

# VERMONT STATE TREASURER'S OFFICE SUSTAINABILITY REPORT

Update on Environmental, Social and Governance Issues and Actions to Address Climate Change

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Initial Report  
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Below is a summary of the Treasurer's Office efforts in Environmental, Social and Governance (ESG) issues, in its capacity as a constitutional office and in its role as both staff support and a voting member of the Vermont Pension Investment Committee (VPIC), and the boards of trustees representing the State, municipal and teachers' retirement systems (Retirement Boards). The document builds on activities initiated in the Treasurer's Office for the past ten years. These include efforts by former Treasurer Jeb Spaulding, Treasurer Beth Pearce, the Retirement Boards and VPIC. While a broad range of ESG issues are covered, the Treasurer's Office has made significant efforts in addressing the issue of climate risk and greenhouse gas emissions. Much of the focus of the report will address these issues. The report also includes recommendations for future efforts. Much of the work was compiled by Katie Green in the State Treasurer's Office Investment Division.

This preliminary report represents the activities and planned next steps and recommendations of the Treasurer's Office. While the Treasurer is the sole trustee for the State's operating cash and certain trust funds, it does not exercise such authority over the defined benefit pension funds and most supplemental retirement funds. Those are managed by VPIC or the retirement boards' trustees.

### **Vermont Has Taken a Leadership Role Alongside Coalitions on ESG Issues and Climate Risk**

#### **Investor Network for Climate Risk (INCR)**

In 2003, Ceres coordinated with State Treasurers and Comptrollers from Vermont, California, Connecticut, Massachusetts, Maine, New Mexico, New York City, New York State, and Oregon to develop a 10-point action plan that included the formation of an Investor Network on Climate Risk with a mandate to continue joint action on climate risk issues. The following is a list of INCR action steps.

1. Petition the Securities and Exchange Commission (SEC) to enforce corporate disclosure requirements under regulation S-K on material risks, such as climate change, and to strengthen current disclosure practices.
2. Request that the Securities and Exchange Commission re-interpret or change its proxy rules under Section 14(a)-8 relating to "ordinary business" to recognize that shareholders should have the right to vote on resolutions asking their companies to report on financial risks that may be faced due to climate change.
3. Encourage the boards of directors of companies, under the principle of "duty of care," to ask corporate management to provide them with information and analysis on the potential financial risk to the company from climate change, including plans to mitigate any risk, and to report this information to shareholders.
4. Require that companies in sectors that are the major source of greenhouse gas emissions – including automobile manufacturing, electricity generation, and oil and gas production and refining to prepare a report for shareholders with financial analysis (at reasonable cost and omitting proprietary information) on how the company may be affected by regulatory, competitive, legal, and physical impacts of climate change.
5. For companies that are not sources of greenhouse gases, but whose operations may be affected by climate change, require such companies to analyze the potential impact of climate change on their operations and report the results of that analysis to shareholders.

6. For investment managers, who manage funds for Vermont and other institutional investors and who make recommendations for the buying or selling of stock, require that they include in their examination of corporations, sectors, and managed funds an analysis of the potential financial impact of climate change.
7. Institutional investors – including mutual funds, pension funds, foundations, endowments – require that they adopt proxy voting guidelines which support the disclosure of the potential financial risk to companies in which they invest due to climate change and to vote for shareholder resolutions requesting disclosure of this information.
8. The U.S. Congress and the Executive Branch, when developing policies to address greenhouse gas emissions, ask that they assess the future financial impact of climate change on the value of our long-term investments.
9. Encourage state governments, (and their regional organizations), to assess the potential financial impact of climate change on their states, and the businesses that operate in them.
10. Creation of the Investor Network on Climate Risk (INCR).

Vermont was one of the founding members of INCR in 2003. INCR is now a network of 114 institutional investors representing more than \$13 trillion in assets under management. INCR remains committed to addressing the risks and seizing the opportunities resulting from climate change and other sustainability challenges. It continues its original mission and has expanded on it (See 2012 Investor Action Plan on Climate Change Risks & Opportunities at <http://www.Ceres.org/investor-network/investor-summit/summit-files/2012-investor-action-plan>). The combined investment assets and their leverage through shareholder engagement is an important element to its success. The Vermont State Treasurer's Office is an active member of several INCR working groups, including those focused on shareholder activism and SEC/disclosure. These working groups meet monthly to coordinate efforts on initiatives by active shareholders.

### Ceres Coalition

To address the focus on business accountability, the Ceres Coalition was created. It includes the Vermont State Treasurer's Office as a member, as well as Vermont's Shelburne Farms and Sentinel Investments, labor groups, SRI investment managers (including Calvert, Domini, Trillium Asset Managers, Walden Asset Managers), and environmental organizations (including Sierra Club, World Wildlife Fund, Environmental Defense Fund). These and other groups work to promote sustainability by encouraging companies, policy makers and other market players to incorporate environmental and social factors into their decision-making processes and to mobilize investor and business leadership to build a thriving, sustainable global economy.

### Council of Institutional Investors (CII)

The Council of Institutional Investors is a non-profit association of corporate, public and union employee benefit funds, foundations and endowments with combined assets that exceed \$3 trillion. The organization advocates, “for effective corporate governance and strong shareowner rights.” CII represents members on a range of committees at the SEC, stock exchanges and other regulators. In addition, they help members coordinate coalition efforts at specific companies and disseminate information about members’ advocacy efforts. The Vermont Pension Investment Committee has been a member of CII since 2007.

### ISS Conference (Miami, FL)

Katie Green, the Treasurer’s Office Investments Manager, attended the ISS “Gateway to Global Governance” conference in Miami, FL on February 11, 2014. This well attended event included a number of investment management firms, public funds and vendors that either disseminate proxy data or coordinate shares by various shareholders for activist purposes. The tone was largely focused on changes globally for management say-on-pay and the increase in engagement efforts in the U.S. seen over the last few years. Say-on-pay refers the allowing shareholders to have a say on the compensation of a company’s executives.

### Investor Summit on Climate Risk

On January 15, 2014, Treasurer Beth Pearce served as a convener at the 2014 Investor Summit on Climate Risk, hosted by the United Nations Foundation, the United Nations Office for Partnerships, Ceres, and more than 20 institutional investors and United Nations leaders. Treasurer Pearce shared ideas on how governments can augment state dollars to lower the cost of financing for thermal efficiency and clean energy projects. Constructive engagement strategies were discussed, developing the various policy approaches available to states as they press for environmental change by leveraging their assets. This was followed on April 30 when Treasurer Pearce attended the Ceres annual conference in Boston to discuss the upcoming year’s initiatives and receive updates about the working groups involving the Treasurer’s Office and VPIC.

### Annual General Meeting – ExxonMobil

In December 2014, the VPIC and State Treasurer Pearce co-filed a shareholder resolution at ExxonMobil to urge the company to adopt measurable goals for reducing greenhouse gas emissions. The Treasurer is planning on attending the ExxonMobil annual general meeting in May 2015 to ensure that VPIC and Vermont’s concerns are heard.

## Energy Action Network (EAN)

The Treasurer is a member of EAN, a network of nonprofit, business, and government leaders working to transform Vermont's energy economy. EAN's work is also aligned with the State's energy goals as articulated in the Comprehensive Energy Plan. The Treasurer's Office is working with the Capital Mobilization Group within EAN to create financing models to support this plan.<sup>1</sup>

## **Vermont Has a History of Actions to Address ESG Issues and Climate Change Risk**

### SEC and Environmental Disclosure

The Securities and Exchange Commission (SEC) is the primary regulator that oversees federal efforts to provide investors with information about corporate risks and opportunities. As noted in the INCR action plans previously, since 2003 INCR has urged the SEC to improve disclosure of climate change risks in companies' annual financial filings. In 2007, Vermont was one of over two dozen investors representing \$1.2 trillion in assets under management that sent a formal petition to the SEC. It asked the commission to issue an interpretive release clarifying that material climate-related information must be included in corporate disclosures under existing law. As noted in the petition "(T)he fundamental principle underlying the Commission's disclosure requirements is that a public corporation must fully and fairly disclose all facts about its performance and operations that would be material to a shareholder's investment decision"<sup>2</sup>. The SEC responded in February 2010 by issuing disclosure guidance that said climate change and related regulations lead to risks and opportunities for companies in a variety of sectors, and those issues, when material, must be disclosed in SEC filings. The guidance covers three major areas: regulatory risks, indirect effects of regulation or business trends, and physical impacts, as outlined below in a Ceres document<sup>3</sup>.

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<sup>1</sup> <http://eanvt.org/>

<sup>2</sup> "Petition for Interpretive Guidance on Climate Risk Disclosure", filed with SEC, 2007, p.13

<sup>3</sup> Ceres, "Reducing Systemic Risks: The Securities & Exchange Commission and Climate Change", February 2014, p 2.

SEC INTERPRETIVE GUIDANCE ON CLIMATE CHANGE DISCLOSURE	
Section of Guidance	Examples of Potential Disclosure Items
Impact of Legislation & Regulation International Accords	<ul style="list-style-type: none"> <li>• Cost to purchase credits in a cap and trade system</li> <li>• Costs to improve facilities to comply with regulatory limits of a cap and trade system</li> <li>• Changes to profit/loss from changed demand for goods and services</li> </ul>
Indirect Consequences of Regulation or Business Trends	<ul style="list-style-type: none"> <li>• Decreased demands for goods with significant GHG emissions, or increased demand for those with lower emissions</li> <li>• Increased demand for energy from alternative energy sources</li> <li>• Decreased demand for services related to fossil fuels, such as drilling services or equipment maintenance</li> </ul>
Physical Impacts	<ul style="list-style-type: none"> <li>• Disruption of manufacturing or transport for registrants with operations on coastlines</li> <li>• Indirect impacts to major customers or suppliers from severe weather, such as hurricanes or floods</li> <li>• Increased claims and liabilities for insurance and reinsurance companies</li> <li>• Decreased agricultural production due to drought or other weather changes</li> </ul>

While this is a significant step forward, a recent review conducted by Ceres in 2014 indicated less than optimal compliance by companies. The report found that:

- The SEC is not prioritizing the financial risks and opportunities of climate change as an important disclosure issue.
- The SEC issued 49 comment letters that addressed the adequacy of climate change disclosure in 2010 and 2011, but only three comment letters in 2012 and none in 2013.
- Most S&P 500 companies that disclose via the Carbon Disclosure Project (CDP) provide significantly more detailed information in voluntary climate reporting compared to mandatory 10-K filings.
- A large number of companies fail to say anything about climate change in their annual filings with the SEC.<sup>4</sup>

The same report made the following recommendations relative to the SEC:

- Issue more comment letters to companies with inadequate disclosure of material climate risks.
- Focus on companies in sectors facing significant climate risks and opportunities when reviewing corporate filings.
- Focus on the adequacy of disclosures concerning recent, major regulatory developments when reviewing corporate filings.

<sup>4</sup> Colburn, Jim and Jackie Cook, Cool Response: The SEC & Corporate Climate Change Reporting Ceres, February 2014.

- Where reporting appears inadequate, compare SEC filings with a company’s voluntary disclosures.
- Create a federal interagency working group focused on climate risks and opportunities to businesses, and an SEC task force focused on reviewing climate change disclosures.<sup>5</sup>

On April 17<sup>th</sup>, the Treasurer’s Office and the VPIC were signatories on a letter sent to the SEC, on behalf of a coalition of institutional investors managing more than \$1.9 trillion assets, that requested the SEC improve enforcement and require more transparent disclosures by companies in the fossil fuel industry to ensure they are in compliance with the SEC requirements and guidance. Signatories are awaiting response from the SEC and will continue to encourage company compliance and SEC enforcement going forward as participants in the Ceres’ INCR SEC working group.

On April 21<sup>st</sup>, the Treasurer’s Office joined five other states in calling on the SEC to strengthen disclosure of corporate political spending contributions and adopt a rule that would require all publicly traded corporations to disclose political giving. As noted by Ceres, the INCR SEC “... working group aims to move the SEC towards improved implementation of its climate change guidance (issued in February 2010), as well as to address other key environmental, social and governance (ESG) disclosure issues with the goal of improving corporate disclosure on material sustainability risks and opportunities.”

*Next Steps:* The Treasurer’s Office as part of the INCR SEC working group will continue to look for opportunities to engage with the SEC in improving the application of its climate change guidance and in addressing other important environmental, social and governance disclosure and transparency issues.

### Vermont Proxy Votes and Proxy Policy Update

The Treasurer’s Office and VPIC view the execution of proxy-voting rights at shareholder meetings as a required duty of pension fund fiduciaries. The U.S. Department of Labor (DOL), entrusted with oversight of the Employee Retirement Income and Security Act of 1974 (ERISA), issued its so-called Avon Letter, putting private pension plan trustees on notice that proxy voting rights must be diligently exercised as an aspect of fiduciary duty.<sup>6</sup> In 1994, the DOL updated its Avon Letter in a bulletin that consolidates the voting requirements of ERISA fiduciaries.<sup>7</sup> While ERISA applies to private plans, interpretive guidance has led public plans to treat proxies as assets subject to the same fiduciary care as all other plan assets.<sup>8</sup> Prior to 2003, investment managers for the State’s various retirement systems voted their proxies without specific guidance. In 2003 and 2004, on recommendation of then Treasurer Spaulding, the boards of trustees for the Vermont State Employees’ Retirement System (VSERS), the Vermont State Teachers’ Retirement System (VSTRS) and the Vermont Municipal Employees’ Retirement System (VMERS) voted to actively exercise their pension fund shareholder voting rights in order to promote corporate responsibility. The three boards approved an extensive set of proxy voting guidelines to be used by their investment managers when voting on a wide range of issues up for consideration at corporate annual meetings. The proxy guidelines deal with issues such as executive compensation, auditor independence, shareholder rights, discrimination, and fair labor practices, as well as guidance on a range of subjects relating to environmental disclosure and climate change. These policies were adopted in 2004 and have

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<sup>5</sup> Colburn and Cook, 2014, p.36

<sup>6</sup> DOL Op. Letter. to Helmut Fandl, Avon Products, Inc. (Feb. 29, 1988).

<sup>7</sup> DOL Interp. Bulletin 94-1 (July 1994).

<sup>8</sup> Morales, Jennifer C. “Public Pension Fund Trustees and Proxy voting”, Government Finance review, Vol. 8, No.3, June 1992.

been updated on an ongoing basis. We originally adopted these policies in 2004 and have continued to update them to further address environmental issues. The proxy policies, both domestic and international, are available on the Treasurer's Office website at:

[http://www.vermonttreasurer.gov/sites/treasurer/files/pdf/retireVPIC/policy/Vermont\\_DOMESTIC\\_2013\\_May%2028\\_Final.pdf](http://www.vermonttreasurer.gov/sites/treasurer/files/pdf/retireVPIC/policy/Vermont_DOMESTIC_2013_May%2028_Final.pdf)

[http://www.vermonttreasurer.gov/sites/treasurer/files/pdf/retireVPIC/policy/Vermont\\_INTERNATIONAL\\_Guidelines\\_2013%20May%2028\\_FINAL.pdf](http://www.vermonttreasurer.gov/sites/treasurer/files/pdf/retireVPIC/policy/Vermont_INTERNATIONAL_Guidelines_2013%20May%2028_FINAL.pdf)

In January 2004, Vermont retained Institutional Shareholder Services Inc. (ISS), to develop proxy voting policies and guidelines. ISS is the world's leading provider of proxy voting, shareholder advisory services, and corporate governance research. ISS serves more than 950 institutional and corporate clients worldwide with its core business — analyzing proxies and issuing informed research and objective vote recommendations for more than 10,000 U.S. and 12,000 non-U.S. shareholder meetings each year. ISS is currently engaged to vote our proxies. During the 2013 proxy season, ISS voted 2,500 proxy ballots in accordance with the VPIC proxy voting policy on the VPIC's behalf. For more information about ISS, please visit [www.issgovernance.com](http://www.issgovernance.com).

### VPIC Proxy Policy Review

VPIC convened a proxy sub-committee, including State Treasurer Pearce in 2013 to strengthen its proxy policies on social, environmental and sustainability issues. Guidance relating to hydraulic fracturing (fracking) was incorporated, whereby the guideline stipulates votes in favor of proposals that support the use of alternative approaches in lieu of harmful chemicals to extract natural gas and in support of requiring companies to report on the environmental impact of the practice. In addition, the section in the international proxy policy relating to director elections was elaborated on to include more support for votes targeting board chair independence. The changes to the proxy policies were adopted by VPIC on May 28, 2013 and were effective for the 2014 proxy season. On January 31, 2014, the VPIC proxy sub-committee and Treasurer's Office staff met with ISS to discuss prior year votes and to address upcoming issues in the 2014 season.

### Value of Shareholder Engagement

The process that leads to constructive engagement begins with the investor inviting dialogue or filing a shareholder resolution requesting the company include it on the proxy ballot for voting at the annual company meeting. The SEC is the regulating body of proxies, and companies can challenge resolutions requesting the SEC to allow the company to exclude the resolution from the proxy. Votes are non-binding in the United States, but when a resolution receives support greater than 30 percent, it often prompts a response from management. Withdrawn filings are not included in the proxy season's statistics gathered by proxy administrators, such as ISS, because they were never formally voted, but many are often considered successes by shareholders. This is because many companies will actively engage with the filing party and commit to fulfilling the goal of the resolution before it gets before all shareholders for a vote. If negotiations are productive, the resolution will be withdrawn by the filing party. Many companies prefer to engage shareholders rather than have a resolution show up on their proxy ballot, which makes this a powerful tool.

Shareholders hold a unique position and are able to get results through engaging firms. A study by Ceres showed that over a three-year period from 2008-2010, 230 sustainability-focused resolutions were filed by investors. Of those, 110 were withdrawn after companies agreed to begin a dialogue relating to the issues of concern with shareholders. After withdrawal, 80 percent resulted in at least partial fulfillment of the agreement with the shareholders and 65 percent resulted in completely fulfilled agreements. Many of the agreements led to tangible environmental improvements and case studies.<sup>9</sup>

During the 2014 proxy season, nearly 150 resolutions were tracked by Ceres related to climate and sustainability and 20 major international corporations committed to set goals to reduce greenhouse gas (GHG) emissions or sustainably source palm oil. Of those, 34 percent of filed resolutions were voted on by shareholders. Of those voted, the average level of support on the proxy ballot was 25 percent, with 29 percent of all voted ballots receiving at least 30 percent support. Fifty-five percent of filed resolutions were withdrawn. Approximately 80 percent of those withdrawn were due to successful agreements put in place or continued constructive ongoing dialogues with the company, through active engagement efforts by shareholders.<sup>10</sup>

Recently there have been several high profile cases of shareholder engagement. Several efforts are detailed below regarding how shareholders were able to open up dialogues with companies and encourage them to change their reporting process to be more transparent or their supply chain procedures to be more sustainable for the long term.

### Palm Oil

According to the group *As You Sow*, which promotes environmental and social corporate responsibility through shareholder advocacy and coalition building, worldwide land use accounts for 31 percent of annual GHG emissions, with about 17 percent of that being derived from deforestation<sup>11</sup>. *As You Sow* also notes that a key driver of tropical deforestation is palm oil. Palm oil is found in food, personal care products, and fuel; demand is growing rapidly, and production is expanding worldwide. The increase in supply to meet growing demand resulted in deforestation of mass amounts of forest land, leading to a rise in greenhouse gas emissions. Eighty-five percent of the world's palm oil is produced in Malaysia and Indonesia. Indonesia is the third largest greenhouse gas-emitting nation in the world. Again, according to *As You Sow*, a major cause of GHG emissions is the cutting and burning of carbon-rich rainforests and peat lands to make way for palm oil plantations. Destruction of Indonesian peat lands alone is currently responsible for 4 percent of annual global GHG emissions. *As You Sow* also points out that in addition to climate impacts, palm plantations are a significant source of human rights and child labor abuses, land grabs, and threats to endangered species.

In 2011, investors concerned about the long-term environmental impacts of the increased production of palm oil targeted the largest distributors with resolution filings and engagement efforts to encourage these firms to purchase their products from 100 percent certified sustainable palm oil distributors. Through consistent shareholder engagement, it has been reported that 55 percent of the world's palm oil suppliers have committed themselves to produce or trade a 100 percent deforestation-free product.

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<sup>9</sup> Ceres "Investor Power" report available on [www.Ceres.org](http://www.Ceres.org)

<sup>10</sup> <http://www.Ceres.org/investor-network/resolutions>

<sup>11</sup> <http://www.asyousow.org/2014-proxy-season-updates/advocacy-position-palm-oil/>

On July 1, 2014, Treasurer Pearce was the sole governmental signatory, along with investors totaling \$24.5 billion assets under management, to a letter addressed to Krispy Kreme urging them to adopt a policy to only buy from 100 percent certified sustainable palm oil distributors and suppliers that are not engaged in the exploitation of indigenous and local communities. As a result of this pressure by shareholders, Krispy Kreme committed itself to sourcing its palm oil from 100 percent responsible palm oil suppliers by the end of 2016, along with its industry peer Dunkin' Brands.

According to a Ceres report, Clean Yield, Domini, Social Investments, Green Century Capital Management, the New York State Comptroller's Office, Trillium, and members of the Interfaith Center on Corporate Responsibility (ICCR) were among investors that secured palm oil commitments. While there is still more work to be done, below are a few additional recent commitments secured by shareholders through constructive engagement.<sup>12</sup>

- Wilmar, the world's largest supplier of palm oil, adopted a zero deforestation policy. This change is estimated to reduce CO2 emissions by approximately 1.5 billion tons by 2020 – the equivalent of annual CO2 emissions from all of Central and South America. A letter organized by Green Century and supported by 40 investors totaling \$250 billion in assets, publicly supported Wilmar's decision.<sup>13</sup>
- Avon agreed to purchase enough sustainably grown palm oil to offset 100 percent of their uncertified palm oil consumption.
- Hershey and General Mills agreed to purchase all of their palm oil through sustainable means by 2015.<sup>14</sup> Hershey, in December 2013, increased their commitment to the cause by also agreeing to use 100 percent traceable palm oil as verified by its suppliers and moved its deadline for both requirements up a year to the end of 2014. The firm increased pressure on its suppliers to verify the sources of the palm oil it purchases and is working with NGOs (non-governmental organizations) on the possibility of third party verification of its suppliers' production means. This is in line with the world's largest buyer of palm oil, Unilever, who buys 100 percent sustainable palm oil and committed itself to purchasing only traceable sources that can prove they are sustainable by December 31, 2014.
- Kellogg has been working since 2009 to source its palm oil responsibly. To further its commitment, the firm announced it is implementing a zero deforestation policy with fully traceable suppliers by December 31, 2015.
- ConAgra agreed to use only sustainably produced palm oil in its products. This commitment came on the heels of a prior commitment to support the development of sustainable palm oil, which investors did not feel was enough. Shareholders felt the firm was not doing enough and filed a resolution for the firm to use only sustainably produced palm oil, which the firm agreed to do in exchange for a withdrawal of the resolution on the proxy ballot.<sup>15</sup>
- Cargill, the largest importer of palm oil in the United States, announced it would no longer purchase from suppliers that engage in deforestation. This private company felt pressured by its

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<sup>12</sup> Please see: <http://www.ceres.org/files/in-briefs-and-one-pagers/proxy-power-shareholder-successes-on-climate-energy-sustainability>, [http://www.ucsusa.org/news/press\\_release/new-dunkin-brand-palm-oil-0436.html#.VGyIXDTF-4I](http://www.ucsusa.org/news/press_release/new-dunkin-brand-palm-oil-0436.html#.VGyIXDTF-4I), <http://newsroom.kelloggcompany.com/2014-02-14-Kellogg-Announces-Global-Commitment-To-Fully-Traceable-Sourcing-Of-Palm-Oil>, [https://www.cargill.com/wcm/groups/public/@ccom/documents/document/palm\\_oil\\_policy\\_statement.pdf](https://www.cargill.com/wcm/groups/public/@ccom/documents/document/palm_oil_policy_statement.pdf)

<sup>13</sup> <http://www.wilmar-international.com/sustainability/>

<sup>14</sup> <http://www.ceres.org/files/in-briefs-and-one-pagers/proxy-power-shareholder-successes-on-climate-energy-sustainability>

<sup>15</sup> <http://www.triplepundit.com/2014/08/conagra-palm-oil/>

customers to conform to their new requirements for sustainably produced palm oil. ConAgra sources a large amount of its supply from Cargill.

- Mars announced its commitment by the end of 2014 to transition to using 100 percent sustainable palm oil in its products.
- Mondelez, the maker of confections such as Oreo, plans to purchase 100 percent sustainable palm oil by 2015, and implement traceable supply lines by 2020.<sup>16</sup>
- Panera became the first restaurant chain in July 2014 to announce it would use 100 percent sustainably grown and harvested palm oil and its derivatives by 2016.
- Safeway committed to sourcing 100 percent sustainably produced palm oil.<sup>17</sup> No timeline has been given, but the company reports it is using RSPO (Roundtable on Sustainable Palm Oil) certified materials for 41 percent of its palm usage.
- Starbucks is committed to using 100 percent RSPO certified palm oil in its products in its company owned stores by 2015.
- Bunge on October 2014 pledged to trade, process and sell only 100 percent traceable to verified suppliers protecting High Carbon Stock Forests, peat lands and workers and community rights. There was no timeline specified, and many shareholders are calling for a better defined timeline from the company and a further commitment to extend this promise across all its commodity lines citing deforestation is not unique to palm oil.
- Dunkin' Brands committed to working with suppliers to develop a 100 percent sustainable palm oil plan by 2016, in-line with its competitor Krispy Kreme. The franchisee-owned purchasing cooperative will source 100 percent responsible palm oil for use in the U.S. by the end of 2016. Progress reports will begin annually in March 2015. While Dunkin' has shown some progress, shareholders are hoping to continue to engage with Dunkin' to change its policy to include a global scope in 2015.<sup>18</sup>

## PepsiCo

At its June 2014 shareholder meeting, representatives of the Sierra Club and ForestEthics delivered more than 64,000 petition signatures to CEO Indra Noyi, asking the company to stop buying fuel from tar sands refineries for its cars and delivery trucks.<sup>19</sup> A shareholder resolution was filed by Green Century urging Pepsi to avoid purchasing fuel sourced from tar sands whenever possible. As noted by one activist, "If PepsiCo made a commitment to join other enterprises (like Trader Joe's and Whole Foods) in discontinuing the use of tar sands oil, the impact and optics would be major."<sup>20</sup>

On October 31, 2014 PepsiCo announced it was working to reduce its reliance on oil from tar sands and focusing on more environmentally friendly sources to fuel its fleet. The company announced it has reduced its fuel consumption by its trucks by 24 percent since 2010. The firm plans to solicit requests for proposal

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<sup>16</sup> <http://www.triplepundit.com/2014/06/3p-weekend-companies-committed-sustainable-palm-oil/>

<sup>17</sup> <http://csr.site.safeway.com/wp-content/uploads/2012/07/Safeway-Responsible-Palm-Oil-Sourcing-Guidelines.pdf>

<sup>18</sup> [http://www.ucsusa.org/news/press\\_release/new-dunkin-brand-palm-oil-0436.html#.VGyIXDTF-4I](http://www.ucsusa.org/news/press_release/new-dunkin-brand-palm-oil-0436.html#.VGyIXDTF-4I)

<sup>19</sup> <http://content.sierraclub.org/evguide/blog/2014/05/sierra-club-and-forestethics-urge-pepsico-stop-using-tar-sands-fuel>

<sup>20</sup> [http://www.huffingtonpost.com/marcia-g-verman/urge-pepsi-to-stop\\_b\\_5761724.html](http://www.huffingtonpost.com/marcia-g-verman/urge-pepsi-to-stop_b_5761724.html)

for lower carbon alternatives from its suppliers going forward and will continue to work on innovative ways to reduce the carbon produced by its fleet.<sup>21</sup>

### Engagements with Oil Companies on Gas Flaring

As a result of an investor letter that Ceres coordinated in May 2012, a media and social media effort and several shareholder resolutions, four of the five major oil producers in North Dakota set flaring reduction goals, and flaring emissions have been substantially reduced.<sup>22</sup>

### Methane and Water

As a result of investor engagements and a Ceres report on fracking and water stress, Apache Corporation has adopted new water recycling and water use reduction goals for its operations. Also as a result of investor engagements, Apache has begun monitoring and reporting on its methane emissions and methane intensity.<sup>23</sup>

### Carbon Asset Risk Project

In September 2013, both the Treasurer's Office and the VPIC became signatories to an effort by 75 institutional investors that was coordinated through investor groups with collective assets under management greater than \$3.5 trillion. The coalition engaged 45 of the world's largest public oil and gas companies in dialogues focused on how "emissions reductions will impact capital expenditures and current assets in the oil and gas sector and how the physical impacts of unmitigated climate change will impact the sector's operations." The effort, known as the Carbon Asset Risk Initiative (CAR), coordinated by Ceres and Carbon Tracker, with support from the Global Investor Coalition on Climate Change, asked corporations to provide a detailed report outlining the firm's various risks and plans for managing those risks associated with climate change. It also encouraged corporations to reach out to coordinate discussions with signatories. As noted by Ceres, the "initiative has two main goals: (1) to prevent shareholder capital from being wasted on developing high-carbon, high-cost fossil fuel reserves that cannot be used if the world is to avoid catastrophic climate change; and (2) drive fossil fuel companies to acknowledge and plan for the escalating physical impacts of climate change such as higher temperatures, rising seas and stronger storms."<sup>24</sup>

In coordination with the sign-on letter, this year over a dozen CAR-specific shareholder resolutions have been filed along with over 170 climate change related resolutions including several targeted at requiring oil and gas companies to establish science-based greenhouse gas reduction targets. In January 2015, the Treasurer's Office joined over 100 institutional investors with assets over \$200 billion in a resolution filed at BP. The companies responded in support for the disclosure resolutions filed with them, and on April 16<sup>th</sup> a preliminary count of shareholder support for the resolution at BP showed it passed with 98.28% in favor. The INCR CAR Working Group coordinated to build the vote for the "Aiming for A" resolution and held a conference call with BP staff to ensure that the ongoing reporting would meet the expectations of

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<sup>21</sup> <http://greencentury.com/pepsico-announces-carbon-pollution-reductions-and-efforts-to-curb-climate-change/>

<sup>22</sup> <http://www.ceres.org/files/oil-gas/investor-flaring-letter>

<sup>23</sup> [http://www.apachecorp.com/Sustainability/Environment/Water/Fresh\\_ideas\\_for\\_water/index.aspx](http://www.apachecorp.com/Sustainability/Environment/Water/Fresh_ideas_for_water/index.aspx)

<sup>24</sup> <http://www.Ceres.org/roadmap-assessment/roadmap-in-action/explore-by-topic/performance-operations/carbon-asset-risk>

shareholders and fulfill the spirit of the resolution by providing meaningful data. The CAR initiative has helped to create more awareness and engagement on climate issues at the board level of some of the major oil and gas companies. Continued engagement will focus on addressing the need for companies to disclose lower demand scenarios in making decisions around capital expenditures and shareholder dividends, and shifting key performance indicators away from continued reserves growth and toward metrics and investments that are compatible with keeping global temperature rise below 2 degrees Celsius.

Copies of sample letters and the signatories are included as an appendix.

Such conversations that challenge fundamental assumptions and business models will take a number of years to produce significant behavior change satisfactory to shareholders. While we fully expect challenges along the way, the Vermont State Treasurer's Office is committed to this effort. Below are specific examples of progress.

- Statoil chose as its new CEO the head of its renewables division, who said in February that the company will make low carbon initiatives one of the three main pillars of its future energy strategy, and will increase the speed of its transition.
- Conoco Phillips' board has asked the company to stress test its business plan against a number of low carbon scenarios, including three scenarios that would achieve the IEA's scenario of achieving a 50 percent chance of limiting the increase in the average global temperature to 2 degrees C.
- BP and Shell's boards' support of the "Aiming for A" shareholder proposal related to addressing climate change and carbon asset risk, which helped it to pass with approximately 98% support in April.

*Next Steps:* The Treasurer is committed to increased engagement and sign-on to specific proxy voting proposals to support sustainability issues as they impact her role as Treasurer. Ongoing discussions with the VPIC will continue on these issues for their inclusion in activities, as appropriate. VPIC's participation in the carbon asset risk project is one example. The Treasurer has assigned staff to monitor proxy initiatives and shareholder engagement activities through INCR/Ceres, ISS, CII and other entities.

With respect to the carbon disclosure project, the Treasurer's Office and the VPIC are continuing to engage companies by co-filing on shareholder resolutions and through participation in the INCR Carbon Asset Risk Working Group established in July 2014. The purpose of this working group is to (1) coordinate activities of INCR members on engagements with North American oil and gas, coal, and electric power companies, (2) develop strategies for following up with fossil fuel companies, and (3) share and develop best practices for assessing and managing investment portfolio exposure to carbon asset risk.

The VPIC has co-filed on a resolution at ExxonMobil, and participated with other co-filers in discussions to urge the company to adopt quantitative goals for reducing greenhouse gas emissions. The Treasurer will be attending the ExxonMobil annual general meeting in May 2015 to ensure that VPIC and Vermont's concerns are heard.

### Investment Managers

In addition to shareholder activism and constructive engagement with companies, the Treasurer's Office is undertaking a review and dialogue with investment managers on the issues of climate change and stranded

assets. This includes managers within funds managed by the retirement boards, mutual funds within the Treasurer's Office jurisdiction and VPIC managers. While investment managers are expected to invest the funds allocated to them in accordance with the prudent investor rule to maximize risk adjusted returns, the issues of climate change risk are important factors in investment decisions.. The Treasurer's Office staff solicited responses from several of its managers requesting insight into how their firms' investment processes are or are not incorporating climate change concerns in their security selection, fund allocation decisions, and strategic fund initiatives. In addition, the staff has asked, or is in the process of asking, firms for their stance on the Carbon Bubble/Stranded Asset Thesis. We are also cross-checking information received from these firms available through the Ceres and FundVotes sustainability databases. This initiative was undertaken to inform the Treasury office staff, and the various boards and committees we work with, on how the investment managers are assessing the risk of climate change and the steps they have put in place to evaluate its potential impact on the funds they manage, and the investment decision-making process.

U.S. mutual fund companies have been required to publicly disclose how they cast their proxy votes since 2004 (2006 for Canadian mutual funds). A recent report by Ceres indicated "more U.S. mutual fund companies are acting to address the threat of climate change in their portfolios, with one-third of votes cast across 42 fund families supporting climate-related shareholder resolutions on average in 2014"<sup>25</sup> As noted in a Ceres press release, "the 2014 proxy season saw one of the sharpest increases ever in support for climate-related resolutions in the past decade, with 11 fund groups – including GMO, John Hancock, Delaware and Oppenheimer – increasing their support for climate-related resolutions by 12 percent or more between 2013 and 2014. Morgan Stanley, for example, supported climate resolutions 70 percent of the time in 2014 – a shift from supporting only 13 percent in 2013."

Sixteen of the VPIC investment managers are signatories to the U.N. Principles for Responsible Investment (UN PRI). These managers include Aberdeen, Acadian, Allianz, AQR, BlackRock, Deutsche Asset & Wealth Management, Grosvenor, HarbourVest Partners, Mellon, Morgan Stanley, PIMCO, Siguler Guff, Schroders, SSGA, UBS, and Wellington. The UN PRI is an international initiative that requires a pledge to uphold six Principles for responsible investing designed by the United Nations. It expects its network of signatories to incorporate these Principles into their investment decision-making and ownership practices. Signatories "believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole."<sup>26</sup> The following are the six Principles pledged by the signatories

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

Despite affirmation of these Principles by signatories, Ceres and FundVotes have reported cases of a potential contradiction when comparing firms' proxy voting records to their stated positions on

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<sup>25</sup> Ceres Press Release, "Analysis Shows Growing Support from U.S. Mutual Funds for Action on Climate Change Risks", November 13, 2104.

<sup>26</sup> [www.unpri.org](http://www.unpri.org)

environmental and sustainability issues (please note that VPIC's proxies are voted by ISS, per the VPIC stated proxy policies and not by the manager). One such company had a 90 percent record of voting against sustainability related shareholder resolutions in 2013, but at the same time reported to Carbon Disclosure Project its active role in addressing climate change.

*Next Steps:* The Treasurer's Office will continue to engage in additional, substantive dialogue with investment managers and cross reference their proxy activities using a variety of databases. This process is in its initial phases, but will complement the efforts of staff's participation in the INCR working groups on SEC Climate Risk Disclosure and Carbon Asset Risk.

### Fossil Fuel Free and SRI Funds in Optional Retirement Programs

In addition to the defined benefit pension fund managed by VPIC, the various retirement boards offer optional supplemental retirement savings plans, including the deferred compensation program (457 plan), a teacher 403(b) plan, and two defined contribution plans (municipal and State). A brief description of the plans follows.

The deferred compensation program (IRS 457 plan) is the largest such fund and has been available since 1979 as a savings option for State employees, teachers, municipal employees, employees of agencies, and members of the General Assembly. The program is administered by Empower Retirement (previously known as Great-West Retirement Services). Because the deferred compensation plan qualifies as a Section 457 plan under the Internal Revenue Code, the portion of salary that is deferred is not taxed at the time of deferral.

A 403(b) Investment Program, administered by Empower Retirement, for public school districts was implemented on January 1, 2009, providing an additional optional retirement plan for eligible teachers. Exempt State employees were offered a defined contribution plan in 1999. The Vermont Municipal Employees' Retirement System (VMERS) was given statutory authority in 1999 to approve a defined contribution (DC) plan for its members. The board implemented a defined contribution plan on July 1, 2000. The defined contribution plans are modeled similar to private sector 401(k) plans with a lineup of funds from which participating member may invest. The DC programs are managed by Fidelity.

While the fund lineup in each of the above is selected by the appropriate governing body, (state board or VSERS, the municipal board or VMERS, or the State Treasurer) the individual may select investments based on individual risk tolerance and preferences. The various funds include socially responsible investment (SRI) mutual funds that eligible participants may choose as an investment option. SRIs are specialized funds that invest only in companies that meet their defined criteria of ethical operations, social benefits and/or environmental standards. These will vary by plan. For example, the 457 deferred compensation plan has a number of SRI fund options including: Calvert Bond Portfolio A (CSIBX), Vanguard FTSE Social Index Institutional (VFTNX), Pax World Balanced Fund (PAXWX), Pax World Global Environmental Markets Fund (PGINX) and the PIMCO Total Return III Fund (PTSAX). Contributions employees elect to make to the deferred compensation plan are in addition to the defined benefit or pension program. The DC and 403(b) programs also have SRI options.

On the recommendation of the Treasurer, the VSERS Trustee Board (the trustee for the 457 fund) approved the inclusion of a fossil fuel free investment option, the PAX World Global Environmental

Markets Institutional Fund (PGNIX) in February 2014, which was fully implemented in May 2014. The objective of the fund is long term growth of capital by investing globally in businesses that “focus on environmental markets, including alternative energy and energy efficiency; water infrastructure technologies and pollution control; environmental support services and waste management technologies; and sustainable food, agriculture and forestry.”<sup>27</sup> The portfolio managers of this fund do not own stocks of companies on the Carbon Tracker 200 list and they have implemented a program by which they buy carbon offsets in proportion to the holdings of the fund in an effort to make the overall fund carbon neutral. In addition, the portfolio managers have an expertise in alternative energy and related companies that support the technology. As such, they proactively look to invest in alternative energy companies for inclusion in the portfolio.

In April, upon recommendation of the Treasurer, both the State and the VMERS DC plans approved the inclusion of the PAX World Global Environmental Markets Institutional Fund (PGNIX), effective July 1, 2014. Finally, the Vermont State Teachers’ Retirement System (VSTRS) board approved inclusion of the same fund at its meeting in August 2014, with implementation in progress.

As of April 17, 2015, there were 171 participants enrolled in the fossil fuel free option with assets totaling \$517,636.

#### Local Investments by the State Treasurer’s Office

The Treasurer’s Office has made a determined effort to leverage local investments to promote regional economic development and investment in energy efficiency and renewables.

In 2012, the Treasurer’s Office convened a local investment working group focusing on capital gaps. The group included members of the Vermont General Assembly, Vermont Economic Development Authority (VEDA), the Vermont Housing Finance Agency (VHFA), staff from the Gund Institute, Montpelier Community Development, Vermont Municipal Bond Bank, the Vermont Student Assistance Corporation (VSAC), the Vermont Bankers Association, Vermont Credit Unions, Efficiency Vermont, NeighborWorks of Western Vermont, the Clean Energy Development Fund, and many others. The group’s goal was to identify areas where capital was not being matched with existing needs. The Treasurer’s Office and the local investment working group took steps to address these barriers with several proposals that were acted upon through collaboration with the Vermont General assembly in 2013 and 2014.

During the 2013-2014 legislative session, spurring from the efforts and success of the Local Investment Working Group, Senators Pollina, Ayer, French, McCormick, White, and Zuckerman sponsored S. 204, “An Act Relating to the Establishment of the 10 Percent in Vermont Program.” Elements of the bill were ultimately included in a comprehensive Economic Development bill signed into law (Act 199 of 2014, S.220). The legislation authorized the use of up to 10 percent of the State’s average daily cash balance to be disbursed for local investments at the Treasurer’s discretion, with recommendations from the Local Investment Advisory Committee (LIAC). Any investments must meet the established fiduciary standards applicable to the duties of the Treasurer.

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<sup>27</sup> Prospectus 5/1/2014 for Pax World Global Environmental Markets Institutional

The LIAC is now tasked with advising the Treasurer's Office on how to best implement sustainable investments that will benefit Vermont's local economy and the sustainability and efficiency goals established by the State. The Treasurer's Office is pleased to have had the opportunity to bring this diverse group together through a collaborative approach to find potential solutions by including all interested parties in the conversation.

Over the past two years the following investment initiatives were implemented:

- An increase in the Treasurer's Office current loan commitment to the Vermont Community Loan Fund from \$200,000 to \$500,000. The funds were dedicated to support VCLF's childcare loan program. This, in turn, will provide child care subsidies, including services to lower income households and support jobs in the early education and child care industry.
- A legislative change was adopted to extend a line of credit from the Treasurer's Office to VEDA to support their activities including commercial energy efficiency and renewable energy capacity. This will lower VEDA's reliance on outside investment bank financing and lower the cost for entities financing through VEDA, supporting Vermont jobs and economic development, with a significant focus on commercial energy. The Treasurer's Office is committed to providing up to \$10 million in financing at terms acceptable to the Treasurer and with a guaranteed repayment. This initiative will provide support in reaching our state energy goals while also promoting local economic development—all at no risk to the taxpayer.
- In addition to the \$10 million commitment to VEDA, a residential energy credit facility was implemented with a maximum commitment of \$6.5 million. The loan programs leverage capital through a public-private partnership to help businesses save energy.
- \$2 million has been committed to NeighborWorks of Western Vermont that has implemented a statewide residential energy efficiency program. NeighborWorks is drawing these dollars down as they complete residential efficiency agreements. NeighborWorks' portfolio of energy efficiency retrofits is estimated to reduce annual carbon emissions by more than 5,300 pounds annually for an average annual cost savings of \$1,000 per household.
- The Treasurer's Office and the Local Investment Working Group also worked with VHFA on a multi-family energy financing strategy and provided \$2.8 million for VHFA's 2014 Multifamily Bond transaction, which involved financing for 329 housing units. The \$2.8 million financed 12 multi-family projects, including energy efficiency improvements representing 111 units of housing at Wright House in Shelburne and Bardwell House in Rutland. As part of the agreement, the State also provided its moral obligation to support bonds which will, among other things, fund rehabilitation and efficiency improvements at Rail City in St. Albans and Richmond Terrace in Rutland.
- Approximately \$1.7 million in residential energy efficiency capacity is available for commitment to reach the \$6.5 million total. The LIAC expects to begin allocating these in the coming year.
- Up to \$8 million has been allocated, pursuant to the 2014 Capital Bill (Act 178 of 2014, Section 41) to create a state energy revolving fund. The loans will be used to make cost-effective energy improvements that focus on bringing older State buildings up to Energy Star standards or better. Improvements could save the state between 5 to 10 percent on its energy bills. Individual projects are reviewed for technical specifications, as well as a financial review to assure that the necessary savings can be generated. The first such proposal is currently under review.

- In addition to the direct investments noted above, other actions have been taken to stimulate local investment. These include: (1) the adoption by the State Legislature of a recommendation increasing the moral obligation authority for VEDA by \$15 million, (2) the application of existing moral obligation authority to the VHFA multi-family financing taken in conjunction with the energy initiatives cited above, and (3) the development of a loan program, for public and private groups, to develop electric vehicle charging stations using funds from the State Infrastructure Bank, to be administered by VEDA.

*Next Steps:* The LIAC and the State Treasurer are in the processes of soliciting additional proposals for local investment in four key areas (housing and energy, transportation, municipal infrastructure, student financing of higher education) of up to \$8.2 million. A portion of this will be designated to energy efficiency and/or renewable energy investments. Financing announcements for accepted proposals will be made by the Treasurer’s Office in the spring and summer of 2015. An update will be available after these announcements have been made.

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### **Summary and Conclusions**

The threats resulting from climate change are acute and global in scale, requiring efforts at all levels of government, the private sector and the public at large. A transition to a low carbon future will require fundamental changes in demand and transformation of our energy systems. These changes will result in additional regulatory and financial risks on companies. As institutional investors, VPIC and the Treasurer’s Office seek environmental, social and governance (ESG) changes by companies and encourage our investment managers to incorporate considerations of these risks into their investment processes and encourage ESG changes by portfolio companies. As outlined in the report, the Treasurer’s Office has and will continue to address these in a number of ways, including, but not limited to the following:

- The Treasurer’s Office will continue its work as a founding member of the Investment Network for Climate Risk (INCR), operating through Ceres, a non-profit organization advocating for sustainability. INCR has since grown to a network of 114 institutional investors representing more than \$13 trillion in assets under management, pooling their collective efforts for joint action on climate risk.
- The Treasurer’s Office and VPIC will continue to utilize their proxy-voting rights at shareholder meetings according to the VPIC proxy policies in support of progressive ESG initiatives endorsed by the VPIC. The proxy guidelines deal with issues such as executive compensation, auditor independence, shareholder rights, discrimination, and fair labor practices, as well as guidance on a range of subjects relating to environmental disclosure and climate change. These policies were originally adopted in 2004, and have continued to be reviewed annually to further address ESG issues.
- The Treasurer’s Office and VPIC will continue to use investor sign-on letters to urge companies to require transparency in their political spending, increase environmental disclosure, and pressure major companies in the palm oil industry to adopt policies that will ensure environmentally sustainable practices.

- The Treasurer’s Office will continue to encourage increased compliance in regard to climate risk disclosures by companies by calling on the SEC to improve enforcement of its climate change guidance issued in February 2010. The goal is to improve corporate disclosure on material sustainability risks and opportunities that can be used by investors when valuing the company and assessing the risks associated with the firm.
- The Treasurer’s Office and VPIC will stay engaged in its participation in the Carbon Asset Risk project. Staff will continue to engage oil and gas companies targeted by this initiative through shareholder resolutions and participation in the INCR Carbon Asset Risk working group. To date, the project has received several guarantees of additional reporting on company issued annual reports regarding sustainability goals and the effects of climate change on company business models.
- The Treasurer’s Office and VPIC will continue to use shareholder engagement to utilize combined assets under management and our “seat at the table” to file shareholder resolutions to encourage companies to address risks relating to climate change. On April 16, 2015, 98% of BP shareholders, in an historic vote, passed a resolution requiring increased annual reporting on climate change risks (a 75% vote was required to make it binding). Vermont was a co-filer of this resolution. Vermont is also a co-filer on a resolution requesting ExxonMobil adopt quantitative goals for reducing greenhouse gas emissions. Treasurer Pearce will attend the annual meeting in May 2015 to ensure that VPIC and Vermont’s concerns are heard.
- The Treasurer’s Office will continue its work with its investment managers to survey how they are incorporating concerns related to climate change, and specifically how they integrate these concerns into security selection, fund allocation decisions, and strategic fund initiatives.
- The Treasurer’s Office will build off the approximately \$25 million already committed to local investments in energy efficiency and renewable energy in Vermont and expects to increase this total over the next several months. An update will be made available by the end of the summer of 2015.
- The Treasurer’s Office will continue to oversee and administer the fossil fuel free investment option that 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. To date, 171 participants have enrolled in the fossil fuel free option with assets totaling \$517,636.

The key to the Treasurer’s Office and VPIC approach is the use of constructive engagement to further environmental, social and governance goals. The Treasurer’s Office and VPIC leverage their standing and rights as shareholders to influence corporate and governmental entities to act responsibly. This includes, but is not limited to, shareholder resolutions, shareholder sign-on letters, and supporting policy initiatives for transparency. A collaborative approach to this engagement is essential. By pooling our efforts with other institutional investors, the Treasurer’s Office and VPIC are able to leverage the combined assets under management to effect change.

The Treasurer's Office and VPIC stand ready to work with all stakeholders to address the important issues surrounding environmental, social, and governance issues. While it is clear that there is much work left to do, the Treasurer's Office is looking forward to a collaborative effort in meeting the challenges that lie ahead and accomplishing real change in the arena of Vermont's energy and climate risk mitigation goals, while also continuing to provide financial security to the state and the 48,000 active, vested, and retired members of the retirement system in Vermont. It is the aim of the Treasurer to ensure that each retiree can enjoy a lifetime of financial security and, in doing so, continue to support Vermont's economic future.

## Carbon Asset Risk Initiative Investor Signatories as of October 2013

Stephen Abrecht  
Co-Chair, Board of Trustees  
SEIU Master Trust

Geeta Aiyer  
President  
Boston Common Asset Management, LLC

Cambria Allen  
Corporate Governance Director  
UAW Retiree Medical Benefits Trust

Shelley Alpern  
Director of Social Research and Advocate  
Clean Yield Asset Management

Sasja Beslik  
Head of Responsible Investment  
Nordea Asset Management

David Blood  
Senior Partner  
Generation Investment Management

Henry Boucher  
Partner, Deputy Chief Investment Officer  
Sarasin & Partners LLP

Tim Brennan  
Treasurer and Chief Financial Officer  
Unitarian Universalist Association of  
Congregations

Paul Bugala  
Senior Sustainability Analyst  
Extractive Industries  
Calvert Asset Management Company, Inc.

John Chiang  
Controller  
California State Controller's Office

Kathleen Coll  
Administrator for Shareholder Advocacy  
Catholic Health East

Frank Curtiss  
Head of Corporate Governance  
Railpen Investments

Sister Patricia A. Daly, OP  
Corporate Responsibility Representative  
Sisters of St. Dominic of Caldwell, NJ

Sister Patricia A. Daly, OP  
Executive Director  
Tri-State Coalition for Responsible  
Investment

William Dempsey  
Senior Vice President of Finance  
The Nathan Cummings Foundation

Thomas DiNapoli  
New York State Comptroller  
New York State Common Retirement Fund

Jack Ehnes  
CEO  
California State Teachers' Retirement System

Richard Fahey  
Chief Operating Officer and Treasurer  
Skoll Foundation

Steven A. Falci  
Head of Strategy Development  
Sustainable Investment  
Kleinwort Benson Investors

Anders Ferguson  
Partner  
Veris Wealth Partners

Robert Fernandez  
Vice President, Credit Research  
Breckinridge Capital Advisors

Elizabeth Fernando  
Head of Equities  
USS Investment Management

Bennett Freeman  
Senior Vice President  
Sustainability Research & Policy  
Calvert Investments

Danielle Fugere  
President  
As You Sow

<sup>28</sup> [http://www.ceres.org/files/car-mats/car-release/carbon-asset-risk-initiative-investor-signatories-as-of-october-2013/at\\_download/file](http://www.ceres.org/files/car-mats/car-release/carbon-asset-risk-initiative-investor-signatories-as-of-october-2013/at_download/file)

David Gautsche  
President  
Praxis Mutual Funds

Julie Gorte  
Senior Vice President for Sustainable Investing  
Pax World Management Corp.

Alisa Gravitz  
CEO, President  
Green America

Steven Grossman  
Treasurer and Receiver General  
Commonwealth of Massachusetts

Farha-Joyce Haboucha  
Managing Director  
Rockefeller & Co.

Donald G. Hart  
President  
United Church Funds

Wendy S. Holding  
Trustee  
The Sustainability Group at Loring,  
Wolcott and Coolidge Trust, Inc.

Leon Kamhi  
Head of Engagement  
Hermes Equity Ownership Services, Ltd

Nancy Kopp  
Treasurer  
Maryland Treasurer's Office

Sonia Kowal  
Director of Socially Responsible Investing  
Zevin Asset Management, LLC

Lisa Laird  
VP Investments and Cash Management  
St. Joseph Health System

Natasha Lamb  
Director of Equity Research & Shareholder  
Engagement  
Arjuna Capital

Peter Lambert  
CEO  
Local Government Super

Terra Lawson-Remer  
Chair  
Advisory Committee on Investor Responsibility  
The New School

John Liu  
New York City Comptroller  
New York City Pension Funds

Bill Lockyer  
Treasurer  
California State Treasurer's Office

Craig Mackenzie  
Head of Sustainability  
Scottish Widows Investment Partnership

Peter Murphy  
CEO  
Christian Super

Denise Nappier  
Treasurer  
Connecticut Office of the State Treasurer

Nora Nash  
Director, Corporate Social Responsibility  
Sisters of St. Francis of Philadelphia

Daniel Nielsen  
Director of SRI  
Christian Brothers Investment Services, Inc.

William Orum  
Partner  
Capricorn Investment Group, LLC

Matthew Patsky  
CEO  
Trillium Asset Management

Elizabeth Pearce  
Treasurer  
Vermont Office of the State Treasurer

Vermont Pension Investment Committee

Jeff Perkins  
Executive Director  
Friends Fiduciary Corporation

Michael Quicke  
CEO  
CCLA Investment Management

Counsellor Kieran Quinn  
Chair  
Local Authority Pension Fund Forum

Gina Raimondo  
Treasurer  
Rhode Island Office of the General Treasurer

Mark Regier  
Director of Stewardship Investing  
Everence

Cathy Rowan  
Corporate Responsibility Coordinator  
Maryknoll Sisters

Steve Schueth  
President  
First Affirmative Financial Network, LLC

Tim Smith  
Senior Vice President  
Director of ESG Shareowner Engagement  
Walden Asset Management

Susan Smith Makos  
SRI Advisor  
Catholic Health Partners

Susan Smith Makos  
Vice President of Social Responsibility  
Mercy Investment Services, Inc.

Rev. Bill Somplatsky-Jarman  
Mission Responsibility Through Investment  
Presbyterian Church (USA)

Anne Stausboll  
CEO  
California Public Employees' Retirement System

Luan Steinhilber  
Director of Operations and Shareholder Advocacy  
Miller/Howard Investments, Inc.

Greg Sword  
Chief Executive Officer  
LUCRF Super

Phil Vernon  
Managing Director  
Australian Ethical Investment Ltd.

Susan Vickers  
VP Community Health  
Dignity Health

Stephen Viederman  
Chair, Finance Committee  
The Christopher Reynolds Foundation

Dieter Waizenegger  
Executive Director  
CtW Investment Group

Peter Wallach  
Head  
Merseyside Pension Fund

Richard Walters  
Director of Corporate Social Responsibility  
United Church of Christ - Pension Boards

Steve Waygood  
Chief Responsible Investment Officer  
Aviva Investors

Ted Wheeler  
Treasurer  
Oregon Office of the State Treasurer

Ross Youngman  
CEO  
Five Oceans Asset Management

David Zellner  
Chief Investment Officer  
Wespath Investment Management

Vicki Bakhshi, Director  
Matthias Beer, Associate Director  
Juan Salazar, Associate Director  
Governance & Sustainable Investment  
F&C Asset Management plc

## Attachment B: Sample Carbon Asset Risk letter

Re: Assessment of Carbon Asset Risk by [COMPANY]

Dear [Lead Director, CEO and CFO]: A number of publications over the last year have discussed the climate change-related risks facing fossil fuel companies – both from current and future policies to reduce greenhouse gas (GHG) emissions as well as from the physical impacts of climate change. In addition, investment analysts have expressed concerns about the viability of the current capital expenditure plans of many oil and gas companies. We are an international group of XX institutional investors, collectively representing \$X.X trillion in assets, writing to inquire about [COMPANY'S] exposure to these risks and plans for managing them. In 2010, international governments formally set a long-term goal to limit global warming to below 2°C,<sup>29</sup> requiring a stabilization of the atmospheric concentration of GHGs below 450 parts per million (ppm) carbon dioxide equivalent (CO<sub>2</sub>e). Because the combustion of fossil fuels is the largest contributor of GHG emissions, it is widely recognized that strong policy action will be necessary globally to transform how we produce and use energy to achieve this 2°C goal. We support such action because we think the long-term health of the economy depends on effectively managing the financial risks posed by climate change.

According to the International Energy Agency (IEA), the world is currently on a path to raise the atmospheric concentration of GHGs to at least 660 ppm CO<sub>2</sub>e, corresponding to a warming of 3.6°C or more.<sup>30</sup> The World Bank recently warned that there could be no certainty that adaptation to this level of climate change is possible, and that, “a 4°C warmer world can, and must be, avoided – we need to hold warming below 2°C”.<sup>31</sup>

As investors with diversified portfolios, we recognize the critical importance of having affordable energy to support economic growth. We also recognize that more than 80% of the world's growing energy demand is met by fossil fuels, but that to achieve the 2°C goal, fossil fuel-related GHG emissions will have to be reduced by about 80% by 2050. It is therefore important to understand how current and probable future policies to make these emissions reductions will impact capital expenditures and current assets in the oil and gas sector and how the physical impacts of unmitigated climate change will impact the sector's operations.

In its *World Energy Outlook 2012*, the IEA concluded, “No more than one-third of proven reserves of fossil fuel can be consumed prior to 2050 if the world is to achieve the 2°C goal, unless carbon capture and storage (CCS) is widely deployed.”<sup>32</sup> Under a carbon-constrained scenario, investment bank HSBC assessed how a number of oil and gas companies would be affected and estimated that 40 to 60% of their market value could be lost because a portion of their proven reserves would become stranded assets and reduced demand for oil would drive down the prices for petroleum products, significantly reducing the value of their remaining proven reserves.<sup>33</sup> According to Standard & Poor's, such a price decline could pressure the creditworthiness of oil and gas companies, particularly those that have large exposure to high

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<sup>29</sup> "The Cancun Agreements," (2010).

<sup>30</sup> International Energy Agency, "World Energy Outlook 2012," (2012).

<sup>31</sup> The World Bank, "Turn Down the Heat: Why a 4°C Warmer World Must Be Avoided," (2012).

<sup>32</sup> International Energy Agency, "World Energy Outlook 2012."

<sup>33</sup> Paul Spedding, Kirtan Mehta, and Nick Robins, "Oil & Carbon Revisited: Value at Risk from 'Unburnable' Reserves," (HSBC Global Research, 2013).

cost unconventional oil and gas production such as oil sands.<sup>34</sup> Despite the risk that a portion of current proven reserves of fossil fuels cannot be consumed if governments act on the 2°C goal, recent analysis by Carbon Tracker and the Grantham Research Institute found that the world's 200 largest fossil fuel companies collectively still spent \$674 billion in 2012 on finding and developing *new* reserves.<sup>35</sup> This raises concern about the possibility that returns on this capital may never be realized.

The costs of inaction could be considerable if the world continues on a path to a 3.6°C warming or more. The *Federal Advisory Committee Draft Climate Assessment Report* recently concluded, "There is mounting evidence that the costs to the [U.S.] are already high and will increase very substantially in the future, unless global emissions of heat-trapping gases are strongly reduced."<sup>36</sup> In 2011 alone, the costs of extreme weather events, which are expected to increase with climate change,<sup>37</sup> totaled about \$170 billion globally.<sup>38</sup> The oil and gas industry is also vulnerable to extreme weather due to the exposure of infrastructure such as refineries, ports, and offshore drilling rigs to hurricanes, flooding, and sea level rise.<sup>39</sup> Hurricanes Katrina and Rita, for example, caused extensive damage to the industry's assets along the Gulf Coast, taking more than a million barrels per day of refining capacity offline for months.<sup>40</sup> Extreme weather may also cause severe disruptions to other sectors, especially those such as agriculture that are particularly vulnerable to changes in weather patterns, as well as to communities and commerce generally, resulting in reduced overall economic growth and changes in energy demand.

As investors with long-term investment strategies, we would like to understand [COMPANY'S] reserve exposure to the risks associated with current and probable future policies for reducing GHG emissions by 80% by 2050 to achieve the 2°C goal (including carbon pricing, pollution and efficiency standards, removal of subsidies, and/or reduced demand), and the risks to its operations as well as the economy as a whole of increasing extreme weather associated with the world's current path to a warming of 3.6°C or more. We would also like to understand what options there are for [COMPANY] to manage these risks by, for example, reducing the carbon intensity of its assets, divesting its most carbon-intensive assets, diversifying its business by investing in lower-carbon energy sources, or returning capital to shareholders.<sup>41</sup>

These long-term, climate change-related risks raise additional concerns for discussions already underway between the investment community and oil and gas companies about the viability of their capital expenditure plans.<sup>42</sup> There is now a widespread view that it is not in the best interest of investors for companies to expend further capital on low-return projects.<sup>43</sup> Government policies to reduce GHG emissions would be likely to further reduce the return of these projects.

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<sup>34</sup> Simon Redmond and Michael Wilkins, "What a Carbon-Constrained Future Could Mean for Oil Companies' Creditworthiness," (Standard & Poors, 2013).

<sup>35</sup> Carbon Tracker and The Grantham Research Institute, "Unburnable Carbon 2013: Wasted Capital and Stranded Assets," (2013).

<sup>36</sup> National Climate Assessment and Development Advisory Committee, "Draft Climate Assessment Report," (United States Global Change Research Program, 2013).

<sup>37</sup> C.B. Field et al., "Managing the Risks of Extreme Events and Disasters to Advance Climate Change Adaptation," (IPCC, 2012).

<sup>38</sup> Cynthia McHale and Sharlene Leurig, "Stormy Future for U.S. Property/Casualty Insurers: The Growing Costs and Risks of Extreme Weather Events," (Ceres, 2012).

<sup>39</sup> International Energy Agency, "Redrawing the Energy-Climate Map," (2013).

U.S. Department of Energy, "U.S. Energy Sector Vulnerabilities to Climate Change and Extreme Weather," (2013).

<sup>40</sup> Lawrence Kumis and Robert Bamberger, Congressional Research Service, "Oil and Gas Disruption From Hurricanes Katrina and Rita," Updated Apr. 6, 2006, <http://www.au.af.mil/au/awc/awcgate/crs/rl33124.pdf>.

<sup>41</sup> International Energy Agency, "Redrawing the Energy-Climate Map."

<sup>42</sup> Andrew Peale, "Europe's Oil Majors Should Focus on Shareholders," *Wall Street Journal* 2013 and della Vegan, M et al. "No Light at the End of the Tunnel" (Goldman Sachs Equity Research, 2013)

<sup>43</sup> Rats, M et al "Why 'Big Oil' has Underperformed so Much..." (Morgan Stanley Research Europe), Same, A et al. "Investing for Commodity Uncertainty".(City Research, 2013); della Vegan, M et al "Death and Rebirth of an Industry" (Goldman Sachs Equity Research, 2012)

Therefore, we ask that [COMPANY] review both its exposure to these risks and its plans for managing them. To inform this review, in line with IEA's recent report, *Redrawing the Energy -Climate Map*, we recommend that [COMPANY] conduct a risk assessment under at least two main scenarios: (1) a business-as-usual scenario such as that used in [COMPANY'S] current reporting and (2) a low-carbon scenario consistent with reducing GHG emissions by 80% by 2050 to achieve the 2°C goal. We recommend that this assessment evaluate:

- Capital expenditure plans for finding and developing new reserves, including consideration of rates of return and payback periods and alternative uses of capital;
- The potential GHG emissions associated with the production of all unproduced reserves categorized by resource type, e.g., onshore conventional, tight oil, shale gas, oil sands, offshore, etc.;<sup>44</sup>
- The risks to unproduced reserves, due to factors such as carbon pricing, pollution and efficiency standards, removal of subsidies and/or reduced demand;
- The risks to assets, particularly oil and gas infrastructure, posed by the physical impacts of climate change, including extreme weather, water stress, and sea level rise; and
- The impacts of the above-referenced risks associated with climate policies and the physical impacts of climate change on the Company's current and projected workforce.

While we recognize that detailed disclosure of the results of such an assessment could be commercially sensitive, we ask for disclosure that demonstrates [COMPANY'S] commitment to managing the risks outlined in this letter. Finally, given the strategic nature of these issues, we would like to understand what role the Board has in overseeing this assessment.

We would appreciate receiving notification of [COMPANY'S] intent regarding this request by September 27, 2013 or immediately following the next Board meeting and your full response in advance of [COMPANY'S] 2014 Annual Stockholders Meeting or AGM. We realize that these are complex issues and welcome the opportunity to meet with you to discuss our requests in more detail. Please direct your response to Ryan Salmon, Manager, Oil and Gas Program at Ceres ([salmon@ceres.org](mailto:salmon@ceres.org), 617-247-0700 x122), who is coordinating this engagement on behalf of the participating investors, and will communicate your response to the undersigned.

Sincerely,

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<sup>44</sup> A similar question appears in: Carbon Disclosure Project, "Investor Cdp 2013 Information Request," (2013).



April 17, 2015

The Honorable Mary Jo White  
Chair  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Inadequate Carbon Asset Risk Disclosure by Oil and Gas Companies

Dear Chair White:

As institutional investors representing over \$1.9 trillion in assets under management, we are concerned that oil and gas companies are not disclosing sufficient information about several converging factors that, together, will profoundly affect the economics of the industry. They include capital expenditures on increasingly high cost, carbon intensive oil and gas exploration projects, government efforts to limit carbon emissions, and the possibility of reduced global demand for oil as early as 2020 (collectively “carbon asset risks”).

We have found an absence of disclosure in SEC filings regarding these material risks, which constitute “known trends” under SEC rules, and respectfully ask the Commission to address this issue in comment letters to issuers.

**Carbon asset risks to oil and gas companies:** A growing number of investors are working to integrate climate risk into their investment strategies,<sup>1</sup> and obtaining more information from fossil fuel companies about their capital expenditures and related risks is a critical part of this process. Some investors have increased their allocation to lower-carbon assets. Others have signed the Montreal Pledge, committing to measure and publicly disclose the carbon footprint of their investment portfolios annually, or have joined the Portfolio Decarbonization Coalition, agreeing to implement portfolio strategies towards climate-related objectives.

We are concerned that some carbon assets—current and future hydrocarbon reserves and resources of oil and gas companies—may become stranded assets, which are “fuel energy and generation resources which, at some time prior to the end of their economic life (as assumed at the investment decision point), are no longer able to earn an economic return (i.e. meet the company’s internal rate of return), as a result of changes in the market and regulatory environment associated with the transition to a low-carbon economy.”<sup>2</sup>

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<sup>1</sup> See, for example, World Bank Group, *Investors shift into low-carbon and climate-resilient assets*, September 12, 2014.

<sup>2</sup> <http://www.carbontracker.org/resources/>. See also <http://www.smithschool.ox.ac.uk/research-programmes/stranded-assets/>.

The economics of the oil and gas industry are changing rapidly as exploration and production costs increase. As conventional oil and gas reserves decline, companies have been forced to increase investments in high cost, carbon intensive “unconventional” exploration projects. Kepler Cheuvreux has called this a “capex crisis” driven by the need for more costly investments in unconventional crude development projects to stem decline rates in conventional oil fields.<sup>3</sup> Since 2005, annual upstream investment for oil has increased by 100%, from \$220 billion in 2005 to \$440 billion in 2012, while crude oil supply has only increased 3%. In 2014, the global oil industry spent \$650 billion on exploration and development of new reserves, which is producing diminishing marginal returns in terms of new reserves being added.<sup>4</sup> Thus, the industry is investing more money to produce less oil and has become less profitable in recent years.

The Carbon Tracker Initiative (CTI) estimates oil and gas companies are likely to spend approximately \$1.1 trillion in capex from 2014-2025 on high cost, carbon-intensive exploration projects that require at least an \$80 break-even price.<sup>5</sup> Due to recent low oil prices, we have seen oil majors cancel or delay billions of dollars worth of projects, and nearly \$1 trillion of projects face the risk of cancellation.

Many of these projects face operational challenges and increasing costs due to the nature of the projects, including Arctic, deepwater, ultra-deepwater, and unconventional production of oil sands, heavy oil, shale oil, extra heavy oil and tight liquids projects. For major oil and gas companies, these higher risk capital expenditures represent 18-28% of total projected capex through 2025.<sup>6</sup>

The increase in high risk, carbon intensive capital expenditures comes at a time when governments are focusing on reducing carbon emissions to prevent catastrophic climate change. Last October, EU leaders agreed to a binding target for reducing domestic greenhouse gas emissions by at least 40% compared to 1990. In November, President Obama and Chinese President Xi Jinping announced an agreement to ambitiously reduce both nations’ carbon emissions. These agreements support the need for reducing dependence on fossil fuels and increases risks associated with expensive, carbon intensive exploration projects.

While discussions continue at the international level, an increasing range of climate-related actions are being taken or are already required by national and subnational governments across the world, including actions to increase energy efficiency (for instance increased fuel economy standards) and to substitute cleaner sources of energy, such as renewables. As more of these measures are implemented, demand for fossil fuel based energy could plateau, which decreases the likelihood that high cost, carbon intensive reserves will be cost-effective to develop and produce.

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<sup>3</sup> Mark Lewis, Kepler Cheuvreux, *Toil for oil spells danger for majors: Unsustainable dynamics mean oil majors need to become “energy majors”* (September 15, 2014)

<sup>4</sup> Rineesh Bansal, Stuart Kirk, *Peak carbon before peak oil*, in Deutsche Bank, *Konzept*, Issue No. 2 (January 20, 2015)

<sup>5</sup> Carbon Tracker Initiative, *Carbon supply cost curves: Evaluating financial risk to oil capital expenditures* at 16, (May 2014)

<sup>6</sup> *Id.* at 19.

**Investor efforts to improve voluntary disclosure:** Institutional investors have and continue to raise these concerns with oil and gas companies through letters,<sup>7</sup> dialogues and shareholder resolutions.<sup>8</sup> Starting in 2013, a coalition of 70 investors managing assets of \$3 trillion began collaborating with Ceres, Carbon Tracker, the European Institutional Investors Group on Climate Change (IIGCC) and the Australia/New Zealand Investor Group on Climate Change (IGCC) to engage with the world's largest oil and gas, coal and electric power companies, asking them to assess risks under climate action and "business as usual" scenarios. In January 2015, fifty institutional investors representing over £160 billion filed resolutions with BP and Shell calling for routine annual reporting beginning in 2016 to include information about asset portfolio resilience to the International Energy Agency's (IEA's) scenarios, low-carbon energy research and development (R&D) and investment strategies, and related items.<sup>9</sup> In an important development, the boards of both Shell and BP advised shareholders to support the resolutions.<sup>10</sup>

Organizations working with investors have issued carbon asset risk disclosure guidelines, expectations and requests, including the Global Investor Coalition on Climate Change<sup>11</sup>, CDP<sup>12</sup>, the Climate Disclosure Standards Board<sup>13</sup> and the Sustainability Accounting Standards Board.<sup>14</sup> As discussed in these guidelines, investors are seeking low carbon scenario assessments; capital expenditure plans for new reserves, including rates of return, payback periods, and alternative uses of capital; potential greenhouse gas emissions of unproduced reserves by resource type and by country; average breakeven oil price for their portfolio, including how breakeven prices are calculated for both planned and existing projects, and a further breakdown of breakeven prices by project or hydrocarbon type; and a discussion of the risks to unproduced reserves from pricing, standards, reduced subsidies or reduced demand.

However, there has been a lack of meaningful, substantive carbon asset risk disclosures in response to these investor requests. A recent report analyzing voluntary climate risk reporting by 49 oil and gas companies found low levels of assessment of these risks and application of the findings to current and future exploration projects.<sup>15</sup> Ten of these companies acknowledged running scenario analyses of different global temperature increases, eight ran internal carbon price stress tests for prospective investments, and five ran stress tests regarding the resilience of their capital expenditures under a scenario consistent with limiting the average global temperature increase to 2°C. However, no companies disclosed their stress testing parameters, leaving investors unable to objectively assess the adequacy of these resilience tests.

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<sup>7</sup> Ceres, Investors ask fossil fuel companies to assess how business plans fare in low-carbon future: Coalition of 70 investors worth \$3 trillion call on world's largest oil & gas, coal and electric power companies to assess risks under climate action and 'business as usual' scenarios (Oct. 24, 2013)

<sup>8</sup> See, for example, <http://www.nytimes.com/2014/03/21/business/in-a-shift-exxon-agrees-to-report-on-carbon-asset-risk.html>.

<sup>9</sup> [http://www.ccla.co.uk/ccla/press/Aiming for A 21st January Press Release\\_FINAL.pdf](http://www.ccla.co.uk/ccla/press/Aiming%20for%20A%2021st%20January%20Press%20Release%20FINAL.pdf)

<sup>10</sup> <http://www.ipe.com/news/esg/bp-follows-shell-to-back-climate-change-resolution/10006577.fullarticle>

<sup>11</sup> On December 9, 2014, the Global Investor Coalition released *Investor Expectations: Oil and Gas Company Strategy—Supporting investor engagement on carbon asset risk*.

<sup>12</sup> Carbon asset risk questions have been incorporated into the 2014 and 2015 CDP climate change questionnaires.

<sup>13</sup> CDSB, *Proposals for reporting Carbon Asset Stranding Risks*.

<sup>14</sup> SASB Oil & Gas Exploration & Production sustainability accounting standard, reserves valuation and capital expenditures accounting metrics.

<sup>15</sup> Carbon Tracker Initiative, *Recognising Risk, Perpetuating Uncertainty: A baseline survey of climate disclosures by fossil fuel companies at 21-22* (October 2014).

**Carbon asset risks are material under SEC rules:** According to the SEC, “Registrants must identify and disclose known trends, events, demands, commitments, and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance.” The SEC also notes, “Disclosure of a trend, demand, commitment, event or uncertainty is required unless a company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect on the company’s liquidity, capital resources or results of operations is not reasonably likely to occur.”

The 2010 SEC interpretive guidance on climate change disclosure provides additional guidance, noting, “Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for registrants. These developments may create demand for new products or services, or decrease demand for existing products or services.” Specifically, the guidance suggests disclosing potential “decreased demand for goods that produce significant greenhouse gas emissions.”

Carbon asset risks have undoubtedly become “known trends” within the meaning of the Commission’s regulatory standards and therefore must be discussed in SEC filings. The risk of reduced demand for oil, uneconomic projects and stranded assets due to the factors discussed above is material to the companies and their investors, as it directly affects the profitability and valuation of the companies.

Investors and other groups have asked the SEC and other regulators to improve reporting on carbon asset risks. In February 2015, the Carbon Tracker Initiative wrote to the Commission asking for improved MD&A disclosure by fossil fuel companies of the effects of low carbon scenarios on commodity demand and price and subsequent effects of those shifts on future capital expenditure plans, liquidity and reserves valuations. The letter also suggested changes to regulations, including uniform requirements for future capital expenditure disclosure and standards for reporting the carbon content of reserves and resources. In 2013, Carbon Tracker, former SEC Commissioner Bevis Longstreth and former Deputy Chief Accountant Jane Adams petitioned FASB, asking that disclosure of carbon content of reserves should be required for companies with significant fossil fuel reserves.

In 2008, a group of investors and other groups wrote to the SEC regarding the *Modernization of Oil and Gas Reporting Requirements*, concerned that climate change and policies adopted to combat greenhouse gas emissions could render certain assets—particularly those with high carbon intensity—uneconomic. The letter asked that the revised rule ensure that companies disclose material risks posed by the extraction and development of additional reserves as well as reported reserves that have higher than average full lifecycle greenhouse gas emissions associated with their extraction, production and combustion.

**Examples of carbon asset risk disclosure: ExxonMobil, Chevron and Canadian Natural Resources:** As a result of the investor letters, dialogues and resolutions mentioned earlier, oil and gas companies have provided limited voluntary disclosure relating to carbon asset risks, but they have provided no or poor reporting in their SEC filings.

While the three companies discussed below provided little carbon asset risk disclosure in their annual SEC filings, we emphasize that other oil and gas companies likewise reported little or nothing about the range of risks from existing and future laws and trends, such as those related to carbon pricing, pollution and efficiency standards, removal of subsidies, fuel switching and other factors that may reduce demand for oil and gas.

In response to investor requests, ExxonMobil released two reports in March 2014 concerning carbon asset risk and climate change.<sup>16</sup> The company stated it is confident its hydrocarbon reserves are not and will not become stranded through 2040. However, it did not provide a well-supported analysis, instead including only a brief discussion of a “low carbon scenario” through 2040 and failing to discuss current and anticipated laws and trends that are likely to affect demand for its products. The company did not consider the financial risks it could face from a reduction in demand for oil within 10-15 years, nor the implications for its business model of a scenario in which carbon dioxide is kept under 450 parts per million (ppm).<sup>17</sup> While the company stated that it tests investment opportunities against low price scenarios that could be representative of a carbon-constrained environment, it did not discuss how those tests are performed or the scenarios it analyzed, let alone the results.

In its latest 10-K filing, ExxonMobil provided virtually no information about carbon asset risks. The company mentioned that government regulations could “reduce demand for hydrocarbons”, shift demand “toward relatively lower-carbon sources such as natural gas” and increase costs in other ways, without providing any further discussion. It stated that it expects oil to remain the largest source of the world’s energy—about one-third—in 2040, without discussing other possible scenarios for the world’s energy mix. It discussed its capital and exploration expenditures in 2013 and 2014 and mentioned they should average about \$34 billion per year “for the next few years.”

ExxonMobil also discussed projections for total renewable energy growth (15% of total energy by 2040) and the International Energy Agency’s (IEA) fossil fuel energy investment projection from 2014-2040 (about \$28 trillion). The company did not mention IEA research that examined other realistic scenarios. A 2013 IEA report<sup>18</sup> found that a world in which atmospheric CO<sub>2</sub> is kept below 450 ppm “requires . . . reduced investment in fossil-fuel supply [\$4.0 trillion lower than in the “New Policies Scenario” through to 2035]. However, this saving is more than offset by a \$16.0 trillion increase in investment in low-carbon technologies, efficiency measures and other forms of intervention.” The report also found, “In the case of oil and gas fields that have yet to start production, or have yet to be found, the lower level of demand in the 450 Scenario means that fewer of them justify the investment to bring them into production (or to find them) before 2035. . . .”

Chevron has provided some limited voluntary reporting related to carbon asset risks. For example, in its response to the CDP climate change survey, the company said it does not conduct scenario analyses based on a 450ppm goal because, it argued, the risk exposure to current assets

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<sup>16</sup> ExxonMobil, *Energy and Carbon – Managing the Risks* (March 2014) and *Energy and Climate* (March 2014).

<sup>17</sup> Carbon Tracker Initiative, *Responding to Exxon – A Strategic Perspective* (September 2014)

<sup>18</sup> International Energy Agency, *Redrawing the Energy-Climate Map: World Energy Outlook Special Report*, June 10, 2013.

and capital is minimal in view of the continuing global demand for oil and gas, the future investment required to meet that demand, and other factors. The company discussed how it may fare under the IEA's global energy demand and 450ppm scenarios, and the embedded carbon within different types of fossil fuel reserves. It did not provide most of the information investors require, such as capex plans for new reserves including payback periods and alternative uses of capital, potential GHG emissions of unproduced reserves by resource type and a discussion of existing and long term risks to unproduced reserves.

In its latest 10-K filing, Chevron provided almost no information about carbon asset risks. The company briefly mentioned that "incentives to conserve or use alternative energy sources" could reduce demand for its products and affect sales volumes, revenues and margins. It discussed regulatory and physical risks related to climate change, renewables projects, a range of environmental issues, oil and gas reserves and related matters. It discussed its oil sands and heavy crude oil projects and the differential in crude oil prices between high-quality and lower quality crudes. It discussed its capital and exploration expenditures in 2012-2014, and it estimated \$35 billion in expenditures in 2015: a "planned reduction" compared to 2014, "in large part a response to current market conditions." However, it did not disclose the trend towards increasingly high cost, carbon intensive oil and gas exploration projects nor other information investors require about carbon asset risks.

Canadian Natural Resources is included here as an example of a company with more than 50% of its capex exposed to high risk, carbon intensive projects, according to the Carbon Tracker Initiative. The company provided almost no voluntary disclosure of carbon asset risks. In its CDP response, the company said it does not conduct scenario analyses based on a 450ppm goal but instead completes scenario planning exercises to identify "various risks" to the business. The company mentioned its six core principles for GHG emissions management, which do not include consideration of carbon asset risks. While the company discussed the four techniques it uses to extract bitumen from oil sands, it did not disclose information about the relative energy intensity of each method or breakeven costs for such projects.

In its form 40-F filed on March 24, 2014, Canadian Natural Resources discussed climate-related and oil sands regulations, its emissions reduction efforts and related issues. It did not discuss carbon asset risks, apart from briefly mentioning differing market prices for heavy crude oil and bitumen vs. light and medium crude, and possible U.S. regulation to limit purchases of oil in favor of less energy intensive sources.

**Request to the Commission:** We believe it is crucial that SEC staff closely scrutinize oil and gas companies' reporting on carbon asset risks under existing SEC rules. We appreciate the attention you already pay to carefully examining disclosures in all industries. A recent report<sup>19</sup> found that the SEC issued 1,528 comments to energy and mining companies<sup>20</sup> from October 2013 to September 2014. However, while the Upstream subsector received the most comments

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<sup>19</sup> PwC, Stay informed: SEC comment letter trends—Energy and Mining (December 10, 2014).

<sup>20</sup> The report analyzed the following energy subsectors and Standard Industry Classification codes: Downstream (2911, 5171), Midstream (4610, 4922), Oilfield services (1381, 1382, 1389, 3533), Upstream (1311, 5172, 6792) and Mining (1000, 1040, 1090, 1220, 1221, 1400).

in this group, and the primary areas of focus for comments were proven undeveloped reserves, third party reports and proven reserves, the comment letters did not address carbon asset risks.

Specifically, we ask that staff scrutinize disclosures in annual filings by ExxonMobil, Chevron, Canadian Natural Resources and other oil and gas companies regarding carbon asset risks, and provide comments to these issuers that address reduced demand scenarios, risks associated with capital expenditures on high cost unconventional resource projects and associated stranded asset risks.

Jim Coburn at Ceres will follow up on our behalf with a request for a meeting to discuss our concerns. Thank you very much for your consideration of these issues.

Sincerely,

Lura Mack  
Director  
Portfolio Advisory Board, Adrian  
Dominican Sisters

Natasha Lamb  
Director of Equity Research & Shareholder  
Engagement  
Arjuna Capital

Danielle Fugere  
President  
As You Sow

Steve Waygood  
Chief Responsible Investment Officer  
Aviva Investors

Daniel Simard  
CEO  
Bâtirente

Steven Heim  
Managing Director  
Boston Common Asset Management, LLC

Sophie Purdom  
Co-President  
The Brown University Socially Responsible  
Investment Fund

Betty Yee  
Controller  
State of California

Anne Stausboll  
Chief Executive Officer  
California Public Employees'  
Retirement System

John Chiang  
Treasurer  
California State Treasurer's Office

Bennett Freeman  
SVP, Sustainability Research and Policy  
Calvert Investments

Stephen Viederman  
Chair, Finance Committee  
Christopher Reynolds Foundation

Mary Kate Wold  
President and Chief Executive Officer  
The Church Pension Fund

Ken Jacobs  
President  
Colorado Sustainable Financial Planning

Denise Nappier  
Treasurer  
Connecticut Office of the State Treasurer

Sister Louise Gallahue  
DC, Provincial  
Daughters of Charity, Province of St. Louise

Adam Kanzer  
Managing Director  
Domini Social Investments LLC

Steve Zielinski  
SRI contact  
Dominican Sisters of Springfield, IL

Philippe Uzan  
Chief Investment Officer Long Only  
Edmond de Rothschild Asset Management

Steven J. Schueth  
President  
First Affirmative Financial Network

Jeffery W. Perkins  
Executive Director  
Friends Fiduciary Corporation

Leslie Samuelrich  
President  
Green Century Capital Management

Ken Locklin  
Director  
Impax Asset Management

Matthew Kiernan  
Founder and Chief Executive  
Inflection Point Capital Management

Clare Payn  
International ESG Manager  
Legal & General Investment Management

Bill Hartnett  
Head of Sustainability  
Local Government Super

W. Andrew Mims  
Partner and Trustee  
The Sustainability Group of Loring,  
Wolcott & Coolidge

Mark Kriss  
Managing Partner  
Macroclimate LLC

Deborah B. Goldberg  
Massachusetts State Treasurer and Receiver  
General

Kate Wolford  
President  
The McKnight Foundation

Molly Murphy  
Chief Investment Officer  
Mercy Health (formerly Catholic Health  
Partners)

Marcela Pinilla  
Director, Shareholder Advocacy  
Mercy Investment Services

Luan Steinhilber  
Director of Shareholder Advocacy  
Miller/Howard Investments, Inc.

Narina Mnatsakanian  
Senior Advisor Responsible Investment &  
Governance  
MN

Laura Campos  
Director of Shareholder Activities  
The Nathan Cummings Foundation

Robert Walker  
Vice President Ethical Funds & ESG  
Services  
NEI Investments

Kimberly Ryan  
Partner and Senior Portfolio Manager  
Nelson Capital Management

Mark Fawcett  
Chief Investment Officer  
NEST  
Ted Wheeler  
Oregon State Treasurer

Julie Fox Gorte, Ph.D  
Senior Vice President for Sustainable  
Investing  
Pax World Management LLC

Mark A Regier  
Vice President of Stewardship Investing,  
Everence  
Praxis Mutual Funds/Everence Financial

Rev. William Somplatsky-Jarman  
Coordinator for Mission Responsibility  
Through Investment  
Presbyterian Church (U.S.A.)

Tom Nowak, CFP  
Principal  
Quantum Financial Planning LLC

Stephen B. Heintz  
President  
Rockefeller Brothers Fund

Farha-Joyce Haboucha  
Managing Director and Director of  
Sustainability and Impact Investing  
Rockefeller Sustainability and Impact  
Investing Group

Niall O'Shea  
Head of Responsible Investment  
Royal London Asset Management

Natasha Landell-Mills, CFA  
Head of ESG  
Sarasin & Partners LLP

Kenneth J. Nakatsu  
Interim Executive Director  
Seattle City Employees' Retirement System

Sr. Ruth Geraets  
Treasurer  
Sisters of the Presentation

Sally Osberg  
CEO and President  
The Skoll Foundation

Danielle Ginach  
Impact Manager  
Sonen Capital

Lisa Laird  
VP, Investments and Cash Management  
St. Joseph Health

Jonas D. Kron  
Senior Vice President  
Director of Shareholder Advocacy  
Trillium Asset Management, LLC

Timothy Brennan  
Treasurer & CFO  
Unitarian Universalist Association

Kathryn McCloskey  
Director, Social Responsibility  
United Church Funds

Steven L. Serman  
Senior Portfolio Manager  
Office of the CIO of the Regents  
University of California

Elizabeth Pearce  
Treasurer  
Vermont Office of the State Treasurer  
Vermont Pension Investment Committee

Aaron Ziulkowski  
Senior ESG Analyst  
Walden Asset Management

Theresa Whitmarsh  
Executive Director  
Washington State Investment Board

James L. McIntire  
Washington State Treasurer

Marc Robert  
COO  
Water Asset Management

Sonia Kowal  
President  
Zevin Asset Management, LLC

cc:  
Commissioner Luis A. Aguilar  
Commissioner Daniel M. Gallagher  
Commissioner Kara M. Stein  
Commissioner Michael S. Piwovar  
Director Keith F. Higgins, Division of Corporation Finance  
James Schnurr, Chief Accountant  
Disclosure Effectiveness Review

Attachment D: Sample letter to the SEC regarding Political Contributions by Companies



Janet Cowell  
State Treasurer  
North Carolina



Seth Magaziner  
State Treasurer  
Rhode Island



James McIntire  
State Treasurer  
Washington



Beth Pearce  
State Treasurer  
Vermont



Ted Wheeler  
State Treasurer  
Oregon

April 21, 2015

Mr. Brent J. Fields, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: File No. 4-637, Committee on Disclosure of Corporate Political Spending, Petition for Rulemaking

Dear Secretary Fields:

As State Treasurers we have an obligation to make sure public funds are invested responsibly and accountably. The last election underscored a persistent flaw in our investment system – anonymous corporate political spending. As elected officials representing funds with assets under management totaling more than \$300 billion, we call on the Commission to stand up for shareholders by embracing disclosure for all publicly traded corporations.

Secret political spending continues to be a top issue in the investment world. Since the petition to add political spending to the list of information available to shareholders was filed in 2011, the Commission received well over a million comments on the petition. And the number one shareholder proposal to American companies each of the past three years has been disclosure of political and lobbying activities. As shareholders representing hundreds of billions of dollars in funds, we frequently vote on those proposals in support of disclosure that could have bearing on the company's bottom line.

In the absence of action on the petition over the past three years, the trend continues to be toward greater accountability. In addition to successful shareholder activism, many companies have voluntarily agreed to disclose political spending. A recent survey of the top 300 companies in the S&P 500 found that 61% of companies disclose direct political spending and 43% disclose payments made to trade associations that engage in political spending.<sup>1</sup> The sunlight is steadily expanding, prompting the question: when will the SEC realize the shift and turn the lights on for all companies?

Amid the encouraging signs are grim realities about the need for comprehensive reform. The patchwork adoption of various disclosure policies leaves shareholders like us with a complex system of partial and disjointed information to consider. This has a substantial financial implication. After last November's

<sup>1</sup> Freed, Bruce et al. "The 2014 CPA-Zicklin Index of Corporate Political Disclosure and Accountability: How Leading Companies are Making Political Disclosure a Mainstream Practice." Center for Political Accountability 2014.

election, the Center for Responsive Politics noted a jump in dark money spending from \$135 million to \$170 million since the previous mid-term election. Far too many companies can cloak donations from shareholders behind the anonymous 501(c)(4) groups and other intermediaries that have grown in prominence the past several election cycles. A comprehensive system of disclosure is needed to complete the shift towards disclosure to all companies and along a uniform structure.

Respectfully,



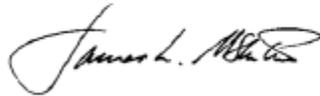
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Janet Cowell, State Treasurer  
North Carolina



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Seth Magaziner, State Treasurer  
Rhode Island



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James McIntire, State Treasurer  
Washington



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Beth Pearce, State Treasurer  
Vermont



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Ted Wheeler, State Treasurer  
Oregon