Part Two

KNOW YOUR SHAREHOLDER POWER

CLIMATE FINANCE ACTION

Introduction to the World of "Shareholder Engagement"

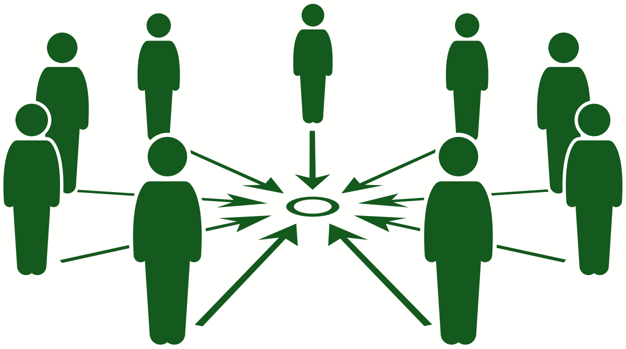
With more than $6.5 trillion in investments, U.S. public pension systems own a hefty amount of shares in companies. Those shares mean votes– and a powerful opportunity to harness the power of pension dollars to impact corporate behavior on climate change.

Let's break down how:

- When you own stock in a company, you are a shareholder with a "share".
- Every share owned comes with a vote in the company, which is made through "proxy voting" at the company's annual meeting. The more shares you own, the more votes you have.
- Since pension funds are very large sums of money, they own a lot of shares in companies-- and are often some of the very biggest shareholders in a company.

So the voting power of pension funds matters and can make a difference.

This active engagement is a key element of pension systems' fiduciary responsibility. To protect the health of the fund, pension funds need to ensure the companies they are investing in are acting responsibly. That includes limiting risk to the company's long-term success– which is essential to the long-term returns of the pension funds *and* lessening the destruction of climate on the overall economy and society we depend on.



What can impactful shareholder engagement look like for tackling climate risk? Shareholders can advocate for companies to adopt policies and practices to push for climate risk through:

- Filing (or supporting) resolutions that call on a company to disclose or take action on a policy or practice
- Engaging directly with a company to urge them to change a policy or practice
- "Proxy vote" on resolutions or board directors & members of a company at Annual General Meetings

Through proxy voting, pension funds can play more of a leadership role to move companies to use more renewable energy, create plans to reduce emissions, increase equitable business practices, and seek to protect worker health.

And as the public employees or trustees whom these investments represent, you should have a say on what the pension system does with its shares.

This section will walk through how a pension system can strengthen its shareholder power to more effectively influence companies' responsible behavior in addressing climate risk and how trustees, workers, and retirees can play a role.

Three Common Ways to Strengthen Shareholder Influence

Shareholders wield considerable power to shape company policies and strategic direction. Learn more about common strategies— Corporate Engagement Policies, Proxy Voting Guidelines, and Proxy Advisor Standards—to enhance shareholder impact and ensure corporate accountability.

1 CORE PROXY AND CORPORATE ENGAGEMENT POLICIES

The Investment Policy Statement (or "Investment Beliefs") and the Corporate Governance or Stewardship Policy are examples of foundational policies in a pension. Making sure those name the responsibility to tackle climate risk sets the stage for effective proxy voting and corporate engagement.

Elements of a Strong Policy

States that climate change and other sustainability challenges pose a systemic risk to its portfolio and the economy– and commits to using all votes to achieve emissions targets for keeping temperatures below 2°C.

Defines these financial risks and lost opportunities to investors– physical risks (such as extreme weather, biodiversity, and sea level rise), legal transition risks (such as policy changes or technological developments), or adaptation opportunities.

Asserts that the risk must be managed and mitigated via its stewardship of the pension fund– making investment decisions, proxy voting and engagement with portoflio companies, and clear directives with asset managers and voting services.

These policies are strongest when they explicitly name the intersection of climate change, racial justice, and economic inequity at the core of economic systems. At status quo, these systems are driven by and benefit a small, powerful group of special interests at the expense of all others and the planet.

State Examples:

- Connecticut names climate as a systemic risk their pension fund needs to navigate. Investment Policy Statement for the Connecticut Retirement Plans & Trust Funds (starting page 105)
- California's PERS spells out exactly why and how climate is a systemic, long-term risk to be managed. California Public Employees' Retirement System Total Fund Investment Policy (pages 58, 62 & 64, and 107)
- Massachusetts new Stewardship Principles that guide all their engagement activities is here

2 PROXY VOTING GUIDELINES

Proxy voting guidelines spell out the criteria and directives that guide the pension fund's voting decisions on various issues, from the election of company board directors or disclosing compensation to human rights, labor laws, climate and social issues.

Proxy voting is a powerful tool that offers shareholders a way to send directors and management a message and drive change. That's why having strong proxy voting guidelines is such an important step. The following three policy changes create clear directives and plans for proxy votes:

DIRECTOR VOTES

SHAREHOLDER RESOLUTIONS

ENGAGEMENT STRATEGIES

Director votes.

Corporate directors serve on the boards of companies and are responsible for serving the interests of shareholders (not the CEO). They, along with CEOs, set the company's strategy. When businesses fail to address the realities of climate change, and show an unwillingness to grapple with the climate risks in their businesses, it puts that risk onto their shareholders.

So when corporate directors refuse to address climate risk, shareholders may vote them out to demonstrate that they are no longer serving as shareholder representatives

Shareholder resolutions.

Investors and shareholders can file resolutions, which cover a range of topics for changes in the policies and practices a company takes up. When it comes to urging a company to better manage climate risk, resolutions commonly call for:

- Assessments of their climate risk and “transition-readiness” (a.k.a. how able they are to move away from high-emitting, high-risk practices)
- Concrete transition plans
- Disclosure of any lobbying spending or activities related to climate

Resolutions usually aim to pressure or persuade a company, or to publicly spotlight a company’s practices.

Engagement strategies or campaigns that focus its capacity on a high-risk company or sector in its portfolio.

Ahead of shareholder season, a pension system can decide to proactively reach out to companies or propose resolutions for positive change within specific companies. Activist Ownership campaigns or collaboratives– such as Climate100, CERES, Net Zero Asset Owners Alliance, or Task Force on Climate-related Financial Disclosures– offer resources and guidance for pension funds on how to run or join a shareholder strategy that focuses on an issue, company, or sector. For example, “Climate Action 100”, a coalition to coordinate across big investors on climate-related votes, has a database of resolutions and votes to consider.

Examples:

CONNECTICUT POLICY ON DIRECTOR VOTES:

“The Connecticut Retirement Plans and Trust Funds may WITHHOLD votes from or vote AGAINST directors individually or the entire board where the company has failed to align their business plans with the goals of the Paris Climate Agreement, to establish a plan to achieve net zero emissions by 2050, or where a director individually or the entire board have failed to exercise appropriate risk oversight of environmental and social issues.”

WASHINGTON STATE POLICY ON CLIMATE LOBBYING DISCLOSURE:

“When companies actively lobby, whether directly or indirectly, in a manner that seems to contradict their espoused priorities and positions, it can result in the inefficient use of corporate resources, confuse a company’s messages, and expose a company to significant reputational risks.

Accordingly, the Washington State Investment Board will generally vote in favor of proposals requesting more information on a company’s climate-related lobbying. When reviewing proposals asking for disclosure on this issue, we will evaluate: (i) whether the requested disclosure would meaningfully benefit shareholders’ understanding of the company’s policies and positions on this issue; (ii) the industry in which the company operates; (iii) the company’s current level of disclosure regarding its direct and indirect lobbying on climate change-related issues; and (iv) any significant controversies related to the Company’s management of climate change or its trade association memberships.”

EXAMPLE OF AN ASSET MANAGER’S PROXY GUIDANCE ON CLIMATE LOBBYING, FROM THE FIRM WESPATH:

“Supports proposals calling for board oversight of political spending and for the publication of reports on the amounts and destination of funds exceeding $10,000.

A company’s political contributions, lobbying activities and membership in trade associations or interest groups may conflict with company policy statements and may be at odds with the long-term interests of the company and its investors. Beyond oversight, Wespath generally supports proposals calling for companies to analyze and report on the alignment of political spending and lobbying activities the company supports (either directly or through trade association membership) with the stated ESG objectives of the company.”

3 "DUE DILIGENCE": PROXY ADVISOR DIRECTIVES AND PERFORMANCE STANDARDS

Most pension funds pay an outside asset manager to manage some of the fund's money. A strong due diligence policy for outside asset managers will ensure their behaviors line up with your fund's values and risk management decisions. This policy should have clear criteria for hiring, engaging, and evaluating its external asset managers (and others) to ensure alignment with the pension fund's commitment to address climate risk.

Pension funds will create a questionnaire for prospective external managers to fill out in their application, as well as a review of managers' proxy voting guidelines and their voting records.

Steps a pension fund can take:

- Identify and review the asset managers' proxy voting policies, specifically as they relate to climate change risk.
- Check for whether their vote record is consistent with their stated policies? What was the rationale (if explained) for voting Against a proposal? (See worksheet for how to find votes.)
- Create criteria for selecting external managers with clear and consistent reporting on how they've voted on climate-related shareholder resolutions. For example, the RFP can ask provider candidates to share a list of their climate-related resolutions and votes for the last two years.

DUE DILIGENCE

How to more concretely check for alignment between the guidelines and their policies? Here are four specific prompts the pension system can use to evaluate a proxy service provider's performance with their stated ESG or Climate policies, to ensure alignment with the guidelines:

Percentage and number of board directors proxy advisors recommend votes against due to climate risk management considerations

How did proxy advisor recommendations compare to the recent climate banking proposals that were introduced in the last two years?

How do they compare shareholder proposals seeking the establishment of GHG targets, climate lobbying reports, just transition plans, and methane measurement reporting?

Do they review and update their policy annually? Do they share their voting record %, benchmarked to their policies?

State examples:

- The Illinois Treasury's questions and criteria for an asset manager due diligence policy can be found here.
- Maryland's State Retirement Pension System's due diligence questionnaire for public equity assets can be found here.

WORKSHEETS

WORKSHEET:
Proxy Guidelines "Strength-Gauge" Checklist

How strong is the pension system's proxy and engagement?
Use this checklist to find out:

- [ ] Investment Policy recognizes the systemic risk of climate
- [ ] Includes guiding principles for stewardship to address systemic climate risk. (For example, if the pension fund prioritizes ESG issues, they may develop principles that prioritize companies with strong ESG practices or that are working to improve their ESG performance.)
- [ ] Guidelines include specific voting direction that the fund may/will vote out directors of companies that fail to align their business practices consistent with 1.5 C degree warming
- [ ] Guidelines include specific criteria that the fund will vote for resolutions calling on companies to disclose their climate emissions, transition plans, and lobbying activities.
- [ ] Due diligence policies for hiring external managers, which include climate risk policies that align with those adopted by the fund and report on their performance.
- [ ] Fund conducts an annual assessment of proxy votes, benchmarked against proxy guidelines and stewardship beliefs.
- [ ] Campaign and proxy performance reports are publicly accessible and shared with trustees and beneficiaries.
- [ ] Guidelines clearly define ESG-related issues to address through proxy voting, including climate risk– and state the intersection between the impact of climate, racial and economic equity, and governance practices (i.e. racial and gender board diversity, fair compensation, labor standards).

WORKSHEET FOR TRUSTEES:
How to Raise the Bar for Stronger Corporate Engagement (Page 1 of 3)

As trustees who hold the fiduciary responsibility to protect the long-term health of worker retirement funds and represent the public workers and retirees' needs, you have a unique role to play in pushing proxy guidance review and enhancements. You have a powerful voice at the table and an opportunity to ask important questions that ensure material risks are appropriately addressed.

To build clarity, transparency, and confidence in the fund, a pension system should share regular, publicly accessible reports on voting policy, engagement plans, and vote performance– benchmarked against its guidelines and stewardship beliefs. This is something trustees are well suited to raise as key stakeholders who have a role in ensuring the fund is addressing risks to the fund, including climate risk.

FIVE QUESTIONS TO BEGIN THE PROCESS OF DISCOVERY:

1. How much of our fund is managed internally, that is by staff of the fund?
2. How much of the fund is managed by other outside asset managers?
3. What is the name of those companies, how much of the fund's assets do they manage, and what types of assets does each external manager manage?
4. Do our outside managers of public equities-- where proxy voting is an issue-- vote "our" proxies? (For example, are they voting the proxy votes that are attached to the pension fund's investments they manage.) Or do we employ proxy voting services–for example ISS and Glass Lewis–directly to handle the pension fund's proxy voting?
5. How do the pension fund's external managers decide their proxy voting?
    a. Have we provided our own proxy voting guidelines to the managers? How clear are we about expectations to follow our guidance? (For example, do we leave discretion to the manager to vote according to their guidelines?)
    b. Do they vote according to our pension fund's proxy voting policies, or their own proxy voting policies?

WORKSHEET FOR TRUSTEES:
Prompts to Gauge Effectiveness of Proxy Guidelines and Performance (Page 2 of 3)

01 *How frequently and when does the fund review proxy and stewardship policies? What in this process will make proxy policies around environmental and social risks more robust?*

02 *Do our policies acknowledge the systemic risk that climate change poses to our investments?*

03 *How are our asset managers voting on climate change-related proposals? Is this information disclosed transparently?*

04 *What criteria are we using to select staff and/or consultants managing our asset allocations and proxy voting? And who has a say in that?*

05 *What are the strategies our pension system is willing to engage in to ensure that engagement is productive and not window-dressing?*

06 *How will our pension system use its proxy voting power to create accountability for portfolio companies?*

07 *How will our pension system ensure engagement is robust and includes accountability when companies fail to act? What are the guidelines the system can set to ensure it uses shareholder power as a catalyst for change to a low-carbon economy?*

08 *Are there networks or resources we should use to augment our capacity and influence in stewardship? Have we researched leading practices for proxy voting by peer pension systems to help identify key issues and approaches?*

OPPORTUNE MOMENTS TO RAISE THESE QUESTIONS:

- Board strategy retreat
- Setting agenda for audit/investment committee
- Ahead of hiring staff or consultants
- During asset or engagement performance reviews
- Onboarding new trustees or staff

WORKSHEET FOR TRUSTEES:
How to Raise the Bar for Stronger Corporate Engagement (Page 3 of 3)

FOUR EXPECTATIONS TRUSTEES CAN CALL ON THEIR FUND TO HAVE ON PROXY VOTING:

- ***Research the landscape.*** It's important to research leading practices for proxy voting guidelines, such as those developed by peers. This can help identify key issues and approaches that may be relevant to the pension fund.
- ***Define key issues.*** The pension fund should define key ESG-related issues to address through proxy voting, including on climate risk.
- ***Develop guiding principles.*** Based on the pension fund's values and objectives, they should develop guiding principles that will inform their voting decisions on each issue. For example, if the pension fund prioritizes ESG issues, they may develop principles that prioritize companies with strong ESG practices or that are working to improve their ESG performance.
- ***Monitor and review.*** The pension fund should regularly monitor and review the voting outcomes based on their proxy voting guidelines. This ensures these guidelines remain aligned with their values and objectives and to make any necessary updates or revisions.

HOW TO TRACK DOWN A PROXY VOTING RECORD:

ISS and Glass Lewis provide voting recommendations for both management and shareholder proposals and provide proxy voting services. Other proxy voting platforms include Broadridge. Contact the proxy advisor or voting provider to obtain reports on voting activities for all managers.

KNOW YOUR SHAREHOLDER POWER

Key Takeaways:

- To adequately address the harms of climate change to your fund’s health, make sure your fund’s guiding policies explicitly name climate risk and corporate accountability as core responsibilities of the board and staff.
- Proxy voting guidelines are a key driver for how a fund exercises its role as a shareholder. Strong voting directives and company engagement strategies can wield shareholder power to advance more responsible policies, practices, and leadership on climate risk.
- Explicit standards for how your fund hires and evaluates its external managers are critical to making sure your fund's commitments on climate risk are put into practice. Our prompts and assessment tools can help you gauge how effective your fund is, and how they can improve.

Thank you for exploring Know Your Shareholder Power, Part Two of **Investing in Our Future: A Guide for Climate-Conscious Pension Strategies**.

What to do Next:

CONTINUE LEARNING:
Part Three: The Power of Investment

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