
COMMENTS ON S.251

REVIEW OF VPIC ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ACTIVITIES

Vermont State Treasurer's Office
February 22, 2022



SUMMARY

- The VPIC Environmental, Social and Governance (ESG) Committee met on February 4, 2022, to review S.251.
- The Committee expressed its strong commitment to addressing climate change but did not support divestment based on the existing recent divestment studies completed specifically for VPIC.
- Further, the ESG Committee noted
 - Divestment does not reduce fossil fuel emissions, but rather abdicates our voice in effecting positive change.
 - Engagement with companies and their boards of directors has proven to be effective in changing corporate behavior. Some results will be presented.
 - VPIC has also engaged its investment managers on ESG issues, including climate change, with positive results. Some of these successes will be presented.

SUMMARY

- In 2017 VPIC engaged an Independent Pension Advisor, selected by members of the environmental community, to study divestment. Divestment increases investment costs and lowers investment performance.
 - VPIC exercised its fiduciary responsibilities by initiating this study.
 - While divestment was not feasible, the consultant (Pension Consulting Alliance) did make recommendations on steps to address climate change.
 - VPIC adopted an action plan and has made progress on each component.
- Any discussion of divestment should be preceded by an independent study on the impacts on VPIC. Anything less is an abrogation of the fiduciary responsibilities of both the VPIC and the General Assembly.

FIDUCIARY RESPONSIBILITY AND PRUDENCE

- Procedural prudence is the process by which a fiduciary reaches a decision, and substantive prudence, is the outcome of the fiduciary's process.
- Procedural prudence refers to whether the fiduciaries followed an appropriate process to reach a decision.
- Fiduciary duties have both a substantive and a procedural component. A fiduciary who makes an adequate investigation, but then makes an investment decision that exposes beneficiaries to a risk that is excessively high relative to return, violates his or her substantive fiduciary duties.
- Adapted from: "Tobacco Divestment and Fiduciary Responsibility, A Legal and Financial Analysis", by Carol V. Calhoun and "Expert Analysis: Using Simulation to Assist Courts in Assessing the Prudence of Retirement Plan Investment Decisions" and "Can a 401k Fiduciary Rely on Luck?" by Roger Levy.

FIDUCIARY RESPONSIBILITY AND PRUDENCE

- The PCA study was an example of procedural and substantive prudence in action. A study was done, its conclusions were reviewed and decisions, including the development of ESG initiatives, were adopted.
- Any change of course must demonstrate the same level of prudence including a study before any action is taken that affects the portfolio.
- Maine Board of Trustees Minutes November 18, 2021:

An expert “panel will assist in preparing an RFP for a divestment consultant to assist in evaluating the investment implications of the legislation. This work will then be used as a basis to support any Investment Policy changes to be recommended to the Trustees”
- Any discussion of changes to the VPIC direction must include steps to ensure both procedural and substantive prudence. Action without these steps is not in keeping with good faith to the members of the systems.

THE ESG COMMITTEE SUPPORTS THE ALTERNATIVES PRESENTED BY THE VPIC COMMISSION CHAIR TO THE SENATE COMMITTEE ON GOVERNMENT OPERATIONS

- VPIC Carbon Policy vetted by ESG Committee.
- Expanded Engagement Activities Identifying Priority Companies to Target.
- Collaboration with Pension Oversight Joint Committee, Pension Boards, Legislature and Interested Parties.
- Active Internal Review with Divestment of Positions when Engagement Fails.
- Creation of Study Group to Review 2017 Effort and Make Recommendations to VPIC.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

- Examples of environmental factors include climate change, pollution, and deforestation.
- Examples of social factors include human rights, working conditions, and employee relations.
- Examples of governance factors include bribery and corruption, executive pay, lobbying, and board diversity.

- ESG is all about investment decision-making.

- Responsible investment is an approach to managing assets that sees investors include environmental, social and governance (ESG) factors in their decisions about:
 - what to invest in;
 - the role they play as owners and creditors;
 - it aims to combine better risk management with improved portfolio returns, and to reflect investor and beneficiary values in an investment strategy;
 - it complements traditional financial analysis and portfolio construction techniques.

ESG INITIATIVES

- **Environmental, Social & Governance (ESG) Policy**
 - The Commission adopted an ESG policy to set forth how it would apply ESG considerations into the management of the retirement assets and exercise its shareholder rights.
 - The VPIC recognizes that ESG issues are among core factors when assessing the risks and opportunities of an investment and should be fully integrated into the investment process by the Commission and its managers.
 - Policy: <https://vermonttreasurer.exavault.com/share/view/2oy85-ggb74e94>
 - **Manager Engagement, Assessment and ESG Actions**

- **Proxy Voting Policies**
 - Proxy voting allows an equity shareholder of a company to vote on resolutions pertinent to the operations of the firm.
 - An outside vendor evaluates the policies annually with the ESG Committee who makes recommendations for adoption to the Commission regarding amendments to the policies.
 - Domestic Proxy Voting Policy Statement & Guidelines
 - <https://vermonttreasurer.exavault.com/share/view/2oy81-e47dn8rx>
 - International Proxy Voting Policy Statement & Guidelines
 - <https://vermonttreasurer.exavault.com/share/view/2oy87-9jbv8ir5>
 - Download the proxy voting results at
 - <https://vermonttreasurer.exavault.com/share/view/2oya9-1e79s2od>

- **Shareholder Resolutions.**
 - VPIC files and/or co-files proxy resolutions.

VPIC ENGAGEMENT MAKES A DIFFERENCE

- Not only does shareholder engagement provide an effective means for Vermont to vote its values as an institutional investor.
- It allows Vermont to join forces with other, larger institutional investors to have an outsize influence relative to its size.

“Then again, the enormous size that makes multinational companies like ExxonMobil seem so immovable is precisely why these seemingly minute victories are actually huge. If you get a giant corporation with global reach to change even a tiny bit, you have made a global impact”

- Sirota, David, The Uprising: An Unauthorized Tour of the Populist Revolt Scaring Wall Street and Washington

PROXY VOTING AND SHAREHOLDER ENGAGEMENT SELECTED RESULTS

■ Hess Corporation

- On December 22, 2020, VPIC and Minnesota State Investment Board filed a shareholder resolution with Hess Corporation to encourage the company to reduce its impact on climate change by requesting details on how the Company would reduce routine flaring and venting. Followed by discussions with the company.
- Result: Hess reported in an 8-K filing that it would link executive pay incentives to a flaring reduction target in the Bakken area.
 - The Bakken region incorporates about 70% of Hess's flaring activity.
 - Executive pay incentives are the most effective tools for incentivizing achievement of corporate goals.
- The company announced its plans to eliminate routine flaring by 2025 and endorsement of the World Bank's "Zero Routine Flaring by 2030" initiative as part of its "overall strategy to proactively manage our carbon footprint and limit emissions of methane and other greenhouse gas emissions."

PROXY VOTING AND SHAREHOLDER ENGAGEMENT

SELECTED RESULTS

■ ExxonMobil

- In what has been described in news reports as “groundbreaking” at the May 25th ExxonMobil annual meeting, three dissident directors replaced three management nominees to the 12-member board.
 - VPIC backed the activist investor, Engine No. 1, which contested the board elections, with votes in favor of two of the four dissident nominees.
 - These Directors have experience in sustainable business consulting and diversification of operations at large corporations.
 - This ensures Exxon’s Board has the expertise needed to prepare the company for a transition to a low-carbon economy and maintain shareholder value for the long-term.
 - Treasurer Pearce and a group of a dozen Treasurers met with Engine No. 1 staff to discuss the results.
- ### ■ Other shareholder votes at ExxonMobil
- Proposal 6: Issue Audited Report on Financial Impacts of For IEA's Net Zero 2050 Scenario (48.9% shareholder support)
 - Proposal 8: Report on Political Contributions (30.5% shareholder support)
 - Proposal 9: Report on Lobbying Payments and Policy (55.6% shareholder support)
 - Proposal 10: Report on Corporate Climate Lobbying (63.8% shareholder support)

REACTION TO EXXON VOTE

Bill McKibben
@billmckibben

Whoa, yet more news on this watershed day: over Exxon's strenuous objections, two directors calling for climate action have been elected to the company's board.

1:17 PM · May 26, 2021·Twitter
Web App

Big Oil and Gas had a no good, very bad day
It was a great day for the planet
By Justine Calma@justcalma May 26, 2021,
5:25pm EDT

“US oil giants ExxonMobil and Chevron have suffered shareholder rebellions from climate activists and disgruntled institutional investors over their failure to set a strategy for a low-carbon future.

Exxon failed to defend its board against a coup launched by dissident hedge fund activists at Engine No. 1 which successfully replaced two Exxon board members with its own candidates to help drive the oil company towards a greener strategy.”

-The Guardian

In a historic rebuke of fossil fuel giant ExxonMobil, shareholders on Wednesday voted to elect at least two people to the company’s board of directors who were backed by activist investors eager to accelerate the transition to clean energy.

By Kenny Stancil
Common Dreams

ENGAGEMENT WINS THROUGH NEGOTIATION

- Proposals to Activision Blizzard on pay parity reporting, Hess on a flaring reduction target, and Prosperity Bancshares on inclusive recruitment policies in support of board diversity were withdrawn following **successful negotiations** with the companies in which each agreed to implement the respective proposals. VPIC played a significant role in these negotiations.
- On behalf of VPIC, Treasurer Pearce agreed to a conditional withdrawal for a VPIC led proposal with an entertainment company after their Board of Directors, in response to VPIC engagement, agreed to conduct and publish an analysis of company wide median pay by gender and nonbinary populations in their 2022 environmental, social and governance (ESG) report. Staff met in October 2021 with the Company to review progress on the report. The resolution has been formally removed from the proxy.
- The Treasurer assembled a group of 11 state treasurers to engage a large real estate investment manager on its hotel management practices during the pandemic. The group met with unions and employees and successfully secured changes that improved employee safety, health care, and jobs.

Voting Trends of Passive Investment Managers

How the top three passive managers voted on the top three most commonly voted shareholder proposals on environmental issues for the past five years.

Proposal	BlackRock	Vanguard	State Street
2021	%For	%For	%For
Create Climate Change Report [S]	45.5	40.6	50
Adopt Say on Climate Vote [S]	62.5	37.5	37.5
Create Environmental Report [S]	13.3	13.3	13.3
2020	%For	%For	%For
Create Climate Change Report [S]	13.8	21.4	42.9
Adopt/Amend Environmental Policy [S]	6.3	3.7	17.9
Create Environmental Report [S]	0	0	25
2019	%For	%For	%For
Create Climate Change Report [S]	10.5	11.8	22.2
Adopt/Amend Environmental Policy [S]	7.1	14.3	21.4
Create Environmental Report [S]	10	0	0
2018	%For	%For	%For
Create Climate Change Report [S]	3.2	12.9	25.8
Adopt/Amend Nuclear Policy [S]	0	0	0
Adopt/Amend Environmental Policy [S]	0	0	40
2017	%For	%For	%For
Create Climate Change Report [S]	0	0	30.4
Assess Impact of a 2 Degree Scenario [S]	12.5	13.3	53.3
Adopt/Amend Environmental Policy [S]	9.1	0	15.4

Source: ProxyInsight

 Segal Marco Advisors

VPIC ENGAGEMENT PARTNERSHIP AND COALITIONS

VPIC Achieves Results Both Individually and as an Active Participant as a Partner with Institutional Peers

- **PRI** (Principles for Responsible Investment) gives VPIC access to a sophisticated, global network of institutional investors working toward increasing shareholder value by engaging companies on ESG areas. PRI is a leader in corporate engagement and research in all three ESG issue areas, having the support of the United Nations Environment Programme Finance Initiative and United Nations Global Compact.
 - VPIC is a member
 - The vast majority of VPIC managers are members and their reports and scoring are reviewed as part of the ESG process.
- **Climate Action 100+** is an initiative to achieve the goals of the Paris Climate Agreement through shareholder engagement with companies contributing most to greenhouse gas emissions globally. The coalition brings together several organizations across the world to coordinate and focus engagement efforts, including Ceres and the PRI.
- **Majority Action** is a group of institutional investors that engage utility companies with a request they pledge zero net emissions by 2050. VPIC has sponsored numerous initiatives with Majority Action.
- **Council of Institutional Investors (CII)** is an association primarily of pension funds and other employee benefit funds, foundation, and endowments that promotes the interests of US institutional investors. Its membership has an aggregate asset base of \$4 trillion.

VPIC ENGAGEMENT PARTNERSHIP AND COALITIONS

- **CERES** is a non-profit organization that coordinates and supports the work of investors and stakeholders in engaging with companies, policy makers, and other market players on issues related to environmental sustainability, human rights, corporate governance, and policy.
- **Investors for Opioid and Pharmaceutical Accountability (IOPA)** is a group of investors collaboratively engaging with pharmaceutical companies on financial, legal, and reputational risks presented by the opioid crisis that could diminish long-term shareholder value. The investor group has 61 members with \$4.27 trillion in assets.
- **Say-on-Pay Working Group** is a group of 20 institutional investors advocating for reasonable executive compensation policies among U.S. firms. Segal Marco Advisors and the AFL-CIO Office of Investment co-lead the initiative. The group, comprised primarily of public and multiemployer pension funds, view excessive CEO pay: as a driver of income inequality; an indicator of an overly beholden board of directors; and a barrier to growth when it dampens morale and career opportunities for the work force.
- **Investor Alliance for Human Rights** is a collective action network designed to facilitate investor and stakeholder engagement on labor and human rights issues with companies.
- **Human Capital Management Coalition (HCMC)** is engaged with companies regarding their employee management. The Coalition is led by the UAW Retiree Medical Benefits Trust and has 28 institutional investors with \$4 trillion in assets.
- **Northeast Investors' Diversity Initiative (NIDI)** focuses on small to mid-cap companies with a large presence in the Northeast that lack Board diversity. This group will engage regional companies that have a low percentage of women or no directors self-identifying as a member of a minority group. The group consists of institutional investors from the Northeast and is led by the Connecticut State Treasurer's Office.

VPIC ADOPTED FIVE ESG RECOMMENDATIONS

(IN ADDITION TO PROXY POLICY AND SHAREHOLDER ENGAGEMENT)

- The VPIC ESG policy should be revised to include: “When conducting an investment manager search, the investment consultant shall require each prospective investment manager to disclose, in addition to its proposed investment guidelines and practices for investment selection, its ESG policies, processes and systems for identifying ESG related value drivers and managing material ESG-related risks, to the extent the same may be applicable.”
- PCA recommends exploring the possibility of creating a new passive investment vehicle that could be seeded by VPIC and would be consistent with our ESG policy.
- Related to recommendation 2 above, the Treasurer’s Office recommends working with investment consultant to explore ways to identify renewable energy opportunities as incorporated in asset classes or as a subset of asset classes.
- Consistent with the PCA recommendation, the Treasurer’s Office recommends working with our third-party vendors to review the feasibility of developing reporting tools on ESG factors to further our monitoring efforts.
- VPIC should continue its dialogue with investment managers on climate change and ESG issues and prepare periodic updates.

VPIC FIVE-POINT ESG PLAN ADOPTED 2017

Recommended Action

- The VPIC ESG policy should be revised to include to integrate ESG into the investment selection and risk assessment of managers

Next Steps

- Applying improved metrics- measuring carbon reduction
- Further integration into risk management and investment decisions

Results

- The following language was developed by the Treasurer's Office working with Clean Yield and others

“When conducting an investment manager search, the investment consultant shall require each prospective investment manager to disclose, in addition to its proposed investment guidelines and practices for investment selection, its ESG policies, processes and systems for identifying ESG-related value drivers and managing material ESG-related risks, to the extent the same may be applicable.”

- Adopted 2017

- VPIC investment consultant includes an ESG assessment in its manager search
- Annual survey of managers ESG policies

VPIC FIVE-POINT ESG PLAN ADOPTED 2017

Recommended Action

- Explore the possibility of creating a new passive investment vehicle that could be seeded by VPIC and would be consistent with our ESG policy.

Results

- VPIC has invested \$200 million in a low carbon index fund created specifically for Vermont.
- Will assess making more investments as performance is monitored
- Look to partner with other institutional investors on this approach.

VPIC FIVE-POINT ESG PLAN ADOPTED 2017

Recommended Action

- Consistent with the PCA recommendation, the Treasurer's Office recommends working with our third-party vendors to review the feasibility of developing reporting tools on ESG factors to further our monitoring efforts.

Results

- Purchase of a new data platform to provide more in-depth review of portfolios.
- Will continue work with newly appointed investment advisor.
- While delayed during COVID, reengaging with environmental groups to develop metrics to evaluate manager actions on climate change.

VPIC FIVE-POINT ESG PLAN ADOPTED 2017

Recommended Action

- Work with Investment Consultant to explore ways to identify renewable energy opportunities as incorporated in asset classes or as a subset of asset classes.

Results

- Contracted with a private equity fund with Key sector for investments: Environmental sustainability and climate change through investment in sustainable agriculture technology companies.
- Through manager engagement, identifying renewable opportunities.
- Assessing renewable sectors included in manager portfolios.

VPIC FIVE-POINT ESG PLAN ADOPTED 2017

Recommended Action

- VPIC should continue its dialogue with investment managers on climate change and ESG issues and prepare periodic updates.

Results

- Conducted periodic reviews with investment managers.
- VPIC conducts an annual survey of its managers to evaluate their ESG policies, integration of ESG into their investment policies, investments consistent with their policies and progress on metrics to evaluate their carbon footprint.
- Review of investment manager investment policies, PRI reports and sustainability reports, and follow-up on issues.
- Manager responses are public
- Additional information follows next pages.

MANAGER ASSESSMENT AND ESG ACTIONS

- The Commission, in conjunction with the Investment Consultant, evaluates each manager's ability to integrate ESG factors into their investment process alongside financial factors through the procurement process.
- Once the investment is made, the Commission conducts ongoing evaluations of each manager on a quarterly basis through the Investment Performance reporting process.
- VPIC conducts an annual survey of its managers to evaluate their ESG policies, integration of ESG into their investment policies, investments consistent with their policies and progress on metrics to evaluate their carbon footprint.
- *This is a work in progress as we continue to engage managers.*
- Manager responses are made public and can be viewed at:
 - <https://vermonttreasurer.exavault.com/share/view/2uc23-34ir6owh>
- Specific Manager ESG initiatives follow

INVESTMENT MANGER REPORTED ACTIVITIES

- **Artisan Partners**
 - Has not had any exposure to fossil fuel energy corporations in its portfolio since 2019
 - Well documented sustainability report
 - Metrics: Estimates company's carbon footprint (scope 1-3 emissions) and discloses to investors
 - Well below benchmark: MSCI AC World Index
- **BlackRock**
 - Acknowledge that BlackRock does maintain positions in some oil and gas firms including Exxon and ConocoPhillips
 - \$200 million VPIC investment in low carbon transition fund
 - global index fund that seeks to invest in companies that are well-positioned to maximize returns and minimize risks associated with the transition to a global, low-carbon economy,
 - Blackrock has developed a series of ETF funds aligned with 1.5 C scenario

INVESTMENT MANGER REPORTED ACTIVITIES

- **Blue Vista Capital Management (real estate)**
 - Per Manager : “Applicable ESG risks and/or opportunities (e.g. lighting retrofit, LEED cortication, etc.) are incorporated into the final Investment Committee memo for each investment as part of the underwiring process.
- **Benefit partners**
 - 2020 engaged a consultant to perform independent ESG analysis on investments, formally integrating ESG considerations into investment process
- **HarborVest:**
 - All investments scored against an ESG template
 - “... developing an actionable climate change strategy that is in line with the Recommendations of the Task Force on Climate-related Financial Disclosures(TCDF)”
 - Included TCDF progress report in the 2020 ESG report

INVESTMENT MANGER REPORTED ACTIVITIES

- **Ares Capital Management**
 - Member UN PRI
 - Became public supporter of the Taskforce on Climate-related Financial Disclosures (TCFD) in November 2021, joining 2,700 supporters in 89 jurisdictions
 - Expects to publish TCFD aligned climate change strategy in Q2 2022.
 - Policy not invest companies and assets in coal, firearms manufacturers, tobacco, among others
 - Escalation policy on certain industries and using this in investment decision making including carbon intensive products and services
 - Seeks out investment in energy efficient products, recycling, energy efficiency and management, inclusion and diversity
 - 2019- Created strategy to invest in investments aimed at cutting greenhouse-gas emissions.
 - December 2021, Raised \$2.2 billion of capital for its inaugural “Ares Climate Infrastructure Partners Fund”

INVESTMENT MANGER REPORTED ACTIVITIES

- **Neuberger Berman**
 - Signatory to the Net Zero Asset Management Initiative which has the goal of achieving net zero emissions in line with the Paris Agreement
 - Initiative has 200 signatories representing \$57 trillion in assets under management

- **Pontifax AgTech**
 - Engaged third partner ESG company to advance and support ESG strategy and develop metrics
 - Key sector for investments: Environmental sustainability and climate change through investment in sustainable agriculture technology companies
 - Reduced synthetic chemical use
 - Water conservation
 - Wastewater reduction
 - Increased soil health/yield improvement

FOSSIL FUEL FREE INVESTMENT OPTION

- At the recommendation of the Treasurer and approval by the Retirement Boards, a fossil fuel free investment option was added in 2014 to its deferred compensation and other optional retirement investment programs.
- The addition of a fossil-free fund offering provides employees the opportunity to invest in companies that support a sustainable future, while supplementing their retirement savings.
- Despite efforts to publicize, pick-up by state, teacher and municipal members has been limited.

Plan:		VSERS 457			
Date:		9/30/2021			
Total Participants	Total Assets	ESG Fund	ESG Fund Participants	% of Participants Using Fund	ESG Funds \$
8,103	\$ 658,047,333	Vanguard FTSE Social Index Fund	658	8.12%	\$ 28,411,811
		PIMCO Total Return ESG Fund	1,542	19.03%	\$ 6,671,892
		PAX Global Environmental Markets	565	6.97%	\$ 3,324,263
		PAX Sustainable Allocation Fund	197	2.43%	\$ 3,386,209
			Total		\$ 41,794,175
			As a percentage of total plan		6.35%

Plan:		VSTRS 403(b)			
Date:		9/30/2021			
Total Participants	Total Assets	ESG Fund	ESG Fund Participants	% of Participants Using Fund	ESG Funds \$
3,053	\$ 159,814,695	Calvert Equity Fund	149	4.88%	\$ 3,890,074
		PAX Global Environmental Markets	70	2.29%	\$ 522,835
		PIMCO Total Return ESG Fund	1,114	36.49%	\$ 4,922,735
			Total		\$ 9,335,644
			As a percentage of total plan		5.84%

Plan:		VSERS Defined Contribution			
Date:		9/30/2021			
Total Participants	Total Assets	ESG Fund	ESG Fund Participants	% of Participants Using Fund	ESG Funds \$
552	\$ 90,203,257	PAX Global Environmental Markets	8	1.45%	\$ 423,015
		Domini Impact Equity Fund	36	6.52%	\$ 3,256,251
		PIMCO Total Return ESG Fund	13	2.36%	\$ 450,559
			Total		\$ 4,129,825
			As a percentage of total plan		4.58%

Plan:		VMERS Defined Contribution			
Date:		9/30/2021			
Total Participants	Total Assets	ESG Fund	ESG Fund Participants	% of Participants Using Fund	ESG Funds \$
427	\$ 32,073,781	Domini Impact Equity Fund	8	1.87%	\$ 86,679
		PAX Global Environmental Markets	1	0.23%	\$ 4,577
			Total		\$ 91,256
			As a percentage of total plan		0.28%