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IMPACT BRIEF

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Linking Pay and Corporate Responsibility at Apple

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Over the past 12 months, the risks and impacts of COVID-19 have taken center stage for Apple. The tech giant was one of the first major companies to warn of the financial impacts of the pandemic in February 2020, and it has fought delays and hiccups in its immense sourcing networks all year.

COVID-19 is a new threat; however, it is best understood as another example of the myriad environmental, social, and governance (ESG) risks that Apple faces as a result of its complex and far-flung supply chain. As socially responsible impact investors, we have pressed Apple to address and devote sufficient resources to the full range of those issues, including diversity and equity challenges in the US and abroad, and concerns around human rights and free expression. Labor standards violations and safety issues persist in the Chinese factories producing Macs, iPhones, and iPads. Workers have been harmed through exposure to toxic chemicals, such as benzene and n-hexane. In 2019, Apple and its supplier Foxconn reportedly broke Chinese laws by deploying too many temporary workers in the run-up to the launch of a highly anticipated new iPhone. In 2018, researchers at the University of Technology Sydney concluded: "human rights, environmental and ethical problems persist inside Apple's vast global supply chains… Apple does address these disturbing issues in its annual Supplier Responsibility Progress Report. Progress has been uneven and limited, but the company has created the appearance of corporate social responsibility."

That's why, when Apple's CEO Tim Cook warned of the COVID-19 threat at Apple's annual shareholder meeting last February, we were there in person to challenge him to take more ambitious steps to address ESG risks and opportunities. We had already written to the company and met with executives to argue that Apple needs to move beyond policies and reports (which have admittedly improved in recent years) and adopt a strategy for real, measurable progress. At the 2020 annual meeting, we escalated our challenge to the board of directors by submitting a shareholder proposal urging Apple to "put its money where its mouth is" and tie a portion of executive pay to environmental and social metrics. (We led this challenge with support from three institutional investors who co-sponsored the measure: the Employees' Retirement System of Rhode Island, the SEIU Master Trust, and Friends Fiduciary Corporation.)

Apple CEO, Tim Cook, leads a Q&A.

Shareholder proposals are effective impact investing tools that we use to highlight a key issue and accelerate change. It also helps that the reform we were seeking is good for business and long-term risk management. Linking executive pay to good management of sustainability issues (like those above) is a commonsense reform already in use at Apple's peer companies, such as Microsoft, Intel and IBM. The 2016 Glass Lewis report In-Depth: Linking Compensation to Sustainability found a "mounting body of research showing that firms that operate in a more responsible manner may perform better financially.... Moreover, these companies were also more likely to tie top executive incentives to sustainability metrics." We argued that creating proper incentives and accountability measures for corporate leaders helps to drive change. That is why Royal Dutch Shell also recently announced plans to tie a portion of executive pay to concrete targets linked to the company's net carbon footprint.

Our proposal won support from 12 percent of voting investors in 2020, a strong vote total for a proposal in its first year. Moreover, we attracted media attention and put public pressure on Apple. We decided to build momentum further and re-submit the shareholder proposal headed into the 2021 annual meeting. Then, last fall, we received a call from Apple executives to set up meetings to discuss the proposal. We had spoken with executives prior and made the business case for change, but these meetings had a different tone, and it was clear that the board of directors and senior management was seriously studying the connections between executive compensation and ESG performance.

After further conversations, Apple executives informed our team that they were considering a significant change that would be responsive to our shareholder proposal. Eventually the company announced that Apple senior executive bonus plans will have an ESG "modifier" beginning in 2021. The company stated in its 2021 proxy statement that the Compensation Committee will now consider certain ESG factors "to increase or decrease the bonus payouts by up to 10%." This will be a completely new practice for Apple, which we believe will show senior executive buy-in around the company's sustainability goals and help to accelerate further change. This change could also deepen the board's involvement in ESG strategy and enhance directors' oversight of management.

Apple's change is just one step, but it is a significant win showing how responsible investors can push large companies for positive impact. As CNBC reported, "the new executive compensation measure revealed in Apple's recent 2021 proxy... comes after years of pressure from activist shareholders. In fact, just last year Apple opposed a proxy measure filed by shareholder Zevin Asset Management...that asked for executive compensation to be linked to ESG."

The work of investor advocacy continues going forward. We will keep engaging with Apple to use its new compensation tool effectively to address the most pressing social and environmental issues. We have already written to the company with suggestions for how to use and report on the ESG modifier. Apple has stated that the ESG modifier will be in line with its broad "Apple Values" of "Accessibility, Education, Environment, Inclusion and Diversity, Privacy and Security, and Supplier Responsibility." That is a positive start, but we are pressing the company to outline more specific environmental, human rights, labor standards & diversity issues that will be considered in determining executive pay. This should be done prospectively, and also — after pay is determined — there should be a full account of which particular factors were decisive in modifying compensation up or down in a given year.

We will also carry this message to other major portfolio companies. Apple's new policy helps define standard practice, and we can point to it when pressing firms like Alphabet and others for change. An initial win can lead to further success in impact investing, within companies and across the markets. We will continue to update you on this issue and the range of our other impact investing work.

Thank you for reading. Zevin Asset Management and our partners are still shaping this work, and we welcome your thoughts at ***pat@zevin.com***.

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