PRESIDENT AND FELLOWS OF HARVARD COLLEGE
CORPORATION COMMITTEE ON SHAREHOLDER RESPONSIBILITY

OFFICE OF THE GOVERNING BOARDS
(617) 495-1534

LOEB HOUSE, 17 QUINCY STREET
CAMBRIDGE, MA 02138

Proxy Voting Guidelines for External Managers

Topic: **Environmental Issues**
Subtopic: **Reporting on Climate Change**
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Description:

Resolutions that ask companies to report on business risks associated with climate change and the potential impacts of these risks upon their business activities, as well as plans to address such risks. Such resolutions may reference the goal (expressed in the Paris Agreement) of limiting global temperature rise to well below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit temperature rise to 1.5 degrees Celsius.

Topic background:

Recent Intergovernmental Panel on Climate Change (IPCC) reports make it clear that anthropogenic greenhouse gas emissions are driving an increase in average global temperatures and an associated increase in severe and damaging weather events.[1] Additionally, resulting permafrost thaw, loss of seasonal snow cover, and melting glaciers will only amplify the problem. Shareholder proposals on climate change reporting reflect not only grave concern about the threat climate change poses to society, but also an understanding, from an investor perspective, that the effects of climate change, and of policies to address climate change, pose material financial risks for unprepared companies. Conversely, shareholders may view companies with robust climate change mitigation or adaptation strategies as positioned for longer-term competitive advantage. Shareholder proposals regarding the business impacts and risks of climate change describe these risks in two keys ways. “Transition risk” refers to the business impact of policies and commercial technologies that will move the world economy toward reduced carbon fuel use and greenhouse gas emissions. As implemented by individual nations, policy-based goals such as those set forth in the Paris Agreement would affect supply and demand for carbon-based energy. Commercial advances include increasingly competitive renewable energy and energy efficient technologies with the potential to win broad acceptance in the market. “Physical climate risk” includes the potential for increased frequency or scope of severe weather events, such as droughts, wildfires, storms, and flooding, or ecosystem loss, and the effect on a company’s operations, infrastructure, or supply chain.

[1] For more information, please see the IPCC’s Sixth Assessment Report - Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change

Considerations for voting:

- While uncertainties surround the timing and impact of climate change on business activity, as well as the likely form of relevant policies and regulations, the scientific consensus about the progress of climate change makes it clear that it is in shareholders' best interests to understand how companies view – and are planning for – the risks a changing climate poses for their business.
- Energy companies in particular face uncertainty surrounding the timing of any shift away from fossil fuels towards other energy sources and the impact such shifts may have on their businesses. Shareholders have reason to take seriously the prospect of reducing demand for carbon-emitting energy sources, to believe that it is prudent for companies to share information on their plans to adapt to an economy with decreasing reliance on fossil fuels, and to better understand how companies are anticipating the physical risks of an altered climate and associated extreme weather events and other disruptions.
- We understand that shareholder interest should extend beyond the energy industry to many other industries, given the likely impacts of climate change on energy, infrastructure, and supply chains. For example:
    - Shareholders in insurance companies may seek information on planning regarding the cost of increased extreme weather events.
    - Shareholders in food and beverage companies may seek information on planning regarding agricultural supply chain disruptions.
    - Shareholders in companies with plants and equipment in areas vulnerable to flooding and wildfires may welcome information on plans to adapt or relocate such assets.
- Given the broadly recognized frameworks for reporting sustainability related disclosures such as CDP (formerly the Carbon Disclosure Project) and the Task Force on Climate-related Financial Disclosures (TCFD), which have been shaped with input from industry experts and investors, reasonably constructed shareholder requests on climate change risk reporting should not pose an undue burden. In addition, reports based on such frameworks offer shareholders the opportunity to compare reporting among companies.
- Generally, we recommend supporting proposals that ask companies to report on climate-change-related business risks and upon plans to address those risks, and particularly encourage support of well-crafted proposals to companies that appear to be lagging behind their peers on climate change issues. Such proposals seem prudent and relevant to a valid shareholder interest in fully understanding the climate risks a company faces and its perspectives on managing them.

- At the same time, we have tended to oppose or abstain on proposals that encroach upon management's discretion to conduct ordinary business by imposing highly prescriptive requirements for policies or plans to address climate change.
- Similarly, we counsel caution with proposals that direct companies to take actions contrary to their core business focus and strategy, such as demanding that an energy company provide a capital distribution to compensate shareholders for assets such as oil reserves that may, in future, become "stranded" (lose their book value).
- Understanding and considering climate-related impacts aligns with Harvard University's institutional efforts and the Harvard endowment's net-zero pledge.[2]

Illustrative examples of votes:

1. Vote in support of well-constructed resolutions requesting that a company report on risks posed by climate change. Examples of such resolutions might include those that request a company to:
   - Report risks and opportunities for business operations that could be materially impacted by, or a significant contribution to, climate change.
   - Provide an explanation of how the board oversees and manages climate-related risks and opportunities.
   - Report on its understanding of the implications of aligning business operations with either a well below 2 degree or 1.5 degree Celsius scenario[3] as outlined in the Paris Agreement.
2. Vote against resolutions that direct companies to take actions contrary to their core business focus and strategy.

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.

[2] In April 2020, the Harvard Corporation directed HMC to set the endowment on a path to achieve net-zero greenhouse gas (GHG) emissions by 2050. The pledge can be viewed here.

[3] Requests for company scenario analysis have often aligned with the goal of limiting global temperate rise to well below two degree Celsius (2°C) above pre-industrial levels, as outlined in the Paris Agreement. There are publically available resources on climate change scenarios, for example, from the International Energy Agency (IEA), the World Resource Institute (WRI), the Food and Agricultural Organization of the U.N.'s Modelling System for Agricultural Impacts of Climate Change (MOSAICC) and the Intergovernmental Panel on Climate Change (IPCC).