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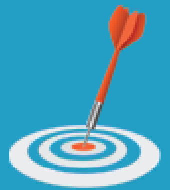
TO THE POINT™



Timely News, Insights & Perspectives on Corporate Sustainability, Responsibility & Citizenship

January 2018

Governance & Accountability Institute shares timely news, insights and perspectives with corporate managers in key topic areas:

- *Corporate Citizenship,*
- *Corporate Responsibility,*
- *Corporate Sustainability,*
- *Community Affairs, and*
- *Sustainable Investing.*

To the Point! is a fee-based educational resource for corporate executives and managers distributed each month with periodic brief updates for critical items.

INVESTORS FOCUS ON CLIMATE CHANGE, GHG EMISSIONS at Fossil Fuel Companies – and Other Public Companies Beyond the Energy Sector

A growing number of institutional investors are focused on "De-carbonizing" their investment portfolios - New York City Pension Funds in the Lead…

But the issues are not clear-cut, and the debate goes on among key players in the capital markets…on the investor and corporate sides.

One of the leaders of one of the nation's most activist investors – the **New York City's** public employee pension funds – announced as the year 2017 was ending consideration of a plan that would lead to "**de-carbonizing**" the five funds' portfolios.

New York City Comptroller Scott M. Stringer, who works with the [five] funds' trustees to help manage the retirement system, is proposing ways to:

1. divest fossil fuel stocks (and)
2. increase investments in clean energy companies.

The 5 funds hold $160 billion in AUM (as of October 2017).

This asset base makes **NYCERS** the fourth largest public pension plan in the United States. One-third of the assets are in U.S. equities; there are also investments in P/E; in Hedge Funds; in Private Real Estate; in Fixed-Income; REITs; and in International Equity.

Comptroller Stringer is elected city-wide and serves as investment advisor and custodian of assets for the five funds – those of Teachers, Police, Fire, NYC employees, and Board of Education non-teaching employees.

The Proposed Steps

On December 19, 2017, Comptroller Scott Stringer stated: "…my office will bring a proposal to the trustees of the NYC pension funds in the coming

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weeks to examine ways to de-carbonize the portfolios, including the feasibility of ceasing additional investments in fossil fuels, divesting current holdings in fossil fuel companies, and increasing investments in clean energy."

Update: January 11, 2018

The City of New York today filed lawsuits against five energy companies over their impact on global warming. (**Royal Dutch Shell, BP, Chevron, ConocoPhilips**, and **ExxonMobil** were named.) The City also said it would begin to divest fossil fuel companies from its pension funds within the next five years.

The City claims the energy companies "were well aware of the effects that burning fossil fuels would have on the planet's atmosphere and the expected impacts of climate change as far back as the 1980s" — and a campaign of deception and denial and about warming was conducted.

Damages sought: The "billions that the City will have to spend protect New Yorkers from the effect of climate change [and] damages necessary to address harm we expect to happen…"

New York City has a $20 billion-plus "resiliency" program underway to protect against rising seas, more powerful storms and hotter temperatures.

The NYC funds have $189 billion in AUM and holds $5 billion in 190 fossil fuel companies.

# # #

…Meanwhile at the State Level in New York…

New York State Governor Andrew Cuomo expressed similar sentiments about the huge **NYS Common Fund** holdings – that portfolio has more than $200 billion in AUM.

Governor Cuomo proposed on December 19th (2017) that the **New York State Common Retirement Fund** stop *all new* investments in fossil fuel companies — and plan to divest existing fossil fuel investments.

The proposal, Cuomo said, "…lays out a roadmap for the Common Fund to take responsible steps to divest from fossil fuel

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holdings."

State Comptroller Thomas DiNapoli immediately pushed back, saying: "There are no immediate plans to divest energy holdings." The Common Fund does not disclose its fossil fuel holdings (much of its investments are indexed).

The Fund did set up a $2 billion "**low-carbon index**," to shift some investments "from the worst emitters to companies that work to reduce their GHG emissions". That fund will be expanded in 2018.

Some Interesting Notes

There are four leadership positions to be elected statewide in 2018: Governor, Lt. Governor, Attorney General, and Comptroller. The State Comptroller is the ***sole trustee*** of the Common Fund and has enormous leverage in deciding fund investments. About $5 billion of its AUM is targeted for ***responsible investment***. That commitment is growing, said Comptroller DiNapoli.

The Governor and Comptroller are both prominent liberal Democrats and will stand for re-election on the same party line.

Comptroller DiNapoli was an elected **NY State Assembly** member and long-time chair of that chamber's proactive **Environmental Committee**, where he was an advocate for greater environmental regulation.

Today, he is a prominent player among U.S. pension fund fiduciaries in activist proxy and corporate engagement campaigns — for example in encouraging public company boards and management to analyze the risks and opportunities presented by climate change and then to disclose those analyses and plans to meet to the challenges to the public…and especially to investors.

The Governor and Comptroller quickly agreed to create an Advisory Council to help the Common Fund develop a roadmap for divesting fossil fuel stocks.

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Investor Campaign – Climate Action 100

Even with dis-investment of fossil fuel and other equities being discussed at the individual fund(s) level, an influential group of investors organizing as "**Climate Action 100**" set out on a comprehensive campaign, and said "companies hiding from climate risk is becoming harder" — and therefore, effecting change at companies, not portfolio dis-investment alone, will make a difference.

The campaign of "Climate Action 100" is now underway in the United States, UK, Europe, and Asia-Pacific.

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While early in 2017, in fulfilling a campaign promise **President Trump** began the process of having the United States withdraw from its commitments reached at the **COP 21 "Paris Accord**" on climate change, a growing universe of investors is pushing ahead in the opposite direction.

A follow-up COP 23 meeting staged in December 2017 in Paris was arranged by President **Emmanuel Macron** as the "**One Planet Summit**," with more than 50 world leaders participating.

The goal was to organize to drive the public and private sectors in "accelerating" the de-carbonization" of the global economy. Investors were enthusiastic participants.

In line with the meeting theme, more than 200 investors with $26 trillion in AUM pledged to engage with 100 companies estimated to be responsible for about 85% of total GHG emissions.

The "Climate Action 100" movement is being coordinated by five partners:

- **Ceres** (Boston-based).
- **Principles for Responsible Investment** (PRI)
- **Asia Investor Group on Climate Change** (AIGCC).
- **Investor Group on Climate Change** (IGCC).
- **Institutional Investors Group on Climate Change** (IIGCC).

Involved investors in what is described as a five-year effort include **Allianz, AXA, BNP Paribas, Deutsche Asset Management, Hermes**, and others.

An important resource being used are the **CDP** data sets on companies' direct and indirect emissions associated with the use of their products.

The companies in focus include **General Electric, ExxonMobil, Boeing, BP, Shell, VW, Ford, Volvo, Airbus, PepsiCo, Nestle, Panasonic**, and, **Proctor & Gamble**.

The strategy for engagement actions over the next five years include:

- Dialogue in and around company boardrooms.
- Proposals to be lodged at board meetings.

There are three overarching goals:

- For companies to implement a strong governance framework, articulating board accountability and oversight of climate change risk.
- Companies need to take action to reduce GHG across their value chain (consistent with the 2015 Paris Agreement goal of limiting global temps to below 2-degrees Celsius).
- Companies should provide "enhanced" corporate disclosure in line with the **Financial Stability Board's Task Force on Climate-**

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related Financial Disclosure (FSB / TCFD) – as well as sector-specific **GIC Investor Expectations** on Climate Change.

A leader of one of the involved investors — **Anne Simpson**, Investment Director of Sustainability at **CalPERS** – said the coordinated effort at corporate engagement would have considerable ripple effects that would influence other companies (beyond the 100 targets) to align their business plans with the goals of the Paris Agreement.

"Our collaborative engagements with the highest emitters," she said, "will spur actions across all sectors as companies work to avoid being vulnerable to climate risk and left behind.

"Money talks, and if we can deploy capital behind the power of the capital markets behind the Paris Agreement, we can really ensure that companies begin to make the transition necessary to keep global warming to a safe degree."

CalPERS is the largest public employee pension system in the U.S. with almost $350 billion in AUM.

- In December, the CalPERS board voted asset allocations for the next four years: 50% in Global Equity; 28% in Fixed-Income; 13% in Real Assets; 8% in Private Equity; 1%, Liquidity.
- The Plan serves 1.9 million members in the retirement system and 1.4 million members and families in the health program.

Not all large asset management houses are on board the coalition. Singled out for criticism by the **NGO Preventable Surprises** were **BlackRock**, **Vanguard,** and **BNY Mellon** – none of these the NGO pointed out, were involved in the Climate Action 100 movement at the time of the announcement.

And, the NGO says, some large banking organizations have not put in place a "coherent plan" to management complex climate risk. These included **BNP Paribas, UBS** and **HSBC Holdings**.

Said CalPERS' Anne Simpson: "There is nowhere to hide from climate risk – we need to address this. We have the tools to help these companies drive this forward."

Corporate climate laggards, the organizers of the coalition said, will have trouble turning a blind eye to what **Bank of England Governor Mark Carney** described [of climate change] – ***the tragedy on the horizon.***

The Corporate Governance & Risk Management Viewpoints

An important element of the still-evolving investor views regarding their portfolio risks is that of incurring liabilities ***if*** future demand for fossil fuels falls short of projections. That is, the oil, gas, coal in the ground will not have the value presently on the books at sometime in the future.

Today, technological advances, public policy, private sector strategies, and the rise of alternative fuel/energy sources are increasing the risk for investors. Uncertainty is rising in the capital markets. And the question hangs – how ready is a company to deal with these changes – these potential or real disruptions to the status quo?

# # #

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Cornerstone Capital Group Weighs In

John Wilson of Cornerstone Capital, a leading corporate governance expert for many years, published a report on "Peak Uncertainty" (a play on the "Peak Oil" theory) in December. His key points:

- Given the difficulty of making accurate forecasts in an uncertain environment, the most useful current signal of how well a company is positioned for the long-term is its corporate governance.
- Oil companies are preparing for the future, but for shareowners, the question is whether the company is envisioning a future that looks like the present – or is preparing for societal change that results in an entirely new operating environment.
- A majority of shareholders at a number of firms now are asking companies to disclose an analysis of the impact of how their company would shift to a "low-carbon" economy (one in which GHG emissions are curtailed).

He noted that **Shell, Statoil**, and **Total** have done so; **ExxonMobil** has promised to produce a report.

There are six key questions investor can ask companies in their engagements:

1. Does company reporting include a scenario envisioning disruption to its production?
2. How transparent is the company regarding the resilience of its resource base?
3. Does company strategy provide a realistic path to meeting investor expectations in a low-carbon economy?
4. Is the board composition and process sufficient to execute strategy in case of disruption?
5. Would exec comp plans align managers and shareowners in a disruption scenario?
6. What effect does the low-carbon strategy have on stakeholder relationships?

The full report is available for you at www.cornerstonecapinc.com. ("Peak Uncertainty: Evaluating oil company governance at the dawn of the electric transport age.")

John K.S. Wilson is Head of Corporate Governance, Engagement, and Research at Cornerstone Capital Group.

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G&A Institute Perspectives

As institutional investors and other key stakeholders increasingly envision what a "low-carbon economy" might look like — what does that mean for your company? Does this "low-carbon" scenario over time – or more quickly – pose ***risk or***

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opportunity for your publicly-traded company…or a combination of both?

Consider the answers to these questions now more frequently posed by fiduciaries:

- What is the company doing in terms of measuring and managing Greenhouse Gas (GHG) emissions?
- What is the company then disclosing/reporting to investors and others?
- Does the company have clear-set goals for GHG emission reduction?
- Does the company communicate the goals and report on progress (or lack of) periodically…such as in Sustainability Reports, the Annual Report, on the web site?

Dow Chemical has done so on a quarterly basis. Check out this example of corporate "Real-Time Sustainability Reporting" at: https://www.dow.com/en-us/science-and-sustainability/highlights-and-reporting.

In examining and databasing key performance indicators, strategies, action steps of public companies in their reporting using the **Global Reporting Initiative G-4** framework and more recently, the [new] GRI Standards, the G&A Institute team is seeing considerable progress being made by company management in measuring and managing GHG emissions. (We analyze more than 1,500 reports annually.)

A small corps of third-party service providers is helping companies measure their energy use and resulting emissions. G&A analysts work with several of these to support client environmental management programs.

One of the things we often find is that our clients have much more information to add to their structured reporting, in responding to **CDP** and **RobecoSAM's Corporate Sustainability Assessment**, and in other third-party queries/responses.

And, in examining the corporate profile in the **Bloomberg, MSCI, Sustainalytics, Thomson Reuters** (or other ESG data providers) there are always "gaps" to address and more complete and accurate information for a company to provide to the analysts. (This benefits both investors and issuers.)

> **The important takeaway *here is that investors and their third party providers are looking ever-more closely at corporate reporting and raising stakes in terms of their expectations of companies.***

Quite often the "low-hanging fruit" is evident (the corporate ESG information) – and not being fully leveraged by company management to meet the rising expectations of their current and potential providers of capital.

The G&A team helps corporate clients develop a more complete, accurate and both quantitatively and quantitatively meaningful reporting framework for the company.

These exercises form a solid foundation for managers to reply to key queries (such as those of RobecoSAM's Corporate Sustainability Assessment, CDP, Sustainalytics, and other third parties and increasingly their customers and suppliers).

The proprietary G&A "**matrix**" approach results in cost savings and more productivity in ESG / Sustainability / CR disclosure

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and structured reporting.

For information on this approach, connect with Lou Coppola at lcoppola@ga-institute.com.

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