Wespath’s Strategic Approach to Climate Change

Avoid—Engage—Invest

a division of Wespath Benefits and Investments, a general agency of The United Methodist Church
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## About Us

Wespath Investment Management (Wespath) is the investments division of Wespath Benefits and Investments, a general agency of The United Methodist Church (UMC) with fiduciary responsibility for the benefit plans it administers and the assets it invests.

Prudent investment management decisions are an ongoing, long-term priority, supporting benefit plans for over 100,000 participants and approximately $20 billion in assets managed on their behalf, and that of many United Methodist-affiliated endowments, foundations and other institutions. This fiduciary obligation reflects the stated values of the Church and helps ensure financial, environmental and social sustainability across all investments.

A not-for-profit administrative agency of the UMC, Wespath Benefits and Investments is the largest reporting faith-based pension fund in the world, and among the top 100 pension funds in the United States. As a sustainable investor, Wespath Benefits and Investments—through its investments division—is committed to active ownership through corporate and public policy engagement, proxy voting and the management of excessive sustainability risk.
Executive Summary

Wespath Investment Management (Wespath), the investments division of Wespath Benefits and Investments, a general agency of The United Methodist Church (UMC), manages investments on behalf of clergy, lay employees, and institutions affiliated with the UMC. Our investment policy and process incorporates sustainable investment strategies that uphold our fiduciary duty while striving to honor the Social Principles of the Church.

Scientific evidence shows our climate is changing, primarily due to the accumulation of greenhouse gases such as carbon dioxide, nitrous oxide and methane—all occur from natural and man-made sources. Their effects on the earth can be measured through warming global temperatures, rising sea levels, extended droughts, and storms that are increasing in frequency and severity. Climate change also has a human toll—a burden disproportionately borne by the poor and people living in developing nations.

Our strategic response to climate change recognizes these effects as a threat to our well-being and to the investments we manage on behalf of our participants and institutional clients.

Wespath’s Avoid—Engage—Invest framework helps us prepare for and support the transition to a lower-carbon economy by identifying and prioritizing where climate change-related risks and opportunities are likely to occur.

Avoid—Engage—Invest

• Avoid—We manage excessive sustainability risks by identifying and excluding from investment companies that are most negatively affected by climate change, specifically those with significant exposure to thermal coal (coal used to make electricity).

• Engage—We work directly with companies and policymakers, encouraging them to adopt more sustainable and environmentally-sensitive business practices and policies. We do this through public policy and corporate engagement, proxy voting and the filing of shareholder resolutions.

• Invest—We urge our investment managers to consider the impact of climate change when making investment decisions on our behalf, and evaluate the degree to which they integrate environmental factors. We also invest in companies offering climate-related solutions, such as renewable energy, energy efficiency and sustainable forestry.

Supporting Climate-Resilient Markets

The world we live in is changing. As the climate changes, the way companies and policymakers adapt will be of vital importance to all long-term investors. Wespath’s Avoid—Engage—Invest framework allows us to make a contribution to addressing climate change while maintaining a diversified portfolio. We believe engaging the companies in which we invest while simultaneously deploying capital in support of low-carbon products and services will reduce investment risk, which promotes the long-term sustainability of the funds we manage on behalf of participants and institutional investors.

1 http://climate.nasa.gov/effects/
The Climate is Changing

Wespath Investment Management (Wespath), the investments division of Wespath Benefits and Investments, a general agency of The United Methodist Church (UMC), manages investments on behalf of clergy, lay employees, and institutions affiliated with the UMC. Wespath Benefits and Investments (and its predecessors) has been administering retirement plans, investment funds, and health and welfare benefit plans for over a century. Our investment policy and process incorporates sustainable investment strategies that uphold our fiduciary duty while striving to honor the Social Principles of the Church.

Scientific evidence shows our climate is changing, primarily due to the excessive accumulation of greenhouse gases such as carbon dioxide, nitrous oxide and methane. These gases occur from both natural and man-made sources, but the industrial revolution and ever-growing demand for goods and services have released more greenhouse gases than can be safely absorbed by the environment.

The effects on the earth can be measured in the air through warming global temperatures and higher concentrations of greenhouse gases in the atmosphere; at sea with melting glaciers and rising sea levels; and on land through extended droughts, floods and storms that are increasing in frequency and severity.\(^1\)

Climate change also has a human toll—a burden disproportionately borne by the poor and people living in developing nations.

Our strategic response to climate change recognizes these effects as a threat to our well-being and to the investments we manage on behalf of our participants and institutional clients.

According to the Intergovernmental Panel on Climate Change (IPCC),\(^2\) “continued emission of greenhouse gases will cause further warming and long-lasting changes in all components of the climate system, increasing the likelihood of severe, pervasive and irreversible impacts for people and ecosystems.” Furthermore, “climate change will amplify existing risks and create new risks for natural and human systems. Risks are unevenly distributed and are generally greater for disadvantaged people and communities in countries at all levels of development.”\(^3\)

Climate Change is a Material Investment Risk

What are the implications of climate change for an investment portfolio? Simply put, climate change is a material investment risk that must be managed.

For decades, governments and financial systems failed to recognize the economic impacts of greenhouse gas emissions—most notably, carbon dioxide. While some countries enacted legislation designed to address climate change, it became apparent that coordinated action on a broader scale was required. World leaders gathered to discuss a global agreement during the 21st Conference of the Parties to the United Nations Framework Convention on Climate Change (COP21),\(^4\) held in Paris in December 2015. With strong support from investors, businesses and the faith community, 195 countries agreed to establish a long-term goal to limit warming to less than 2-degrees Celsius from pre-industrial levels. The pledge that emerged from COP21 provides investors with increasing confidence to support and accelerate investment in low-carbon technologies, energy efficiency and climate change adaptation.

Companies in all sectors face risks from the physical and economic impacts of climate change—energy, utilities, industrials, financials, consumer discretionary, information technology, health care, materials—all are subject to climate change-related business disruptions and costs.

Wespath has been urging companies to create more sustainable business practices for over two decades.

Wespath’s Avoid—Engage—Invest framework helps us prepare for and support the transition to a lower-carbon economy by identifying and prioritizing where climate change-related risks and opportunities are likely to occur.

\(^1\) http://climate.nasa.gov/effects/
\(^2\) The IPCC is an international scientific body created by the United Nations Environment Programme and the World Meteorological Organization in 1988 to review and evaluate scientific, technical and socio-economic information on climate change.
\(^4\) http://ec.europa.eu/clima/policies/international/negotiations/paris/index_en.htm
“All creation is the Lord’s, and we are responsible for the ways in which we use and abuse it.”—The Book of Discipline of The United Methodist Church, 2012 ¶160

“A fiduciary duty is a legal duty to act solely in another party’s interests... A fiduciary duty is the strictest duty of care recognized by the U.S. legal system.”

“There comes a time when failure to take immediate and decisive action represents an existential threat to our well-being and that of future generations. That time is now and the issue is climate change.”—David H. Zellner, Chief Investment Officer Wespath Investment Management

5 https://www.law.cornell.edu/wex/fiduciary_duty
Avoid—Engage—Invest: An Overview

- **Avoid**—We manage excessive sustainability risks by identifying and excluding from investment companies that are most negatively affected by climate change, specifically those with significant exposure to thermal coal (coal used to make electricity).

- **Engage**—We work directly with companies and policymakers, encouraging them to adopt more sustainable and environmentally-sensitive business practices and policies. We do this through public policy and corporate engagement, proxy voting and the filing of shareholder resolutions.

- **Invest**—We urge our investment managers to consider the impact of climate change when making investment decisions on our behalf, and evaluate the degree to which they integrate environmental factors. We also invest in companies offering climate-related solutions, like renewable energy, energy efficiency and sustainable forestry.
Wespath’s Strategic Approach to Climate Change—Avoid

Wespath has long believed that sustainability issues can present investment risks. To address these risks, we implemented a climate change investment guideline in 2015 that resulted in excluding from investment thermal coal companies that had negative environmental impact and poor financial performance.

Our research showed that developed nations are shifting away from electricity generated from thermal coal to other fuel sources. Thermal coal is the most carbon-intensive fossil fuel. We believe that coal will be heavily taxed in many markets or significantly replaced by alternative fuel sources—absent the development of technologies to mitigate coal’s environmental impact. This could result in a meaningful deterioration in the value of securities in companies that derive a significant portion of their revenues from the production and consumption of thermal coal.

The implementation of our Climate Change guideline resulted in the exclusion of:

- mining companies in developed countries deriving greater than 50% of revenue from extraction and/or mining of thermal coal; and
- electric utilities in developed countries deriving 75% or more of their fuel mix from thermal coal.
Wespath’s Strategic Approach to Climate Change—Engage

Engaging Corporations—The Heart of Wespath’s Climate Change Strategy

In our experience, actions designed to mitigate the impact of climate change, or adapt to it, align with the interests of long-term shareholders. For more than 20 years, we—along with other sustainable investors—have persuaded companies to adopt reasonable, cost-effective, climate-related strategies, such as:

• improving energy efficiency in their facilities and operations;
• increasing the use of renewable energy; and
• setting greenhouse gas reduction goals and monitoring the results.

Dozens of the world’s largest companies are now either carbon neutral or have announced plans to be 100% sourced by renewable energy. The list includes industry giants such as Unilever, Microsoft, Procter & Gamble, Deutsche Bank, Walmart, Marks & Spencer, Nestle, and BNY Mellon—all of which are in our investment funds.

Our ongoing engagements include meaningful discussions with the world’s largest publicly-traded oil and gas companies about their role in supporting an orderly transition to a lower-carbon economy.

Reliance on carbon-based fossil fuels is deeply embedded in our society—they help light our homes and power our cars. However, we engage the fossil fuel industry because we believe it can use its capital and technical expertise to become part of the climate-change solution.

We use our voice to hasten the transition to a low-carbon future. Many of Wespath’s climate change engagements have been successful:

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<td><strong>Pulte Homes</strong>—report on its efforts to reduce greenhouse gas emissions from its products and operations (2009)</td>
<td>Provided greenhouse gas emissions data in its annual report and accelerated its energy efficiency programs. Nearly 70% of Pulte’s homes today are built to Energy Star standards.</td>
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<td><strong>Halliburton</strong>—report on its strategy to compete in a low-carbon economy (2009)</td>
<td>Described its development of carbon capture and storage technology on its website.</td>
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<td><strong>ConocoPhillips</strong>—“stress test” its oil and gas reserves and report the projected resilience of its assets in a variety of price and demand scenarios (2013)</td>
<td>Disclosed the results of the “stress-test” and resilience of its assets on its website—the first major U.S. oil and gas company to do so.</td>
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<td><strong>Anglo American</strong> and <strong>Rio Tinto</strong>—report on their strategic resilience in five key climate-related areas. Wespath co-filed shareholder resolutions in collaboration with global investors (2016)</td>
<td>Both resolutions had the backing of management and passed with overwhelmingly strong support—96.25% of shareholders voted in favor of the Anglo American Resolution; Rio Tinto received a vote of 99.16%.</td>
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<td><strong>Chevron</strong> and <strong>Occidental Petroleum</strong>—“stress test” their portfolios in anticipation of a lower-carbon future (2016)</td>
<td>Chevron’s resolution received a 41% vote in favor while Occidental’s received a 49% vote. Both outcomes reflect an unprecedented show of support for first-time filings.</td>
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6 http://www.sustainablebusiness.com/index.cfm/go/news/display/id/26424
Engaging Public Policy Makers

Wespath recognizes that companies operate under environmental guidelines set by legislators and regulators at the global, national and regional levels. Therefore, we engage policymakers—urging them to support cost-effective policies that promote sustainable markets:

Global
- Sent a letter jointly signed by the General Secretaries of four United Methodist general agencies to global policymakers at COP21, declaring support for a climate deal that limits warming to less than 2-degrees Celsius
- Joined global investors representing $12 trillion in assets, in sending a letter to G7 finance ministers requesting economic policies that stimulate low-carbon business opportunities

Outcome: At COP21, 195 countries adopted the first-ever universal, legally binding global climate deal that seeks to limit warming to 2-degrees Celsius

National
- Spoke at two Environmental Protection Agency (EPA) public hearings in support of ultra-low sulfur diesel fuel and higher fuel standards for light- and medium-duty trucks—in both instances, Wespath was the only investor voice in the room

Outcome: Both rules were enacted

Regional
- Joined other investors in asking the Premier of Alberta Canada (home to Canada’s oil sands industry) to strengthen the province’s climate change framework

Outcome: Alberta’s government announced a comprehensive climate change plan that includes closing coal-fired power plants, phasing in renewable energy, and increasing the province’s carbon tax

In April 2016, 175 of the parties that backed the climate agreement at COP21 attended a signing ceremony at the U.N. Countries have until April 2017 to officially sign the accord.

United Nations Secretary-General Ban Ki-moon (left) speaks to the press on April 22, 2016 following the Signing Ceremony for the Paris Agreement on Climate Change that resulted from COP21. On the right is Christiana Figueres, the Executive Secretary of the U.N. Framework Convention on Climate Change (UNFCCC).
Leveraging External Managers

Most of Wespath’s broadly diversified funds are invested through external asset management firms. We expect these managers to consider climate change-related risks and opportunities in the investment decisions they make on our behalf. We piloted a benchmarking analysis in 2012 of how our managers are integrating environmental, social and governance (ESG) factors, including climate change. We share the result of our assessments with managers each year in an effort to increase integration of ESG factors.

Deploying Capital

Wespath believes companies that are positioned to benefit from a low-carbon global economy are attractive long-term investments. We deploy capital in support of climate solutions.

- **Low-Carbon Energy Solutions**—Wespath dedicated $250 million in 2016 to investments in companies providing low-carbon products and services, such as energy efficiency, renewable energy, water infrastructure and pollution control. Our investments specifically focus on companies providing solutions to challenges arising from climate change.

- **Low-emissions Leaders**—Wespath invests in low-emitting or carbon neutral companies such as electric vehicle manufacturer Tesla and ST Microelectronics. We also have exposure to renewable energy through non-traditional green energy producers. Companies like Amazon.com and Google, for example, are building their own, localized renewable energy power centers.

- **Infrastructure**—Companies in Wespath’s funds are helping to modernize infrastructure and develop innovative ways to deliver cleaner energy. Clean Energy Fuels Corp. has constructed approximately 70% of the automotive natural gas fueling stations in the U.S.\(^8\) In addition, ABB, Siemens and General Electric are developing “smart grids” that efficiently manage electric supply and demand.

- **Green Bonds**—These bonds are used to fund projects that have positive environmental benefits. Nearly $42 billion in green bonds were issued in 2015—a dramatic increase from $11 billion just two years earlier.\(^9\) Wespath has added green bonds to our portfolio and we expect to increase investments in these assets as more attractively-priced bonds become available.

- **Sustainable Forestry**—Wespath invests in a North American sustainable forestry fund that is certified by the Forest Stewardship Council (FSC). To achieve FSC certification, the forest must be managed in ways that are environmentally, socially and economically sustainable.

\(^8\) [https://www.cleanenergyfuels.com/services/engineering-and-construction/](https://www.cleanenergyfuels.com/services/engineering-and-construction/)

Conclusion—Supporting Climate-Resilient Markets

The world we live in is changing. As the climate changes, the way companies and policymakers adapt will be of vital importance to all long-term investors.

Wespath’s Avoid—Engage—Invest framework allows us to make a contribution to addressing climate change while maintaining a diversified portfolio. There will likely be disruptions as financial markets adapt to the effects of carbon regulation. We believe engaging the companies in which we invest while simultaneously deploying capital in support of low-carbon products and services will reduce investment risk, which promotes the long-term sustainability of the funds we manage on behalf of participants and institutional investors.