THE PENSION FUND COALITION FOR INCLUSIVE CAPITALISM

An initiative of the Coalition for Inclusive Capitalism and the Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School

Coalition for INCLUSIVE CAPITALISM

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Pension Fund Coalition for Inclusive Capitalism

Pension funds hold powerful levers for change by investing trillions globally for retirees across markets and portfolios, facing environmental and social challenges.

Yet, many can lack standard legal tools to direct how — or whether — their asset managers consider ESG criteria to invest in sustainable businesses and create long-term value.

To address this gap, the Pension Fund Coalition for Inclusive Capitalism convened pension fund managers, as well as legal and other advisors, to develop model a ESG contract establishing minimum ESG guidelines in funds' investment agreements with managers.

Flexible across a range of scenarios, approaches and public or private markets, model language offers portfolio and legal teams pragmatic tools for directing asset manager to invest in line with their ESG priorities, including:

Model Mandates

- Individualized approaches
- Standardized approaches
- Criteria-based approaches
- ESG-related commitments

Voting Rights

- Proxy language
- Investor rights
- Manager guidelines
- Record disclosure

Reporting

- Regular requirements
- Interim updates
- Diligence and research
- Adverse developments

Factors and Criteria

- ESG factors
- Sample language
- Engagement guidelines
- Investment restrictions

>> Download the Resources

CoalitionforInclusiveCapitalism.com/pension-coalition

Model ESG Contract Language: Introduction

- The model provides customizable language **establishing minimum ESG guidelines** that can be used as a baseline for negotiations with investment managers
- The model ESG contract language is meant to apply to **active asset managers in public equities or private investment funds**, and not to passive index funds
- Its ESG provisions are designed to be inserted into a broader investment agreement with an asset manager
- The model language strives to provide **flexibility and a variety of options** (ranging from restrictive approaches to middle-of-the-road approaches) which fit a range of different priorities, focus areas and investment needs
- However, it is not a one-size-fits-all provision, and will require tailoring depending on the situation
- Depending on each organization's specific circumstances and situation, the model ESG language may need significant revisions; Each investor should consult with their legal counsel in determining how or to what extent to use the model ESG language
- Key clauses address the following topics: **ESG Mandate, Proxy Voting Rights, Reporting Requirements and Sample ESG Factors and Criteria**

The following slides include excerpts from the model public equities model contract, which is freely available, alongside private equity versions and further guidance, as documents at CoalitionforInclusiveCapitalism.com/pension-coalition

A. Model ESG Mandate

APPROACH #1 Investors with individualized ESG investment policies/ guidelines	Manager hereby acknowledges that: Investor has informed Manager of its desire to invest in a responsible manner that takes into account [and prioritizes] Environmental, Social and Governance ("ESG") criteria, and confirms that it is aware that Investor has endorsed a list of ESG criteria as set forth in Exhibit A attached hereto (the "ESG Policy"). Manager hereby acknowledges receipt of the ESG Policy and agrees that Manager will, and will ensure that any assignee or subcontractor will [consider] / [incorporate] / [comply with the guidance set forth in] the ESG Policy [into] / [in] its investment decision making processes. [Manager will, upon request of Investor on a quarterly basis, confirm that it has complied with this clause for the prior quarterly period preceding such request.] Investor may update the ESG Policy periodically, in connection with its internal policies and procedures, and will provide the Manager with such updates promptly. The Manager agrees to take such updates into account in connection with any future investments. In the event that Manager is not able to comply with the updated ESG Policy, Investor and Manager shall have good faith discussions and work to agree on a compromise.
APPROACH #2 Investors preferring to rely on standardized metrics and ratings	Manager hereby acknowledges that: Investor has [committed to the application of][is a signatory to] the [United Nations Principles of Responsible Investing ("UNPRI")] / [UN Guiding Principles on Business and Human Rights ("UNPBHR")] / [Task Force on Climate-related Financial Disclosures ("TCFD") guidelines] / [International Sustainability Standards Board principles] / [The Value Reporting Foundation's Integrated Thinking Principles, Integrated Reporting Framework and/or SASB Standards] / [Global Reporting Initiative Sustainability Reporting Standards ("GRI")], and the Investor [is committed to] / [requires] the [application of]/[compliance with] these Environmental, Social and Governance ("ESG") [criteria] / [metrics] / [standards] / [considerations] / [operations guidelines] / [disclosure frameworks] [with respect to investment managers] / [with respect to potential portfolio companies] to the management of its Investment Account. OR: Investor has committed to investing in companies that [promote the United Nations Sustainable Development Goals ("UN SDGs")]/[materially comply with or otherwise satisfy the requirements of [the ICMA green and/or social bond principles]/ [[certain portions of] the European Commission's ten-step action plan with respect to "green financial products"]/[receive a rating equal to or above [___] as evaluated under [ISS's E&S Score]]/[State Street's R-Factor]/[MSCI's ESG Rating]/[S&P's Global ESG Score as calculated from their Corporate Sustainability Assessment] / [Sustainalytics ESG Risk Rating] / [Vigeo Eiris ESG Rating].

** example excerpts from public equities model contract*

A. Model ESG Mandate (cont'd)

Manager's Obligation	
Manager to incorporate ESG criteria in investment decisions	Manager agrees to, and will ensure any assignee or subcontractor will, comply with all applicable laws and regulations relating to sustainable investing, [consider] / [incorporate] / [uphold] / [comply with the guidance set forth in] the above [ESG Principles]/[ESG criteria] in its investment decision making processes, consistent with and in acknowledgement of Investor's [commitment to socially responsible investing]/[status as a signatory of the [UNPRI]/[Impact Principles]/[ESG Principles]], [as articulated in Investor's ESG investment beliefs and the Guiding Principles provided to the Manager, attached hereto as Exhibit A.]

** example excerpts from public equities model contract*

B. Proxy Voting Rights

APPROACH #1 Investor Retains Voting Rights	Manager will assist, as required, Investor in exercising the Voting Rights attached to any voting class securities in each Investment Account. [Within a [reasonable time] / [[ ] business days] following each annual meeting of stockholders [and any special meeting of stockholders] of any entity for which Investor holds voting class securities with attached Voting Rights, Manager shall furnish to Investor, in writing, [(i)] a complete voting record reflecting all of the votes cast by Manager on behalf of Investor for each item of business voted on at such meeting [and (ii) a report on how Manager cast its discretionary votes at all of Investor's portfolio companies on behalf of other asset owners whose portfolios are managed by Manager].]
APPROACH #2 Manager Votes According to Investor's Guidelines	Manager shall exercise the Voting Rights attached to any voting class securities in each Investment Account in accordance with the voting guidelines [attached hereto as Annex [ ]] / [provided in writing to Manager by Investor]. [Within a [reasonable time] / [[ ] business days] following each annual meeting of stockholders [and any special meeting of stockholders] of any entity for which Investor holds voting class securities with attached Voting Rights, Manager shall furnish to Investor, in writing, a complete voting record reflecting all of the votes cast by Manager on behalf of Investor for each item of business voted on at such meeting [and, with respect to any ESG proposals voted on at any portfolio company of Investor, confirmation of whether Manager voted inconsistently with how Manager voted on behalf of Investor with respect to shares managed for other asset owners].
APPROACH #3 Manager Retains Voting Rights	[Upon reasonable written request from Investor, Manager shall provide written notice to Investor describing [the anticipated voting decisions to be made by Manager]/[any anticipated voting decisions that deviate from [management's recommendations]/[ISS's, Glass Lewis's or another identified proxy advisory firm's recommendations] with respect to the voting class securities in each Investment Account. Should Investor [taking into account Manager's fiduciary duty] believe that a specific proxy should be voted a particular way, Investor may, within [__] business days of receipt of such notice, contact the Manager to discuss the Investor's viewpoint and rationale, and, if Investor so chooses, make a request to change any voting decision. The Manager will retain the right to vote the proxy; however, in the event the Manager does not vote in accordance with Investor's recommendation, it shall provide the Investor, in writing, an explanation of the rationale for Manager's vote.]Within a [reasonable time]/[[ ] business days] following each annual meeting of stockholders [and any special meeting of stockholders] of any entity for which Investor holds voting class securities with attached Voting Rights, Manager shall furnish to Investor, in writing, a complete voting record reflecting all of the votes cast by Manager on behalf of Investor [and the final voting results] for each item of business voted on at such meeting.]

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C. Reporting Requirements

Baseline Reporting Reporting Requirements on a Regular Basis	Manager shall, within 45 days after the end of each calendar [year] / [each quarter], deliver a report [("Annual Report")] / [("Quarterly Report")] to Investor detailing Manager's investment and management activity on behalf of Investor and compliance with [the ESG Investment Considerations] / [the ESG Policy] / [clause [(a)] of this Agreement]. Such report shall, at minimum, include discussion of [(i) Manager's process of conducting research and diligence on and tracking ESG activities of portfolio companies, (ii) any stewardship activities conducted by Manager as part of their asset management activities, and (iii) material developments in ESG matters at portfolio companies in which Manager currently holds or has held a material position in the prior [calendar year] / [quarter] with respect to Investor's Investment Account ("Material Portfolio Companies"), in each case in a format generally consistent with [(and no less detailed in any material respect than)] the form reporting template attached hereto as Exhibit B.] [Manager shall promptly advise Investor in writing of any changes or planned changes to its research, diligence or tracking process involving ESG criteria.
Additional Reporting Additional Interim Reports on Material Developments	[Upon Investor's reasonable request and]] [subject to applicable legal, regulatory and confidentiality obligations] In addition to the Annual Report, Manager shall use [best] / [reasonable best] / [commercially reasonable] efforts to notify Investor in writing with additional interim updates on any material adverse developments relating to ESG matters in portfolio companies, as soon as practicable [after becoming aware of such developments] / in sufficient detail for Investor to understand the additional risks to its investment involved in such an adverse development, and provide updates on any corrective action that has been taken in respect thereof.

** example excerpts from public equities model contract*

Exhibit A-1: Examples of ESG Factors

SAMPLE LANGUAGE #1

We believe that responsible corporate behavior with respect to environmental, social and governance ("ESG") factors generally has a positive influence on long-term financial performance. As a long-term investor, we consider ESG factors in making investment decisions, with a particular emphasis on the below list of priorities. In analyzing the opportunities and risks inherent in any investment, we look to identify and mitigate ESG factors that are, or could become material to long-term financial performance. ESG opportunities and risks are monitored throughout the life of the investment.

- Prior to investment, Manager should perform an assessment of the ESG risks or opportunities of such investment, including due diligence of public disclosures, relevant company documents and any research materials from third party service providers, as well as direct engagement.
- We believe that active engagement is usually preferable to screening stocks or investments (beyond the investment restrictions set forth under the contract), a process by which certain companies or entire industries can be precluded from consideration for investment based on ESG factors. Divestment may be appropriate when exhaustive engagement has not resulted in satisfactory progress or risk mitigation.
- Manager should engage in a direct dialogue with companies to discuss concerns on ESG risks, in light of relative risk and size of holdings. All direct engagement activities should have a view towards the ultimate benefit to the value of our holdings. Our preference is to conduct direct engagements privately.
- Proxy voting is an important component of our public equity engagement process. We have adopted Proxy Voting Guidelines addressing the areas of corporate governance in which we may be requested to vote from time to time and the principles on which we will rely, at least initially, in determining a response to such requests. Our Proxy Voting Guidelines are available at [website address].

We expect companies in which we invest, directly and indirectly, to not only comply with all applicable legal and regulatory regimes, but also use [reasonable best efforts / commercially reasonable efforts to] adhere to international best practices (including [UN Principles of Responsible Investing ("UNPRI")] / [UN Guiding Principles on Business and Human Rights ("UNPBHR")] / [Task Force on Climate-related Financial Disclosures ("TCFD")] / [International Sustainability Standards Board Principles] / [The Value Reporting Foundation's Integrated Thinking Principles, Integrated Reporting Framework and/or SASB Standards / [Global Reporting Initiative Sustainability Reporting Standards ("GRI")] / [Science Based Targets ("SBTs")]) while implementing ESG policies.

** example excerpts from public equities model contract*

Exhibit A-1: Examples of ESG Factors (cont'd)

SAMPLE LANGUAGE #2

As a long-term investor, we proactively address and consider ESG factors as part of our investment strategy. In particular, we focus on:

- Biodiversity
- Board quality and composition
- Climate change
- Community engagement
- Conduct, culture and ethics
- Diversity, equity and inclusion
- Executive compensation
- Health & safety
- Human capital management
- Natural resource efficiency
- Pollution & waste reduction
- Product safety
- Risk management, cybersecurity and data privacy risks
- Shareholder protections and rights
- Supply chain risks
- Social justice, including but not limited to [social, economic, racial, gender, sexual orientation, gender identity, access and other forms of inequality]
- [As examples that may be included, but Investor can tailor this list as appropriate] [...]

[In making decisions with regards to investments, Managers should perform an ESG assessment based on (but not limited to) the above factors, including due diligence of relevant company documents, public disclosures and any research materials from third party service providers, and an evaluation of the ESG risks and opportunities any potential company presents that may impact long-term value. We expect any companies considered to not only comply with all applicable legal and regulatory regimes, but also adhere to international best practices (including [UN Principles of Responsible Investing ("UNPRI")] / [UN Guiding Principles on Business and Human Rights ("UNPBHR")] / [Task Force on Climate-related Financial Disclosures ("TCFD")] / [International Sustainability Standards Board Principles] / [The Value Reporting Foundation's Integrated Thinking Principles, Integrated Reporting Framework and/or SASB Standards] / [Global Reporting Initiative Sustainability Reporting Standards ("GRI")] / [Science Based Targets ("SBTs")]) while implementing ESG policies.]

** example excerpts from public equities model contract*

Exhibit A-2: Examples of Investment Restrictions

EXAMPLE #1 BROADER GUIDELINES

The Manager acknowledges that the Investor is subject to investment policies (the “Policies”) precluding its participation in any investment in (a) [___], (b) [___], and (c) [____] (the “Prohibited Investments”). Accordingly, as required by each of the Policies, the Investor shall be excluded from Prohibited Investments and therefore shall not have to contribute to the Manager capital (including expense contributions) in respect of a Prohibited Investment or any follow-on investment thereto. The Investor shall have the right to ask questions and receive additional information about any proposed investment as may be reasonably necessary for it to independently determine whether a proposed investment is a Prohibited Investment.

Managers should not invest in the following:

- companies whose principal field of activity is the production of cluster munitions, biological weapons or chemical weapons
- companies whose principal field of activity is the production of nuclear weapons (excluding companies that are only engaged in transactions with countries that are approved by the United Nations for the purpose of holding and maintaining existing nuclear weapons)
- any company engaged in a transaction violating the Treaty on the Non-Proliferation of Nuclear Weapons
- any securities categorized as tobacco under code 302030 of the Global Industry Classification Standard
- companies operating casinos and other types of gaming/gambling operations including online gambling/gaming
- companies operating in the Adult Entertainment sector
- companies that perform animal testing
- companies that manufacture, sell, purchase or use weapons, platforms for weaponry or material parts of a weapon or platform for weaponry
- companies that derive [material] / [substantial] revenue from the operation of privatized incarceration facilities

** example excerpts from public equities model contract*

Exhibit A-2: Examples of Investment Restrictions (cont'd)

EXAMPLE #2 DETAILED GUIDELINES

Managers should not invest in companies in the following industries and sectors:

Chemicals

Companies that [directly or indirectly] manufacture:

a) Chemical weapons.

b) Chemicals prohibited in Annex A of the Stockholm Convention, an international agreement on persistent organic pollutants (POPs) which create severe health impacts, such as cancer.

c) Chemicals which are inconsistent with Annex III of the Rotterdam Convention, an international agreement on hazardous pesticides and industrial chemicals.

Fossil Fuel-related Energy

Companies that [directly or indirectly] support:

a) Specific operations or projects in UNESCO World Heritage Sites or wetlands listed by the Ramsar Convention on Wetlands.

b) New coal-fired power plants, including expansions, where individual units have a gross generating capacity of 500MW or more, and:

   i. carbon intensity exceeds 850g CO2/kWh; or

   ii. the plant is in a developed country and its carbon intensity exceeds 550g CO2/kWh. With existing technologies, this may effectively prohibit new coal-fired power plants without acceptable CCS plans or without material benefits from either combined heat and power (CHP) or biomass.

[For the avoidance of doubt, indirect support includes (but is not limited to), investments such as general purpose investments, where the use of proceeds is known and materially supports prohibited activities.]

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