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STATE OF VERMONT
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TO: ESG Subcommittee Members
FROM: Beth Pearce, Vermont State Treasurer
RE: PCA Report, Climate Risk Divestment Discussion
DATE: February 7, 2017

Attached you will find a copy of the PCA report entitled, "Climate Risk Divestment Discussion." The report supports previous studies by NEPC LLC and Treasury staff, stating that divestment would increase costs and add diversification and technological risk to the portfolio.

The PCA report also states that "markets now offer meaningful tools to address climate risk." I believe we should take this opportunity to explore these opportunities to move to a low-carbon economy consistent with our fiduciary responsibility.

To that end, I would like to propose some possible recommendations to be discussed at our upcoming Environmental, Social, and Governance (ESG) Subcommittee meeting. I make these recommendations as one member of the Vermont Pension Investment Committee (VPIC) and the ESG Subcommittee and recognize that other members may have recommendations for discussion. Please send recommendations to Matt.Considine@vermont.gov for inclusion on the agenda.

I would like to put forward the following for your consideration:

1. The VPIC ESG policy should be revised to include: "When conducting an investment manager search, the investment consultant shall require each prospective investment manager to disclose, in addition to its proposed investment guidelines and practices for investment selection, its ESG policies, processes and systems for identifying ESG-related value drivers and managing material ESG-related risks, to the extent the same may be applicable."

This language was provided by the Attorney General's Office in our July 2016 ESG Subcommittee meeting as well as other recommended changes to the ESG policy. The ESG Subcommittee elected to wait to make any changes to the ESG policy until the PCA report was completed. At the July 2016 meeting some changes to the body of the ESG policy were recommended by Subcommittee members as well as through public comment taken at the meeting. These need to be reviewed, but I believe that there is significant

interest in inserting the above noted clause. I believe that this is consistent with VPIC's fiduciary responsibility and the findings of Treasury Staff, NEPC LLC, and PCA.

2. PCA recommends exploring the possibility of creating a new passive investment vehicle that could be seeded by VPIC and would be consistent with our ESG policy. I would expand on this recommendation so that we pursue this and explore the possibility of working with other institutional investors together in a collaborative effort. This may provide an opportunity to bring like-minded institutional investors together to identify potential low cost, passive investment vehicles and low-carbon opportunities, consistent with existing manager selection processes.
3. Related to #2 above, I recommend working with NEPC LLC to explore ways to identify renewable energy opportunities as incorporated in asset classes or as a subset of asset classes.
4. Consistent with the PCA recommendation, I recommend working with our third-party vendors to review the feasibility of developing reporting tools on ESG factors to further our monitoring efforts. These efforts need to take into consideration costs but should also be viewed as a means to adding overall value to the portfolio.
5. I recommend that VPIC continue its dialogue with investment managers on climate change and ESG issues and prepare periodic updates. This task was last completed in 2015 and proved helpful in our dialogue. I recommend periodic updates by Treasury staff.

Within the context of our fiduciary responsibility, I do see existing opportunities to look at these issues and review potential options.

I propose the above discussion points for the next ESG Subcommittee meeting. I make these recommendations as one individual on the Subcommittee. I know other Subcommittee members will also have recommendations for this discussion. I encourage Subcommittee members to contact Matt.Considine@vermont.gov so they may be included in the agenda.

I would like to thank the work of PCA, NEPC LLC, and the Subcommittee members as well as stakeholders, interested parties and other members of the public who have been a part of these discussion over the past year.