VERMONT PENSION INVESTMENT COMMITTEE
September 24, 2013

VPIC Members Present:
STEPHEN RAUH, CHAIR
BETH PEARCE, VICE-CHAIR, Vermont State Treasurer – via telephone
ROBERT HOOPER, VSERS Representative, term expiring June 30, 2016
JOSEPH MACKEY, VSTRS Representative, term expiring June 30, 2015
STEVEN JEFFREY, VMERS Representative, term expiring June 30, 2014
DICK JOHANNESEN, Governor's Delegate, term expiring June 30, 2014
VAUGHN ALTEMUS, Governor's Delegate, term expiring June 30, 2014

VPIC Member(s) *Absent*:
None

VPIC Alternate Members Present:
KAREN PAUL, *Alternate* Governor's Delegate, term expiring June 30, 2016
KEVIN GAFFNEY, VSERS *Alternate*, term expiring June 30, 2016
THOMAS GOLONKA, VMERS *Alternate*, term expiring June 30, 2016
LINDA DELIDUKA, VSTRS *Alternate*, term expiring June 30, 2017

VPIC Alternate Member(s) *Absent*:
None

Also attending:
Stephen Wisloski, Vermont State Deputy Treasurer
Matt Considine, CFA, Director of Investments
Katie Green, Investments Manager
Jaye Pershing-Johnson, Attorney General's Office
Chris Levell, NEPC LLC
Jeff Briggs, VSERS Board member
Christopher Talbert, Teucrium Trading, LLC
Monica Chiren, Clerk

CALL TO ORDER:

The Chair, Mr. Rauh, called the Tuesday, September 24, 2013 meeting to order at 8:30 a.m., which was held in the 4th Floor Conference Room, 109 State Street, Montpelier, VT.

ITEM 1: Agenda Approval, Announcements, Minutes of August 27, 2013 Regular Meeting

The Chair, Mr. Rauh, briefly reviewed the agenda. At Mr. Wisloski's request the Chair, Mr. Rauh, indicated the Treasurer's update would be moved to the afternoon session when Ms. Pearce would be available for the discussion. The agenda was approved as amended. There were no announcements.

On a motion by Mr. Jeffrey, seconded by Mr. Altemus, the Committee unanimously approved the minutes of the August 27, 2013, Regular Meeting, as submitted.

<u>ITEM 2:</u> **Director of Investments Report and Action Items**

- **Contract Updates, Amendments and Renewals**
- **Q2 Risk Management Issues Identified**
- **Background Information on Myanmar and McBride/ Northern Ireland**
- **Plan for High Yield Transition to Guggenheim**
- **Meeting with BERS September 19, 2013**
- **Review August Flash Report**

Mr. Considine indicated as of August 31, 2013 the total VPIC assets under management were \$3.66 billion. Mr. Considine indicated as of September 30th the VPIC's portfolio allocation is projected to be 32.5% equities, 33.67% fixed income, 14.2% alternatives and 19.7% multi-strategy, compared to target allocations of 31.4%, 33%, 15.6% and 20% respectively. Mr. Considine indicated September was one of the semi-annual rebalancing periods.

Mr. Considine indicated proceeds from the sale of shares received during demutualizations in the early 2000's were deposited into the VSTRS and VMERS accounts during July and August. Mr. Considine indicated this was from the sale of MetLife and Prudential stock.

Ms. Green reviewed with the Committee members the Myanmar and McBride restrictions as provided by ISS. The Committee discussed this item further. Mr. Considine indicated he would discuss this item further with the Treasurer, and if necessary will report back to the Committee.

(Mr. Briggs entered the meeting during this agenda item.)

Mr. Levell reviewed with the Committee members the 2Q13 questions and answers. Mr. Levell answered the questions posed by the Committee members.

On motion by Mr. Mackey, seconded by Mr. Altemus, the Committee unanimously voted to enter Executive Session at 9:50 a.m. pursuant to Title 1, § 313 for the purpose of discussing contract issues.

(Mr. Briggs and Mr. Talbert left the meeting at this time.)

(The Board exited Executive Session at 10:19 a.m.)

(Mr. Briggs and Mr. Talbert entered the meeting at this time.)

The Chair, Mr. Rauh, indicated they would continue to discuss the transition to Guggenheim in the afternoon once additional information was received.

The Chair, Mr. Rauh, provided the Committee with a brief review of the recent meeting with BERS he had attended along with Ms. Pearce, Mr. Wisloski, Mr. Considine and Ms. Green.

The Chair, Mr. Rauh, indicated the August flash report would be reviewed when it became available later on in the meeting.

ITEM 3: Discussion Items/Updates

- **Vermont State Treasurer's Update**
  - **Discuss/Adopt CERES Initiative**
- **VPIC Investment Policy Statement Project Update**
- **NEPC Investment Manager Watch List: Post Advisory, Wellington EMD**

The Chair, Mr. Rauh, indicated Ms. Pearce would present the Treasurer's update in the afternoon session.

Ms. Pershing-Johnson reviewed with the Committee changes to the Investment Policy Statement. It was indicated Committee members should provide Ms. Pershing-Johnson any additional changes they would like to see incorporated into the Investment Policy Statement. Mr. Rauh indicated there was still work that needed to be done on this item.

Mr. Levell indicated there are two managers on the Watch List, Post Advisory and Wellington EMD. Mr. Levell indicated hopefully in the coming months Post Advisory would be coming off the Watch List and that Wellington EMD might come off the list by the end of the year.

ITEM 4: Comprehensive Investment Manager Reviews

- **Focus on Equity Managers – Performance Net of Fees**
- **Equity Manager Benchmarks**
- **VPIC Equity Sector Allocation Versus ACWI**

Mr. Levell reviewed in detail with the Committee the *Manager Performance Evaluation, Net of Fee Manager Return Analysis* and *VPIC Equity Sector Allocation vs. ACWI* documents. Mr. Levell responded to the questions posed by the Committee members.

(A luncheon recess was taken from 12:00 p.m. to 12:45 p.m.)

(Mr. Golonka and Ms. Paul were not present at this time.)

ITEM 5: **Director of Investments Report and Action Items – cont'd**

- **Review August Flash Report**

Since the August Flash Report was not available Mr. Levell reviewed with the Committee the *J. P. Morgan VPIC Performance Summary for Period Ending August 2013 Gross of Fee* report and indicated the August Flash Report would be provided to the Committee when it became available.

ITEM 6: **Discussion Items/Updates – cont'd**

- **Vermont State Treasurer's Update**
  - **Discuss/Adopt CERES Initiative**

(Ms. Pearce entered the meeting at this time via the telephone.)

Ms. Pearce indicated they are in the process of completing the financial statements for June 30^{th} and that the actuarial report meetings will be held at the end of October.

Ms. Pearce reviewed with the Committee the CERES (Coalition for Environmentally Responsible Economies) letter which was included in the board packet and will be attached to the minutes. Ms. Pearce indicated she was signing off on this initiative and inquired whether the Committee wanted to be included. The Committee discussed the CERES initiative.

On a motion by Mr. Altemus, seconded by Mr. Hooper, the Committee unanimously approved to endorse the CERES Initiative.

Ms. Pearce indicated she will contact CERES to include VPIC on their list.

(Ms. Pearce left the meeting at this time.)

ITEM 7: **Economic and Financial Market Dashboard**

Mr. Considine reviewed with the Committee the economic and financial market dashboard. The Committee discussed the positive and negative factors on the economic and financial market dashboard. Ms. Green reviewed with the Committee the charts on the economic and financial market dashboard.

The Committee reviewed the responses obtained from Guggenheim concerning the transition.

On a motion by Mr. Mackey, seconded by Mr. Jeffrey, the Committee unanimously approved that Guggenheim may increase the 144(a) allocation to 75%, that there would be no leverage utilized in the VPIC Portfolio, and agreed to allow the

Treasurer's Office staff to move forward with the transition plan as presented by the Treasurer's Office.

Mr. Considine reviewed with the Committee the PIMCO portfolio volatility analysis.

ITEM 8: **Public Comment/New or Other Business**

Mr. Hooper indicated he was going to attend the Super Bowl of Indexing again this year.

On a motion by Mr. Altemus, seconded by Mr. Wisloski, the Committee unanimously approved the expenses for Mr. Hooper to attend the Super Bowl of Indexing up to an amount of $2,000.

ITEM 9: **Adjournment**

On a motion by Mr. Jeffrey, seconded by Mr. Wisloski, the Committee unanimously approved to adjourn the meeting at 1:55 p.m.

Respectfully submitted,

Monica Chiren, Clerk

September 9, 2013

Attention:
[COMPANY CEO]
[COMPANY CFO]
[COMPANY LEAD INDEPENDENT DIRECTOR]

Address:
[COMPANY ADDRESS]

Re: Assessment of Carbon Asset Risk by [INSERT COMPANY HERE]

Dear [INSERT NAMES HERE],

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 institutional investors, collectively representing nearly USD 3 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,[1] requiring a stabilization of the atmospheric concentration of GHGs below 450 parts per million (ppm) carbon dioxide equivalent (CO_2e). 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_2e, corresponding to a warming of 3.6°C or more.[2] 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".[3]

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 currently 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,

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[1] "The Cancun Agreements," (2010).
[2] International Energy Agency, "World Energy Outlook 2012," (2012).
[3] The World Bank, "Turn Down the Heat: Why a 4°C Warmer World Must Be Avoided," (2012).

unless carbon capture and storage (CCS) is widely deployed."[4] 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.[5] 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 cost unconventional oil and gas production such as oil sands.[6] 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 the Carbon Tracker Initiative 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.[7] 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 greater. 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."[8] In 2011 alone, the costs of extreme weather events, which are expected to increase with climate change,[9] totaled about $170 billion globally.[10] 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.[11] 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.[12] 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-

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[4] International Energy Agency, "World Energy Outlook 2012."

[5] Paul Spedding, Kirtan Mehta, and Nick Robins, "Oil & Carbon Revisited: Value at Risk from 'Unburnable' Reserves," (HSBC Global Research, 2013).

[6] Simon Redmond and Michael Wilkins, "What a Carbon-Constrained Future Could Mean for Oil Companies' Creditworthiness," (Standard & Poors, 2013).

[7] Carbon Tracker and The Grantham Research Institute, "Unburnable Carbon 2013: Wasted Capital and Stranded Assets," (2013).

[8] National Climate Assessment and Development Advisory Committee, "Draft Climate Assessment Report," (United States Global Change Research Program, 2013).

[9] C.B. Field et al., "Managing the Risks of Extreme Events and Disasters to Advance Climate Change Adaptation," (IPCC, 2012).

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

[11] 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).

[12] Lawrence Kumins 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.

intensive assets, diversifying its business by investing in lower-carbon energy sources, or returning capital to shareholders.[13]

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.[14] 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.[15] Government policies to reduce GHG emissions would be likely to further reduce the returns of these projects.

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 request 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.;[16]
- 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 October 4, 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, 617-247-0700 x122), who is coordinating this engagement on behalf of the participating investors, and will communicate your response to the undersigned.

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[13] International Energy Agency, "Redrawing the Energy-Climate Map."

[14] Andrew Peaple, "Europe's Oil Majors Should Focus on Shareholders," *Wall Street Journal* 2013 and della Vigna, M et al. "No Light at the End of the Tunnel" (Goldman Sachs Equity Research, 2013)

[15] Rats, M et al "Why 'Big Oil' has Underperformed so Much…" (Morgan Stanley Research Europe), Syme, A et al. "Investing for Commodity Uncertainty".(Citi Research, 2013); della Vigna, M et al "Death and Rebirth of an Industry" (Goldman Sachs Equity Research, 2012)

[16] A similar question appears in: Carbon Disclosure Project, "Investor Cdp 2013 Information Request," (2013).