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Proxy Voting Guidelines for External Managers

Topic: **Environmental Issues**
Subtopic: **Water Risk in Operations and Supply Chains**
Approved: **March 1, 2021**

Description:

Resolutions on this topic ask companies to address water risk in their direct operations or in their supply chains. Such resolutions may request that a company report on water risk management, implement a policy to reduce their climate-related water risk, or reduce water pollution through their supply chains.

Topic background:

Water is an essential component in agricultural and industrial operations and production. Agriculture is the largest commercial water user. Climate change is altering the reliable replenishment of water resources; at the same time, population growth, rising incomes and standards of living, and ongoing economic competition are increasing the demand on water supplies. As a result, many companies are beginning to identify material financial risks associated with water, and the World Economic Forum lists "Water Crisis" as a top-10 risk for companies in terms of both likelihood and impact.[1]

Companies may face a wide variety of water risks, including physical water risk (droughts and floods), declining water supply, water supply pollution, and conflict with other stakeholders. Companies must also consider the material effect of changes in regulation aimed at managing such risks and the reputational risks of their water management choices. According to Ceres, groundwater resources are being overexploited in economically important regions around the globe.[2] As an example, in China, the majority of the country relies on polluted groundwater and water shortages are common.[3] Companies that manage water sustainably will be better positioned in the long run for preserving operational continuity during water-stressed periods[4], for example, by reducing costs through water conservation and recycling.

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[1] World Economic Forum, *The Global Risks Report 2020*, https://www.weforum.org/reports/the-global-risks-report-2020
[2] For more information, including case studies see the Ceres *Investor Water Toolkit,* https://www.ceres.org/resources/toolkits/investor-water-toolkit/details#water-risk-drivers
[3] PRI Case Study: *Mitigating community concerns*, by MFS Investment Management, https://www.unpri.org/listed-equity/managing-water-risks-to-mitigate-community-concerns/2809.article
[4] As part of the Harvard Sustainability Plan, the University committed to the goal of reducing water use by 30% by 2020 from a 2006 base line. For more information see, https://green.harvard.edu/topics/water

Companies in the agriculture and semiconductor production sectors face direct exposure to water risk in their operations. Companies in many sectors, including biofuels, steel production, packaged foods, and textiles, face indirect exposure to water risk in their commodity supply chains. Investors consider a number of factors in evaluating a company's exposure to water risk, such as which commodities they are reliant on, how water-dependent their operations may be, and whether their operational or supply chain footprint includes water-stressed regions. To understand the steps a company has taken to mitigate its water risk, investors may consider how the company engages on water issues with its supply chain and other stakeholders. Investors may also look for water efficiency target setting, monitoring of water resources, and any water governance mechanisms. Depending on a company's water risk exposure, investors may also seek to determine whether a company has developed a water scarcity plan or performed third-party water risk assessments.

Considerations for voting:

- In general, we support well-constructed proposals on the reporting of policies and programs to prevent and mitigate water risk at companies for which direct financial and reputational risks can be clearly identified. In addition, we might favor supporting such proposals at companies facing indirect water risk, in, for example, the supply chain.
    - Harvard Management Company explicitly includes assessment of material ESG risks, including water risk, in its portfolio risk assessment, and its board includes consideration of ESG risks in its oversight of material risk. For this reason, we generally support proposals that constructively direct a company's attention to material water risks.
- In reviewing requests for companies to report or take action on water risks, it is helpful to consider whether a company's current practices or targets are robust, and whether the company may be lagging other industry participants or peers.
- We generally recommend opposing proposals that encroach upon management's discretion to conduct ordinary business by imposing highly prescriptive requirements or mandates or recommending actions in conflict with the company's core business.
- All reports should be prepared at reasonable cost and omit proprietary information

Illustrative examples of votes:

1. Vote <u>in support</u> of resolutions that ask companies to report, using quantitative indicators where appropriate, their policies and practices to reduce climate-related water risk and prepare for water supply uncertainties associated with climate change.
2. Vote <u>in support</u> of resolutions that ask a company to report to shareholders on quantitative metrics, such as those identified by the Carbon Disclosure Project (CDP), the Sustainability Accounting Standards Board (SASB) or Global Reporting Initiative (GRI),

to allow tracking of water stress trends and impacts that are expected to be exacerbated by climate change.

3. Vote in support of resolutions that ask a company to provide a report assessing plans to increase the scale, pace, and rigor of its efforts to reduce water pollution from its supply chain.
4. Vote against resolutions that prescribe particular pathways to mitigate specific risks that are not related to the company's long-term financial sustainability.

Harvard offers broader general guidance on its recommended approach to considering shareholder resolutions in "Overview of Harvard University's Proxy Voting Guidelines for External Managers" (follow link to download full text). When determining votes on resolutions, we consider each resolution in light of this general guidance as well as in light of a resolution's specific request and contextual information about the relevant company and its approach to the issue.