Part One

DEMYSTIFYING
THE PENSION FINANCE SYSTEM

CLIMATE FINANCE ACTION

Why Knowing Your Pension System Matters

With more than $6.5 trillion in investor power, pension systems can be a powerful force– either for keeping the status quo, or for investing in a safer climate future, healthier communities, and a more equitable economy. Through public pensions, workers as investors can have a voice in deciding which industries we financially support– corporations that continue to drive the climate crisis and its disproportionate harms on communities of color and working classes communities, or a more sustainable economy that serves the people and the planet.

The majority of pension funds' collective capital has and continues to be used to accelerate climate change (despite the risk that poses to the fund's long-term health.)

But it doesn't have to be this way; it can be a positive force to mitigate the climate crisis– and with stronger seats at the table of our pension funds, we can push back against those corporate decisions driven only by shortsighted self-interest, at the expense of all others.

We need to turn the tide.

Yet pension systems can also be hard to navigate and are inaccessible – even to those who have a direct stake in its decisions and thus should have a say. It's time to demystify the black box of finance systems and open the door for more voices weighing in and shaping the solutions. This section offers a roadmap to climate finance space, roles, and decision points where you can make a difference.

“Say What” Glossary

Let’s translate some of the key technical finance terms into more understandable, actionable concepts – and share what it looks like when wielded for progress.

1 ASSETS

Assets are just the investments your pension system chooses to place its money into. Pension funds invest in many types of assets, comprising the pension's "portfolio." They include public companies, bonds, real estate, and private equity stocks. The "return on assets" refers to the financial return the company has made to its shareholders.

2 ASSET ALLOCATION

Asset allocation is the strategy your pension takes by dividing up a range of investments to balance risk and returns. This strategy clarifies what kinds and degree of risk it will account for in its decisions on what and where to invest, which should include climate risk.

3 ASSET MANAGER DUE DILIGENCE

The policy, criteria, and activities that pension funds use when hiring, selecting, and evaluating any asset managers they hire. This helps to ensure your managers' investment decisions, engagement, and proxy voting performance are implementing your pension system's principles.

4 CLIMATE RISK

Climate risk is the risk to your investments due to the increasing climate crisis. It takes the form of:

- physical risk- destruction of facilities or materials due to climate-related disasters
- financial risk- loss of money or performance from disruption to supply chains or business operations, or inability to transition to more energy-efficient, low-carbon functioning)
- systemic risk- the long-term instability of the economy as the crisis grows and the costly harms that the crisis wreaks on our homes, public infrastructure, public health, ecosystems, etc.

Some climate terms related to managing climate risk: **Net Zero, Paris Agreement, 1.5°C Commitment**

5

DIRECTOR VOTES

Corporate Directors have a fiduciary duty to manage financial risks on behalf of shareholders, including climate risk. Companies that fail to recognize and address climate change can suffer serious financial consequences related to physical damage, transition, litigation, and regulatory costs. Pension plans can vote against directors because the directors' lack of risk management burdens their investors.

6

ECONOMIC, SOCIAL, AND GOVERNANCE (ESG)

“ESG” refers to three categories of factors that investors take into account to assess which companies (or industries) are set up for a successful, sustainable future when deciding how to invest money. “ESG” is quite jargon-laden, so “responsible investing” may be more resonant phrasing. But the term is good to know as it is often used in the financial services field. Essentially, investment decisions with an “ESG” lens seek to limit the environmental, social, and governance risks that affect the long-term health of a portfolio– and benefit from the economic success in opportunities to mitigate risk (such as renewable energy).

Examples of what each category covers:

- **“Environmental”**-- physical destruction or instability due to extreme heat, flooding, wildfires, severe storms, etc.; inability to transition away from production that pollutes local communities, decimates natural resources and biodiversity, or emits lots of carbon
- **“Social”**-- worker treatment, racial equity impacts, and human rights impacts from production
- **“Governance”** covers executive compensation, board diversity, and transparent reporting & accounting.

7

FIDUCIARY DUTY

Fiduciary duty is the legal responsibility of those working in a pension system to ensure that its decisions and actions are in the best financial interest of the beneficiaries. This includes their ability to understand and manage the degree of financial risk within their investment portfolio, such as climate risk.

8 INVESTMENT POLICY STATEMENT (IPS)

A document that outlines an investor's goals and objectives, as well as the investment strategies and policies that will be used to achieve them. This can explicitly include climate-related risks and opportunities in the fund’s investments.

9 NET ZERO

“Net Zero” refers to the plan and practice of a company so the amount of greenhouse gas (GHG) they put into the atmosphere is in balance with the amount removed. It’s achieved from both emission reduction and removal.

10 PARIS AGREEMENT OR 1.5°C COMMITMENT

When policymakers and advocates refer to “Paris” or a “1.5-degree” commitment, they mean policies that would align with the Paris Agreement, an international treaty on climate change passed in 2015. This policy aimed to align nations around limiting warming to 1.5 degrees above pre-industrial levels. When pension funds seek to align their policies with “Paris,” they refer to policies that aim to limit warming to that 1.5-degree level.

11 PROXY ADVISORS

Most pension funds hire a proxy voting advisor (Institutional Investor Services or Glass Lewis). These proxy advisory firms provide institutional investors with a technology solution to cast tens of thousands of votes each year at company annual general meetings. They also provide research and data, as well as recommendations on management and shareholder proxy proposals.

12 PROXY VOTING

When a pension fund owns shares in a publicly traded company, it can cast votes every year on topics such as the structure of the board and directors, policies of the company, and compensation. A “proxy vote” is the ballot cast by a person or firm on behalf of shareholders on the issues raised, often done to push for a policy/ practice change or hold the board accountable.

This is where investors holding company shares will vote For or Against the election of board candidates and shareholder proposals, making a business case for corporate action by the board on important issues, including climate change, worker rights, etc.

13 PROXY VOTING GUIDELINES

These are the guidelines developed by and approved by pension fund boards to guide how they vote their proxies during shareholder season. These guidelines demonstrate each pension fund’s investment beliefs on corporate environmental, social, and governance risks and opportunities.

Pension funds can also request or require that their external asset managers adopt and implement these guidelines. Proxy voting guidelines are reviewed and evaluated regularly by the trustees.

14 PROXY VOTING SEASON (AKA “SHAREHOLDER SEASON”)

The time of year, April-June, when corporate annual general meetings (AGMs) take place. AGMs serve to present annual performance and to vote on proposals brought forward by management and shareholder proposals filed by stockholders. Also referred to as “shareholder season.”

15 RISK MANAGEMENT

Steps an investor takes to understand and limit the degree of loss and fluctuation it can handle within its investments without harming their overall financial security. This is critical to account for in the pension fund board, especially given the responsibility to ensure retirement security for a state's current and future employees.

16 SHAREHOLDER PROPOSALS AND RESOLUTIONS

These are filings to be considered by shareholders in a publicly traded corporation. Proposals are made by interested shareholders and may include a requirement to disclose climate-related risks, the requirement to disclose lobbying activities and corporate commitments, and the adoption of targets to reduce emissions.

Two common applications: negotiate the resolution's terms to get company action ahead of annual general meetings; or, if that doesn't work, get enough shareholder votes for it at the meeting to push for the change.

17 STEWARDSHIP

All the policies and actions an institution takes to oversee its investments and engage its companies in the portfolio. This includes: interactions with companies and votes/ actions to hold them accountable, coalitions or campaigns it joins to advance changes within a sector or economy, and an approach to hiring and asset managers and evaluating service providers.

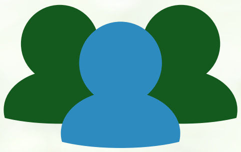
“Who’s Who” of the Pension Finance World

Know the key players who are shaping what your pension fund invests in and how it holds companies accountable– including what role they play and how it connects to your goals.

“Who’s Who?”

With a clearer sense of the different voices in the mix, you can chart relationship-building and engagement efforts that empower labor trustees, retirees, and local workers to have a stronger voice and meaningful seat at the table.

	Treasurer/comptroller: State Treasurers are usually seen as the CFO of the state, though their role varies by state. Some are sole fiduciaries over the state’s pension fund(s), i.e. they alone can make policy decisions related to the fund. In most states, they are not and need to work with a board of trustees that has a governance role over the fund– sometimes as the ex officio-chair and others as one of many board members. Given the treasurer is usually an elected figure, even when they do not have controlling authority over a pension fund, they still have or can have a key role in influencing policy. State retirement systems, which oversee pension investments and benefit administration, often manage several plans.
	Trustees: The board of trustees oversees the pension fund and are the fiduciaries. The election or appointment of trustees is usually outlined in state law. Some are appointed by Governors and State Treasurers and others are elected to represent the beneficiaries - the public employees who typically are unionized.



Board committees: Boards will have separate working committees who focus on an element of the fund's functioning and performance. Audit and Investment Committees play a key role in how the pension fund handles the financial risk of climate change, and what policies and reporting the system undertakes to address it.

There may be a group that guides and supports your pension's stewardship efforts, often called the Environmental, Social and Governance ("ESG"), Stewardship, or Corporate Governance, or Proxy committee.

Staff: Most public pension funds have staff who manage investments, risk, and operations. These staff are often quite experienced and have their own power. Staff includes the Chief Investment Officer, who typically oversees investment decisions, with oversight from an investment committee within the board of trustees.

Some pension systems add staff capacity to strengthen its corporate governance and risk management through Environmental, Social and Governance ("ESG") or Stewardship staff.

External Asset Managers and Services: Pension funds hire asset managers like BlackRock and State Street, as well as many smaller firms, to manage different portions of their pension funds. These groups have a big influence on the specific makeup of the portfolio. Some funds use proxy advisors who act on the pension system's behalf in director, shareholder proposal votes, and other engagement efforts with companies within the portfolio.

The fund may also hire third-party vendors that help the staff manage the portfolio, conduct risk and performance assessments, and /or research that informs a pension's policy change on a range of issues.

	**Beneficiaries:** Beneficiaries are the community of public employees and retirees whose retirement compensation these pension funds represent. Their contributions make up the existence of the fund, and are contractually assured the retirement savings agreed to upon employment. These workers usually have unions that represent them, usually a local affiliate of a national union, such as the Service Employees International Union (SEIU) or the American Federation of State, County and Municipal Employees (AFSCME) for general public employees. Educators are usually represented by an affiliate of either the National Education Association (NEA) or the American Federation of Teachers (AFT). These unions often have elected representatives on the board of the funds, and can have a strong interest in pension fund policies– as those shape both retirement security and what kind of future their pension investments are funding.
	**Community and non-profit organizations with shared interests:** Another set of stakeholder groups that have a different kind of interest are climate change groups, groups representing the state's environmental justice communities, groups working at the intersection of climate and economic and racial inequity, and taxpayers within the state who care about climate. These groups and individuals may engage about the policies of these funds– and ones with shared goals and values could be allies.
	**Corporate Leadership and board members:** The Director and Board of Directors within every company your pension fund invests in have a responsibility to ensure solid financial performance and limit financial risk to your fund, as one of their shareholders. This includes the practices and plans they take to reduce their emissions, pursue climate solutions, and limit the risk climate change has on them. There are levers to push for accountability as a shareholder, such as votes, direct engagement, and investment commitments. When investors implement stronger proxy voting policies, they will influence companies to manage their business with a focus on the triple bottom line– profit, people, and planet.

A Menu for Change: 10 Policy Paths Pensions Can Take To Tackle Climate Risk

Your pension could enact a variety of policy improvements to tackle the harms of climate risk and corporate unaccountability to the fund's long-term health. Here are ten common ways.

MENU FOR CHANGE

10 POLICY PATHS PENSIONS CAN TAKE TO TACKLE CLIMATE RISK

INVESTMENT

1 Develop a robust investment policy statement (IPS) or "investment beliefs" to include climate change

Sets clear direction and benchmarks for asset owners' mission, values, and objectives, including climate change-related risks and opportunities in their investments in public equities. Is used for decision-making, and board and staff performance assessment.

2 Expand climate risk analysis tools and scenarios

A pension system can pursue additional ESG and climate measurement tools to bolster their understanding beyond headline analytics or company self-reporting. That can entail evolving their analytical climate risk tools, as well as setting stronger portfolio monitoring practices that include environmental key performance indicators and climate scenario analyses of CHC emissions.

This action would enhance a pension fund's ability to fully assess the quality and consistency of data it is using to assess risk and inform strategic allocation.

3 Establish a proactive climate risk-informed investment policy

This approach can look differently, depending on how assertive a pension system is willing to go. Here are three degrees of policy action–

- Climate-related risk analysis is an explicit consideration for a board's investment strategy, strategic asset allocation reviews, and asset management decisions.
- Pension systems name climate change risk as a fiduciary duty and incorporate climate risks into their broader capital market assumptions, which would be used to set long-term strategic asset allocation.

Pension leaders can also look at opportunity– setting an explicit commitment to invest in companies addressing climate mitigation and energy sector transitions.

MENU FOR CHANGE

10 POLICY PATHS PENSIONS CAN TAKE TO TACKLE CLIMATE RISK

INVESTMENT

4 Set a portfolio-wide strategic Net Zero/ Paris Aligned goal

Sets clear direction and benchmarks for asset owners' mission, values, and objectives, including climate change-related risks and opportunities in their investments in public equities. Is used for decision-making, and board and staff performance assessment.

5 Requirement for portfolio-wide disclosure

A portfolio-wide disclosure requirement ensures all investments are in companies that transparently share their climate risk, financial performance, and lobby activities.

GOVERNANCE

6 Expand climate risk analysis tools and scenarios

Explicit proxy voting guidance for asset managers– with consistent and transparent reporting– would make sure a state is leveraging its full influence as a shareholder toward addressing the climate crisis and the risks it poses.

This policy would guide how they vote their shares, and urge their asset manager to vote on issues related to climate and corporate governance. Examples of voting policies can include:

- Voting **AGAINST** directors and board members who fail to adhere to policies consistent with 1.5-degree warming or are participating in anti-climate lobby groups.
- Voting **FOR** proposals that request disclosure of climate-related risks, emission reduction targets, or alignment between lobbying activities and corporate commitment.

MENU FOR CHANGE

10 POLICY PATHS PENSIONS CAN TAKE TO TACKLE CLIMATE RISK

GOVERNANCE

7 Commit to joining collective Activist Ownership campaigns or collaboratives

Pension systems join as signatories or supporters of investor organizations to better leverage collective shareholder power to advance stronger climate risk considerations in investment, accountability for company leadership, and proactive climate solutions.

This can range from committing to ongoing campaigns such as Climate100 to joining specific letter-writing or shareholder action efforts. Leading pension systems may join a governance or advisory committee or dedicate staff capacity to their participation.

8 Invest in pension's board and staff capacity

Ensure there are dedicated ESG investment staff and staff following proxy voting. Set competency standards for investment staff in hiring and evaluation. Develop educational programming for the board and staff on the latest trends and resources for an implementation strategy that translates stewardship priorities into innovative action and thought leadership, including at the asset class.

9 Develop an Asset Manager Due Diligence policy

This policy will ensure accountability of the managers of the pension system it hires, to ensure their capital allocation strategy is investing in companies outside of high-impact sectors and voting activity is in-line with the guidance.

10 Establish a formal ESG Committee

What this looks like in action: A committee of experts helps analyze and address risk, as well as guide the ongoing implementation of an ESG framework and related engagement activities.

This can be key to innovative strategy, capacity-building for the board to follow and adapt to ESG trends, and help hold the board accountable to its investment and governance commitments.

“Save the Date”: A Timeline on Pension Policies

While each state and pension fund varies, there are some common trends for when critical decisions are weighed & made. As you chart out opportunities to advance meaningful policy solutions for your pension’s ability to manage and address climate risk, it’s important to map when you engage.

“Save the Date”: A Timeline on Pension Policies

01

Winter (January - March)

Pre-shareholder season is a key time for pension funds to strategize on corporate governance, review and engage with portfolio companies, and prepare or sponsor new shareholder proposals.

02

Spring (April - June)

The Annual General Meeting season is when companies make critical decisions, requiring pension funds to solidify their proxy voting guidelines and collaborate with shareholders to influence high-emitting companies towards change.

03

Summer (July - September)

During the pension board's strategy review, they assess asset allocations and policies regarding external managers, while also considering the integration of systemic climate risk into their investment strategies, amidst significant behind-the-scenes preparations for year-end reviews.

04

Fall (October - December)

The year-end period is crucial for assessing a fund's financial performance and climate risk, while also being an opportune time to influence related legislation and budget considerations for pension fund solutions.

SEASONAL EXPECTATIONS

WINTER / QUARTER 1 (JANUARY -MARCH)

Pre-shareholder season is the time for your pension to decide on a proactive corporate governance strategy (i.e. focus on the top egregious companies in the portfolio or a sector that has strongest potential for renewable energy transition), review shareholder proposals, and start to directly communicate and engage with those companies within its portfolio.

New shareholder proposals are starting to be filed for the next season, and this is the time for a pension to introduce or sponsor new proposals. (See what's been introduced on climate here and here.)

SPRING / QUARTER 2 (APRIL-JUNE)

Common time frame for most companies to have their “Annual General Meetings”. This is where they make key decisions such as votes on director and board members, company policies and governance practices, and shareholder resolutions. This is the time to ensure the pension fund’s proxy voting guidelines, engagement and expectation-setting with any consultants who oversee their shareholder activity– and policies guiding that need to be crystalized ahead of these meetings.

Pension systems can also join other shareholders in efforts to urge passage of resolutions that push high-emitting companies to change.

SUMMER / QUARTER 3 (JULY-SEPTEMBER)

This is a common time for a pension board's "strategy review"– when the board will look into their asset strategic allocations and decide on policies around external managers (such as due diligence and responsible contracting.) In addition to weighing in on these specific policies, this is also a great place to push for addressing systemic climate risk in the fund's investment beliefs and foundational policies.

This time may seem quieter on the surface, but don't be fooled. There is often a lot of behind-the-scenes work being done ahead of the end-of-year performance reviews and policy assessments. This is a great time as a trustee, or union member to work with your trustee, to raise questions about what standards, benchmarks, tools, and firms the pension fund is going to use to assess its performance and policies.

FALL / QUARTER 4 (OCTOBER- DECEMBER)

The end of a calendar year often includes annual assessments of the fund's financial performance and risk evaluation. This moment is great to push for a review of climate risk in the portfolio and exploration of related investment and governance policy revisions.

Each state legislature varies, but the end of the calendar year is often when the full-time legislative session ends– and is also when a new budget is being considered. These are key times to engage in any legislation- or appropriation-based pension fund solutions.

There are many other factors, unique to your state and fund, at play to account for. Check out our worksheet to build out an accurate timeline for change-making moments in your state.

WORKSHEETS

"SAVE THE DATE" WORKSHEET: Build a Timeline for Your State

Six questions to build a calendar of key moments for your state and pension fund(s):

1 - When does the board review external consultants and asset managers?

2 - When does the pension fund put RFPs out for external asset and proxy managers?

3 - If board members and trustees are appointed, when does the Administration change?

4 - When do key decision-making committees– such as investment and audit– in your pension fund meet?

5 - Are there any legislative or Public Administration (such as the Governor or Treasurer) orders for the pension system to implement?

6 - When and how frequently does your pension fund review their policies (statement of beliefs, proxy guidelines, strategic asset allocation)?

CFA CLIMATE FINANCE ACTION

"WHO'S WHO" WORKSHEET:
Map Your Pension System's Key Players

Complete this list to map your pension system's key players.

- ☐ State Treasurer____
- ☐ State Comptroller and/or Auditor____
- ☐ Pension's Executive Director and/ or Chief Investment Officer

  ____
- ☐ Pension's Supporting Staff ____
- ☐ Pension Board Chair____
- ☐ Pension Board Members

  (Include whether they are appointed or elected, and if they chair or serve on an audit, investment, policy, or stewardship committee)

  ____
- ☐ Firm(s) Hired to Manage Assets ____
- ☐ Firm(s)hired to Conduct Proxy Voting____________________________________
- ☐ Firm(s)hired for any Special Projects ____________________________________

  State Legislators with Related Sponsored Bills or Stated Policy Agenda

  ____
- ☐ Main Unions and/or Retiree Associations for Public Employees included within Pension Systems *(Include whether they have a trustee representative and/or if their local leaders have spoken out or engaged on the issue)*

  ____
- ☐ Organizations who have been actively engagement or outspoken on the pension and climate and/or who have a critical voice and shared values with your group ____

  ____

DEMYSTIFYING THE PENSION FINANCE SYSTEM

Key Takeaways:

- Pension and finance lingo can be dizzying. But it's worth it to understand the people, places, and practices where your pension fund can better understand climate risk and protect your retirement savings from it.
- Gaining a better understanding of critical roles within a pension system-- and the influencers on pension decisions and practices-- is key to seeing how positive change can happen.
- Learning about the general timing when pension funds make vital decisions will help you see the most effective times to get people's attention and influence decisions. Use our research questions to know critical moments unique to your state and fund.

Thank you for exploring Demystifying the Pension Finance System, Part One of **Investing in Our Future: A Guide for Climate-Conscious Pension Strategies**.

What to do Next:

CONTINUE LEARNING:
Part Two: Know Your Shareholder Power

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Climate Finance Action (CFA) is a women-led, 501(C)3 non-profit organization equipping stakeholders and decision-makers to leverage the transformative power of publicly-held capital for real-world climate solutions to ensure a just transition to an inclusive economy in favor of people and the planet.