles. We decided the person now serving in both roles should remain, as he has shown a greater willingness than predecessors to consider climate issues.

Vote

Once a decision is reached, a member of our stewardship team executes our votes accordingly.

Conclusion

We seek to achieve our clients' long-term economic objectives by responsibly allocating their capital. Generating strong long-term investment performance is critical to fulfilling this purpose. We believe future investment returns are likely to be impacted by climate change and other ESG matters and the policies designed to address these issues. Influence does, however, require a seat at the table, which is one of the reasons we favor active ownership over divestment or exclusion. The recent events at Exxon show how powerful active ownership can be. With several new climate-conscious and highly experienced board members confirmed, future capital allocation plans look set to change to incorporate the transition to a low-carbon economy. This would be a major shift for a company that has been the world's fifth largest producer of greenhouse gas emissions.[2]

Please keep in mind that a sustainable investing approach does not guarantee positive results and all investments, including those that integrate ESG considerations into the investment process, carry a certain amount of risk including the possible loss of the principal amount invested.

Endnotes

[1] Global 500 jun 2010 web.xls (ft.com).

[2] *The Carbon Majors Database: CDP Carbon Majors Report 2017.*