This document was prepared by participants in the Committee on Workers' Capital (CWC), an international network connecting trade unions and worker-nominated pension trustees in dialogue and action on the responsible investment of workers' capital, and the Trustee Leadership Forum for Retirement Security, an applied research collaboration with U.S. labor-affiliated trustees of public and Taft-Hartley pension funds. The document is based on the CWC's Guidelines for the Evaluation of Workers' Human Rights and Labour Standards, a set of key indicators to measure corporate performance on social issues endorsed by the Council on Global Unions. The full Guidelines can be found at www.workerscapial.org

Protecting People in Our Investments

The retirement savings that we oversee, as trustees, are invested in companies and government agencies that shape the work and lives of people across the globe. We believe investments that contribute to a sustainable world serve our funds and our beneficiaries. We have a responsibility to make sure that our investments are contributing to decent retirements and to a sustainable world. We want to encourage companies and government agencies in which we invest to treat their people, their resources, and their environment in a responsible manner.

What is the Rationale for Integrating ESG Issues into Investment Decision-Making?

Responsible investment is an approach that aims to embed environmental, social and governance (ESG) factors into investment decision-making. The integration of social factors - or the "S" in "ESG" – tends to receive less attention than environmental or governance dimensions of responsible investment. To practice responsible investing, investors must consider how investee companies and government agencies approach the risks and opportunities associated with workers, consumers, and communities. For example, are companies respecting labor rights, protecting occupational safety and health, and engaging with the communities in which they operate?

The incorporation of ESG issues in pension investments has been on the rise in recent years as a result of a number of factors, including:

- The growing recognition of the positive impact of ESG performance on corporate financial performance[1];
- Regulatory clarification around the incorporation of ESG factors into a fiduciary framework[2];
- Enhanced responsibilities of investors under international norms and frameworks.[3]

More and more pension funds around the world are evaluating ESG factors as part of their investment process. Trustees at approximately 330 pension and sovereign wealth funds around the world have signed onto the UN Principles of Responsible Investment, which means they have publicly committed to incorporating ESG into their investment and ownership decisions and encouraging other participants in the investment industry to do the same. These include some of the world's largest asset owners, such as the California Public Employees' Retirement System (CalPERS), ABP (the Dutch public sector employees' pension fund), PGGM (the Dutch health care employees' pension fund), and Japan's Government Investment Pension Fund (the world's largest pension fund). These funds have also written investment beliefs and/or policies that commit them to invest in a responsible and sustainable way without foregoing financial returns. This commitment to responsible investment includes the integration of social issues into their investment processes. Similarly, some two dozen mostly US-based funds, representing more than $2.5 trillion in assets under management, have joined the Human Capital Management coalition to encourage investee companies to take the role of the worker and their contributions to the financial success of companies more seriously.

Funds that endorse responsible investment principles draw on a large and growing body of evidence that reveals a positive correlation between firm-level performance on social metrics and corporate financial performance. An extensive review of literature found that in aggregate, there is "considerable empirical evidence that human capital policies (which encompass training and HR policies which include selection, training, mentoring, incentives, knowledge-sharing, engaging front-line workers in operational decisions and partnership based labour management relations) can be material to corporate performance."[4] Thus, companies that anticipate and manage the social risks and opportunities in their business activity are the ones who will create the most value over the long run, both for shareholders and for society. An increasing number of governments and regulatory agencies have understood this, and they have created or clarified regulations that encourage investors to consider the material social risks of their investments.

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[1] Friede, G., Busch, T., & Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5(4), 210-233

[2] US Department of Labor has released a new Interpretive Bulletin (IB 2015-01) on Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social and Governance (ESG) Factors, p.5

[3] Under the OECD Guidelines for Multinational Enterprises, institutional investors are expected to conduct due diligence and use their leverage to influence companies they invest in to prevent or mitigate adverse human rights impacts. For clarifications, see: http://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdf

[4] Bernstein, Aaron and Beeferman, Larry, The Materiality of Human Capital to Corporate Financial Performance (May 12, 2015)

What Can Trustees Do?

Committing a pension fund to responsible investment is not something that we, as trustees, can do overnight. It takes time to develop the necessary support among other trustees, fund staff, investment managers, and consultants. Luckily, there are resources to help, including several investor organizations working on helping funds incorporate ESG issues, such as the UN Principles of Responsible Investment (www.unpri.org), the Committee on Workers Capital (www.workerscapital.org), and the Trustee Leadership Forum (iri.hks.harvard.edu).

The following steps were informed by trustees that have gone through the adoption and integration of responsible investment within fund portfolios. Section 1 focuses on the actions that an individual trustee can take to build support and place an ESG discussion on the agenda of the board. Section 2 focuses on the steps that can be taken collectively by the board.

Section 1: Initiating Discussions on Social Issues in the Investment Portfolio with Fellow Board Members

Before updating or crafting new policies, informal discussions about social issues in a portfolio can be helpful. It is also important to map the cycles within which key board documents where ESG can be integrated will be updated.

Step 1: Informal discussions to garner support:

- Holding informal discussions with fellow board colleagues on the following points:
  - How can the fund act on the evidence that ESG integration is linked to corporate financial performance that can help deliver returns on the portfolio over time?[5]
  - How do the fund's policies on responsible investment compare with those of leaders?[6]

Step 2: Identifying board discussion windows that can drive the integration of ESG issues (particularly the role of the "S") into investments:

- Mapping discussion windows for key policy updates:
  - When is the next cycle to update key board policies such as the investment policy statement, the investment beliefs and the asset manager selection policy?
  - What decision making committees are best positioned to discuss and act on ESG issues in investments?
- Engaging with fellow board colleagues:
  - Can my peers be encouraged to place responsible investment and the integration of social issues on the agenda of a board meeting (or on the agenda of the investment committee) during the next policy update cycle?

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[5] Friede, G., Busch, T., & Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5(4), 210-233

[6] For example, see ABP Policy Paper on Responsible Investment (2015); CalPERS Total Fund Investment Policy, investment belief IV (2016)

- Does the fund have a framework that allows me to engage to reply to or engage with beneficiaries and stakeholders around their concerns on ESG issues?

Section 2: How to Elevate the Profile of Social Issues in the Fund's Practices

Once social issues have been placed on the agenda of a board meeting or a policy update cycle, other board colleagues are involved and the discussion takes on a collective dimension. Discussions here may focus on the codification of ESG into the guiding policies of pension funds and the tangible processes that will change as a result of the codification, including the asset selection and stewardship practices. During this step, trustees may draw on external experts and peer trustees at other pension funds.

Step 3: Discussing ESG and social issues in the context of the fund's guiding policies:

- Investment policy:
  - Are ESG issues integrated into our fund's investment policy (asset selection, proxy voting and engagement?
  - Do our internal or external investment managers integrate ESG issues into our investment process?
  - Is the focus on social issues different from that given to environmental and governance issues and, if so, why?
  - If ESG issues are not considered in the investment process, why not?

- Investment Beliefs:
  - What impacts do our investments have on our beneficiaries and on society?
  - Can the environmental and social impacts of our investments be detrimental to these groups?
  - How might these impacts hold implications for the long-term performance of our portfolio?

- Connecting Internationally-accepted norms, standards and frameworks with our fund policies:
  - Can we attach a reference to the following international norms, frameworks and standards in our investment policies:
    - The UN Guiding Principles for Business and Human Rights;[7]
    - The Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises;[8]
    - The International Labour Organisation (ILO) Fundamental Conventions.[9]

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[7] The UN Guiding Principles on Business and Human Rights are a set of guidelines for States and companies to prevent, address and remedy human rights abuses committed in business operations. For more information: http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

[8] The OECD Guidelines for Multinational Enterprises are non-binding principles for responsible business conduct for multinational enterprises operating in or from OECD countries. For more information: http://mneguidelines.oecd.org

[9] The ILO's Governing Body has identified eight conventions as "fundamental." For more information: http://ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm

Step 4: Discussing ESG and social issues in the context of our fund's stewardship and asset selection practices:

- Stewardship of the assets that we own (proxy voting and engagement):
  - How did our fund vote on 2-3 key shareholder resolutions over the last 12 months that touched on social issues?
  - Do our proxy voting guidelines help us to incorporate the evaluation of social risks and opportunities in our ownership decisions?
  - Are investee companies engaged around the disclosure of social metrics – sometimes framed as human capital management (HCM) risks – such as those included in the CWC Guidelines for the Evaluation of Workers' Human Rights and Labour Standards? Have companies been engaged on any of the following topics:
    - Workforce composition (job type)
    - Social dialogue (worker voice)
    - Workforce participation
    - Supply chain issues
    - Occupational health and safety
    - Pay levels
    - Grievance mechanisms
    - Training and development
    - Workplace diversity
  - Do we participate in UN PRI collaborative engagements on social issues?

- Incorporation of social issues in the selection and accountability of asset managers:
  - Do we screen external asset managers based on their evaluation of social and/or HCM metrics?
  - Do our internal and current external investment managers evaluate social issues and opportunities when analyzing our equity, fixed income, and alternative investments? Do they track metrics on the topics listed above. If so, how? If not, why not*?*
  - Do we reward our investee companies that have greater disclosure of social and/or HCM metrics via a best-in-class approach?
  - Given that ESG issues with a direct relationship to the economic value of our fund's investment are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices[10], can our internal and external asset managers point to an example where they chose to invest in an entity based on ESG issues in a scenario of competing investment options?

- Comparing with pension fund peers:
  - How does our fund compare with the leading funds with a similar assets under management scale?

[10] See US Department of Labor Interpretive Bulletin (IB 2015-01) on Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social and Governance (ESG) Factors