

Sustainability in Capital Markets

Financing the transition to a sustainable
low-carbon economy

Pension Funds Case Study – Wespath Benefits and Investments



Wespath Benefits and Investments

Wespath Benefits and Investments is a nonprofit pension fund and a general agency of the United Methodist Church (UMC). Created by the UMC's legislative body, the General Conference, Wespath provides over 100,000 UMC members with pension and benefit programs. Additionally, it provides investment services to 150 UMC-related institutional investors. With over \$24 billion in assets under management (AUM), Wespath is one of the largest faith-based pension funds in the world.

Wespath's mission is for its investments to have a positive financial, social and environmental impact, while upholding UMC values. In the words of Wespath's General Secretary and CEO, Andy Hendren, describing its approach to sustainable investing: *"We focus always on our core fiduciary obligation to our participants and investors to maximize returns—seeking alpha, or excess returns compared to our performance benchmarks, wherever we can. And we seek to 'raise the beta'—a strategy to reduce the systemic risks of financial markets and improve market-wide returns—in hopes of lifting all boats in a way that reaps the additional returns needed to care for those we serve. Importantly, we believe lifting all boats also moves the world toward a more sustainable future."*ⁱ



The Wespath Fiduciary Committee approves the Investment Policy, which sets the structure and purpose of the investment program. It also approves new investment funds, asset classes and investment strategies; monitors investment performance and fund risks; and ensures that fiduciary duties and a commitment to UMC Social Principles are carried out in its sustainable investment program.

System-level investing strategy related to climate change

Wespath takes an “invest, engage, avoid” approach to its investment strategy. This approach combines conventional and sustainable investing techniques with system-level techniques to manage risk and abide by the Wespath investment philosophy (expanded upon below).

The Wespath Sustainable Economy Framework has an important influence on its investment strategy. The framework outlines a vision of “*long-term prosperity for all, social cohesion and environmental health.*” Wespath believes that achieving this framework will result in the creation of healthy financial markets, resilient companies, and, ultimately, better market returns.



2016

Published a set of ten investment beliefs, including a focus on the low-carbon transition and sustainability

2018

- Committed \$750 million to the launch of the BlackRock Transition Ready Portfolios (TRPs)
- Developed a Climate Action Plan

2020

- Began engaging with the Net Zero Asset Owners Alliance (NZAOA)
- Incorporated more qualitative analysis into manager ESG due diligence

2021

Co-founded the United Methodist Interagency Just and Equitable Net-Zero Coalition

2022

Co-authored The Future of Investor Engagement which advocates for new forms of engagement to address climate risk

2023

Published a revised set of investment beliefs

Extending Conventional Tools

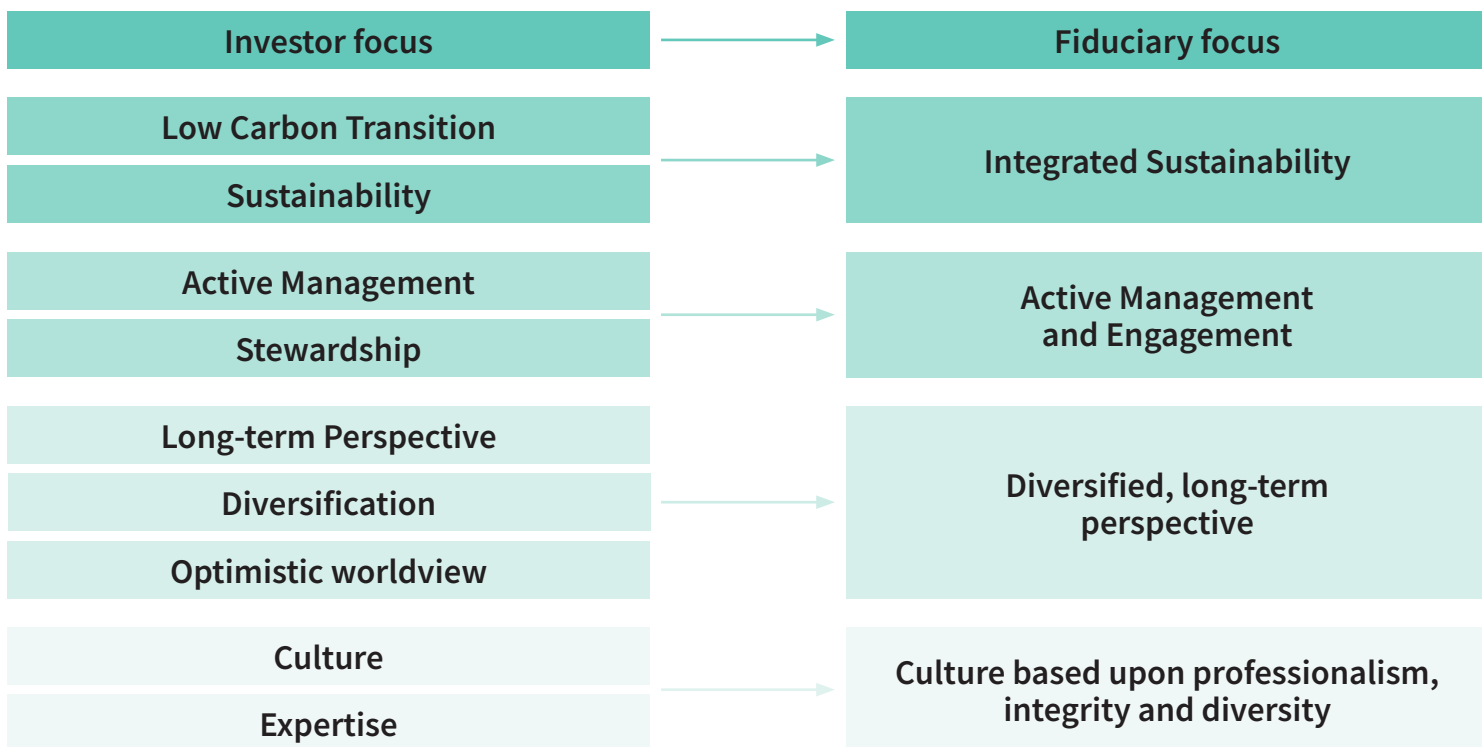
a. Statement of Investment Beliefs

Wespath first published a set of ten investment beliefs in 2016. In early 2023, Wespath’s Investments division, senior leadership team, and its Board of Directors collaborated to consolidate these ten beliefs into five (see Figure 5).ⁱⁱ

Wespath refines its beliefs on an ongoing basis as it identifies new values and specific ways to communicate its investment approach.

For example, Wespath added a Low-Carbon Transition belief and accompanying Climate Action Plan in 2018 to reflect its view that climate change is a systemic risk. This led to a partnership between Wespath and BlackRock, the largest asset manager in the world, who together produced the Wespath Transition Ready Strategy. The strategy identifies business models that are most prepared for the low-carbon transition, generating confidence for Wespath to invest 6% of its total assets in low-carbon strategies.

Figure 5. Consolidation of Wespath’s investment beliefs



In addition to its five investment beliefs, Wespeth follows a Sustainable Economy Framework (SEF), which provides the foundation for its sustainable investing program and a lens through which to identify new investment opportunities. The SEF specifies Wespeth's definition of a sustainable global economy, which it considers necessary to create healthier financial markets and more resilient companies. Wespeth's Chief Investment Officer, Dave Zellner, articulates in its 2022 sustainable investing report: *"Let me be clear—for Wespeth, the pursuit of a sustainable economy is fully aligned with our fiduciary mandate and the ultimate objective of achieving long-term investment success...Our Sustainable Economy Framework helps us identify, assess and respond to these risks—whether they are idiosyncratic (unique to each company) or systematic (affecting the entire economy)."*ⁱⁱⁱ

The SEF includes the following three pillars and corresponding goals:^{iv}

- **Long-term prosperity for all:** Achieve equal opportunity for advancement and access across gender, race, and economic background.
- **Social cohesion:** Achieve reliable access to basic necessities including sustainable food and water, clean energy, and affordable housing.
- **Environmental health:** Develop resilient ecosystems by combatting climate change, biodiversity loss, plastic waste, and other polluting activities.

b. Security selection and portfolio construction

Various initiatives enable Wespeth to act on its belief that climate change is a systemic risk. Its BlackRock Transition Ready Portfolios (TRP) provide an enhanced passive investment approach, overweighting companies that are carbon-efficient (investing in carbon technologies, reducing carbon emissions, using natural resources sustainably) and underweighting companies that are poorly positioned for a low-carbon



economy. The TRP strategies differ from other low-carbon investment strategies that tend to focus solely on emissions reduction, such as screening out carbon-intensive industries, or on thematic areas, such as clean energy. TRP strategies are rooted in the premise that the market is not accurately accounting for the transition to a low-carbon economy, leading to stock prices not reflecting the reality for some companies.^v The strategy evaluates companies in five areas, or

“pillars,” to determine their readiness to transition to the low-carbon economy: energy generation/production, carbon efficient technologies, energy management, water management, and waste management (see Figure 6).^{vi} According to Wespath, the strategy results in a portfolio with a 50% reduction in carbon emissions intensity and a 40% increase in climate technology exposure relative to performance benchmarks (Russell Top 200 Index and the MSCI World ex USA IMI Value Index).^{vii} Since its contribution to the initial commitment of \$750 million to the launch of the Transition Ready strategy in 2018, Wespath has more than doubled its investments into low-carbon ready securities. Given the success of TRP, BlackRock has also expanded the investment strategy to other investors and grown the strategy itself into a business accounting for \$18 billion in AUM.^{viii}

In addition to targeting specific investment opportunities, Wespath utilizes a Management of Excessive Sustainability Risk (MESR) policy to identify exclusion investments that do not align with its climate action beliefs. The MESR policy describes two types of exclusions:^x

- **Ethical exclusions:** When a company’s revenue is more than 10% reliant on the production, sale, distribution, and/or marketing of alcohol, tobacco products, adult entertainment, weapons, gambling, privately-operated correctional facilities.^x
- **Sustainability-related financial risk exclusions:** When a specific issue or set of companies or industries expose investors to higher levels of financial risk, the Wespath board of directors creates a set of guidelines for the issue. To date, guidelines have been set for two issues:^{xi}
 - The climate change guidelines focus on the extraction or mining of thermal coal, with 64 exclusions having been made since its inception.
 - The human rights guidelines exclude companies operating in, and sovereign debt from countries with a track record of, human rights violations. Since its inception, 35 companies and the debt of 12 countries have been excluded.

Figure 6. Five areas within which Wespath evaluates companies’ “Transition Readiness”

| Energy generation / production | Carbon efficient technologies | Energy management | Water management | Waste management |
|---|---|--|---|---|
| Involvement in extraction, refinery, production, generation and ownership of fossil fuels | Involvement in renewable energy, energy efficiency, green building, low-carbon transportation | Energy use, mix, efficiency and indirect emissions through electricity consumption | Water consumption, withdrawal, efficiency, physical stress, and recycling practices | Company waste generation, recycling, and product lifecycle management |

c. Engagement

Although Wespath has a formal exclusion policy, its investment philosophy prioritizes engagement. Written within Wespath's investment beliefs is the conviction that shareholder engagement adds long-term value to its funds.^{xii} Wespath's Chief Investment Officer, Dave Zellner, posits: "Engagement also makes us more thoughtful investors with a well-informed perspective on how our portfolio is positioned for long-term success in a changing world."^{xiii} The UN Principles for Responsible Investment (PRI) serves as a foundation for Wespath engagement work, allowing for greater potential for collective engagement opportunities.

For Wespath, engagement can take multiple forms:^{xiv}

- **Corporate engagement:** Direct dialogues with the companies in which it invests, often through collaborative initiatives alongside other like-minded investors;
- **Asset manager engagement:** Engagement with current and prospective asset manager partners on issues relevant to the Sustainable Economy Framework; and
- **Policy engagement:** Reaching out to policymakers and regulators to support ideas and topics at the macroeconomic level that Wespath believes will lead to improved market-rate returns.

In 2021 and 2022, Wespath recorded over 120 engagements with asset managers and companies on topics related to climate change, human rights, and diversity and inclusion. Through its participation in Climate Action 100+, an investor-led engagement initiative seeking to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change, Wespath co-led several shareholder engagement activities specific to climate change that generated outcomes such as: (1) the publishing of climate risk reports by Occidental Petroleum and Chevron following Wespath shareholder resolutions and executive team meetings, and (2) a commitment by Cummins Inc. to become net zero by 2050 and align its lobbying activity with the Paris Agreement.^{xv} Further, Occidental Petroleum recently stated its intentions to become the first U.S. oil and gas major to achieve net-zero emissions from its operations by 2040 and reach net zero for all emissions by 2050 including those generated by suppliers and customers.^{xvi}

A notable element of Wespath's shareholder engagement activity is its proxy voting approach, which is approved by its Board of Directors and outlined in its Proxy Voting Guidelines. Wespath uses the expertise of Institutional Shareholder Services (ISS) and other data sources to execute its proxy voting strategy.^{xvii} Box 2 details one such engagement activity focused on climate change.

BOX 2. Wespath's collaboration with Engine No. 1 to ensure ExxonMobil's Board of Directors has members with expertise related to the low-carbon economy

In 2020, Wespath joined the hedge fund Engine No. 1 in getting three board members with expertise on the low-carbon economy elected onto ExxonMobil's Board of Directors. Since the new appointments have joined, Exxon has continued to expand its oil and gas production. However, it has also introduced net-zero targets as well as investment into carbon capture and

clean energy technologies such as hydrogen-based energy. Although there are contrasting opinions on the total impact the new board members have had thus far, it must be acknowledged that a healthy environmental system is now of elevated interest at the board level of one of the world's largest oil and gas companies.

d. Manager selection & due diligence

Wespath seeks to integrate sustainable investment best practices with 50 asset manager partners, covering a combined \$24.5 trillion in assets under management. Wespath's Investment Policy includes a requirement that the Wespath board ensures its external asset managers consider environmental, social, and governance (ESG) factors across asset classes. As part of its external manager selection process, Wespath applies an internal ESG Appraisal to assess and monitor manager policies and practices.^{xviii} Wespath has been iterating on its appraisal process since 2014 and it now includes the following:

- **ESG Integration Reporting Questionnaire** that managers complete with their annual reporting requirements. The questionnaire covers ESG integration at the organizational, or firm level and at the individual strategy, or mandate level.
- **Performance Snapshot** uses manager responses to provide general feedback to each external manager.
- **Guidance Document** highlighting the degree of detail that should be included in the questionnaire.
- **Individual Manager Assessment** uses manager responses to provide individualized feedback to each external manager, encourage progress, and increase alignment with Wespath expectations and beliefs.

As part of its goal to partner with asset managers that specialize in identifying publicly traded companies well-positioned to succeed in the transition to a low-carbon economy, Wespath recently hired Wellington Management Company (Wellington) and Impax Asset Management Group (Impax) to actively manage public equity strategies that invest in opportunities with an environmental lens. Impax is a London-based firm with over \$45 billion in AUM that specializes in creating and



managing investment strategies that align with the transition to a sustainable economy across themes such as energy, food, agriculture, forestry, and waste management. Wellington is among the 30 largest asset managers in the world with more than \$1 trillion in AUM and manages several strategies on behalf of Wespath, including public equity strategies that focus on companies enabling the low-carbon transition.^{xix}

Adopting Advanced Techniques

a. Self-organization

Wespath has made self-organization techniques a key part of its investment activities through leadership positions in specific asset owner alliances as well as through active engagement in other strategic partnerships. This includes leadership positions in (1) PRI, where Wespath was a co-author and founding signatory and currently serves on the Stewardship Advisory Committee, where it recommends expectations to be set regarding PRI signatories' active ownership practices; (2) Climate Action 100+, where Wespath was a co-leader in collaborative corporate engagements at four companies; and (3) the Net-Zero Asset Owners Alliance (NZAOA), a group of 86 asset owners with over \$11 trillion combined AUM committed to transitioning their investment portfolios to net-zero greenhouse gas emissions by 2050, where Wespath is co-leading the engagement and communications working groups (see Box 3).^{xx}

Additionally, on Earth Day in 2021, Wespath and 10 of its fellow UMC agencies publicly pledged to achieve net-zero emissions across ministries, facilities, operations, and investments by 2050 to form the United Methodist Interagency Just and Equitable Net-Zero Coalition, which has since grown to 12 general agencies.

As indicated by its name, the coalition is also focused on addressing structural barriers to racial and gender equity that are core components of ensuring a just and equitable transition to net zero. The coalition provides a forum for these agencies to learn from and work with one another in the shared context of UMC values, wherein Wespath uniquely offers insights that culminate from the intersection of its work with NZAOA and UMC's Social Principles. An inaugural progress report was published by the coalition in April 2022.^{xxi}



BOX 3. Wespath & The Net Zero Asset Owners Alliance (NZAOA)

Wespath co-leads the engagement and communications working groups at the NZAOA. The engagement group is tasked with developing relationships with sector companies and asset managers while the communications working group ensures that NZAOA is publicly communicating its initiatives and progress. A notable outcome from this work was a 2022 report called *The Future of Investor Engagement: A call for systematic stewardship to address systemic climate risk*, which was co-authored by Wespath's Managing Director of Sustainable Investment Strategies, Jake Barnett, and Patrick Peura, ESG Engagement Manager with Allianz investments, and advocates for new forms of engagement to address climate risk.

The report lays out limitations to, and recommendations for expanding, conventional corporate engagement strategies. Cited limitations highlight the significant resources needed for effective corporate engagement and the lack of scaling that happens with most investor corporate engagement strategies. Most commonly, investors are engaging with individual, publicly listed companies as they are typically the largest holdings in a given portfolio. This results in a given investor missing a system-level engagement opportunity, for example via regulation that would affect all publicly listed companies, as its resources become committed to influencing a single large company's behavior.

The report's recommendations educate investors on how existing corporate engagement strategies can be altered in order to positively affect systems rather than exclusively individual companies. Recommendations focus on three themes:

- **Sector/value chain engagement:** Investors can redirect their engagement efforts towards the development of incentives and frameworks that positively impact entire sectors or value chains.
- **Policy engagement:** Investor engagement efforts can support mandatory corporate disclosures as well as improved corporate lobbying behaviors in order to manage systemic social and environmental risk.
- **Asset manager engagement:** Asset owners can engage with the asset managers that select their holdings and exercise voting responsibilities on their behalf to ensure they properly understand how to make systemic value-creating choices rather than value-extracting choices.

By helping the development and dissemination of system-level engagement strategies for investors, Wespath is making a system-level contribution to the investment community it is a part of. [Read the full report here](#). Relatedly, Barnett and Peura also published [a resource](#) to help asset owners engage with asset managers on their climate-related proxy voting in April 2021.

b. Polity

Wespath uses public policy statements to engage policymakers and regulators on issues relevant to environmental health and climate change. It sees policy as important in several regards because companies continue to operate in a certain policy environment and need to be incentivized to focus on climate risk.^{xxii} Wespath has published 38 unique public policy statements written between 2009 and 2022.^{xxiii} Included in these statements are independently authored letters to US agencies such as the Environmental Protection Agency (EPA) and Securities and Exchange Commission (SEC) as well as endorsed letters written by major investment groups such as the PRI, the Interfaith Center on Corporate Responsibility (ICCR), Council of Institutional Investors, and others. Topics covered by the public statements range from environmental protection and human rights to corporate governance and standard setting.

In June 2022, for example, Wespath submitted a comment letter to the SEC on “Enhancement and Standardization of Climate-Related Disclosures for Investors.” The letter outlines Wespath’s support for the SEC’s proposed integration of the Task Force on Climate-related Financial Disclosures and the inclusion of greenhouse gas emissions reporting into the SEC’s proposal for investor disclosures.^{xxiv} Also in 2022, Wespath wrote to the EPA regarding its regulation of methane emissions, a powerful greenhouse gas that pound for pound has

approximately 86 times more potency than carbon dioxide over a 20-year period.^{xxv} Its letter focused on the EPA’s proposed standards for regulating methane emissions in the oil and gas industry and offered suggestions to strengthen these standards to more robustly address climate risks.^{xxvi}

The system-level significance of this polity action is that by showing support for climate-related disclosures, Wespath is encouraging the formation of investment industry guardrails that keep system health, in this case the climate system, at the forefront.



Evaluate results

Wespath recently underwent an exercise to expand its measurement and reporting capabilities by incorporating sustainability data based on the components of its Sustainable Economy Framework. The objective was to create an impact measurement and management tool that could help it improve how it: (1) measures its alignment with the Sustainable Economy Framework, (2) engages with asset managers about its investments, and (3) communicates with its stakeholders about the methodologies used to evaluate the investment portfolio.^{xxvii}

To support the collection and management of its dataset, Wespath selected an industry-leading sustainability data provider to generate an overall SDG alignment score of each investment based on 15 relevant sustainability objectives. The standardized score allows for comparison across industries and sectors, and can be elevated to the fund or index level to compare different segments of companies. Importantly, this dataset enables Wespath to look at specific holdings of funds and how they are contributing to SDG alignment or misalignment, ultimately to help guide Wespath's engagement activities.^{xxviii}

Challenges and Looking Ahead

Wespath acknowledges that its impact measurement and management framework is still under development and in the meantime is leaning on its managers and external partners to better understand the positive and negative impacts of its portfolio.

In the near term, the firm intends to add information on issues such as climate risk to inform engagement with managers in a more targeted way, and over time, expand its measurement capacity to fixed income and private market investments across its full portfolio.^{xxix}

Endnotes

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About the Authors

High Meadows Institute is focused on the role of business leadership in society. Our mission is to contribute to sustainable economic and social progress in a global economy and society. High Meadows Institute was founded in 2013 by a small group of senior business and finance leaders with deep experience in the private and non-profit sectors. The Institute works in close partnership with other leading think tanks and academic and business organizations to advance its mission.

The Investment Integration Project (TIIP)'s mission is to help investors understand how healthy social, environmental, and financial systems can benefit their portfolios. TIIP provides consulting services, applied research, and a turnkey solution (SAIL) that supports investors' pursuit of system-level investing, an advanced approach to sustainable and impact investing that focuses on managing systemic risks and investing in solutions to systemic problems.



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