Introduction

The State of New Jersey Department of the Treasury, Division of Investment (the “Division”) is responsible for the management of seven pension funds that comprise the State of New Jersey Pension Fund (collectively, the “Pension Fund”). The Pension Fund supports the retirement plans of approximately 800,000 active and retired teachers, police officers, firefighters, judges, prison officers and other State employees. The Division’s goal is to seek long-term returns for the benefit of participants and beneficiaries in the Pension Fund. Accordingly, the Division recognizes that short-term gains at the expense of long-term gains are not in the best interest of the Pension Fund.

The State Investment Council (the “Council”), which sets forth the policy, procedures and methods governing the actions of the Division, adopted its Environmental, Social and Governance (ESG) Policy in 2018. This policy recognizes that consideration of material ESG factors is an important component of a comprehensive investment management strategy, and an analysis of these factors should be applied, as economically warranted, by the Division in connection with the investment and evaluation of the Pension Fund’s assets.

As stewards of the Pension Fund, the Division’s primary objective is to understand and appropriately manage the investment risks and opportunities that arise from climate change in a manner consistent with its fiduciary responsibilities. These Principles and Practices represent the framework developed by the Division to implement the Council’s ESG Policy and to convey to its stakeholders and partners how the Division plans to address these risks and opportunities.

Principles

The Division’s practices with respect to managing the risks and opportunities arising from climate change are based on three guiding principles: 1) recognition of its fiduciary duty, 2) awareness of global governmental climate policies, and 3) support of corporate transparency.

Fiduciary Duty

First and foremost, the Division must uphold its fiduciary duty to manage assets of the Pension Fund solely in the financial interest of Pension Fund beneficiaries. The Division’s fiduciary obligation is not only the top priority, it is a legal standard against which every investment decision must be measured. The Division cannot be an agent of change tasked to mitigate the existential threat of climate change facing society. Similarly, Pension Fund assets may not be used as a tool to deliberately accelerate the energy transition from carbon to renewables for reasons unrelated to the financial interest of Pension Fund beneficiaries.

The Division believes that the practices outlined in this document will encourage companies to consider how climate change could affect long-term shareholder value. To the extent that climate change reasonably presents risks to and/or opportunities for long-term shareholder value, the Division encourages, in a manner consistent with its fiduciary duties, companies to integrate relevant considerations into their governance and business strategies with the goal of increasing long-term shareholder value.
The Division considers all legal guidance relevant to the scope of its fiduciary duties, including guidance issued by the United States Department of Labor ("USDOL"). Although this guidance is not directly applicable to the Division as a governmental plan, it serves as useful informative guidance.

The Division believes that all of its fiduciary decisions should adhere to the following principles:

- The Division must consider factors that potentially influence risk and return and have a direct relationship to the economic value of the Pension Fund's investment.
- ESG factors may have a direct relationship to the economic value, especially the long-term value, of an investment.
- If the Division prudently determines that an investment is appropriate based solely on economic considerations, including those derived from ESG factors, the Division may make the investment without regard to collateral benefits.
- An investment is not prudent if it is expected to provide a lower rate of return than available alternatives with commensurate degrees of risk, or is riskier than alternatives with commensurate rates of return.
- Shareholder activism (whether via active monitoring, communication, or exercising other legal rights of a shareholder) is consistent with the Division's fiduciary duties if the Division concludes there is a reasonable expectation that the particular form of activism, by the Pension Fund alone or together with other shareholders, is likely to enhance the value of the plan's investment, considering all costs involved.
- Proxies may be voted as part of the normal process of managing investments unless the Division determines that the time and costs associated with such voting may not be in the Pension Fund's best interest.

Broadly speaking, the Division must consider all risks and opportunities that could have a material impact on risk-adjusted returns for the Pension Fund. If the Division reasonably concludes that a potential structural shift in the economy presents a specific risk or opportunity, investing Pension Fund assets to either avoid that risk or access that opportunity may be consistent with the Division's fiduciary duties if guided by the foregoing principles.

**Global Governmental Climate Policies**

The Division believes that governmental policy on climate change may materially impact investment risk. Accordingly, the Division utilizes resources from various recognized organizations to analyze how governments around the world are developing policy responses to the unique socioeconomic challenges they face from climate change.

For example, the Intergovernmental Panel on Climate Change ("IPCC") provides information to global policy makers by reporting on the scientific basis for climate change, the impact of such change, and options for mitigating this impact. The work of the IPCC informed the United Nations Framework Convention on Climate Change in developing the Paris Agreement, to which nearly 200 countries are signatories.

The Paris Agreement aims to strengthen the ability of countries to mitigate and adapt to the effects of climate change, using nationally determined contributions ("NDCs") to establish country-specific goals designed to collectively achieve global warming targets. The NDCs require countries to disclose periodically greenhouse gas ("GHG") emissions and their implementation efforts.
The Division recognizes that assessments by the IPCC and other organizations can be important resources in helping understand the risks and opportunities around climate change.

Corporate Transparency

Corporate transparency allows the Division to more accurately assess economic risk and opportunity. Therefore, supporting greater corporate transparency and accountability is an important principle of the Division and an important means to mitigate climate-related risk and identify new investment opportunities. Engaging with companies and advocating for corporate disclosure of financially material ESG factors has been an initiative of the Division since adoption of the Council’s ESG Policy.

The Division is a member of the Sustainable Accounting Standards Boards (“SASB”), which has been an important resource in putting this principle into practice. Numerous other recognized organizations—including the Global Reporting Initiative Standards (“GRI”), International Integrated Reporting Council (“IIRC”), Carbon Disclosure Project (“CDP”), and FSB Task Force on Climate-Related Financial Disclosures (“TCFD”—offer valuable disclosure guidance and standards. For example, the TCFD has developed standardized climate-related financial risk disclosures for use by companies in providing information to investors and other stakeholders, including disclosures regarding transition risk (relating to the movement to a low-carbon economy) and physical risk (relating to chronic and extreme weather events caused by long-term shifts in climate patterns).

One of the fundamental disclosures recommended by these organizations, including the TCFD, is the metrics and targets used by companies to assess and manage their own climate-related risks and opportunities. Corporate transparency with regard to such metrics and targets allows the Division to more accurately assess the economic risks and opportunities presented by a company or other potential investments. Relevant targets include those related to GHG emissions, particularly in relation to anticipated regulatory requirements, market constraints, or other goals such as efficiency, financial loss tolerances, and net revenue.

As the fiduciary obligations of the Division require it to focus on financially-material risks and opportunities, it is important that the Division is able to review a company’s disclosures regarding its ability to measure and respond to climate change and has a robust framework to analyze such disclosures.

The above principles guide the Division’s practices with respect to managing the risks and opportunities arising from climate change.

Practices

The Division has developed the following framework to clearly convey to its beneficiaries, and other parties, how it actively addresses climate change risk and opportunities on an ongoing basis. Since the adoption of the Council’s ESG Policy in 2018, the Division has been leveraging its experience, relationships, and resources to take a more active ownership role with its investments, specifically as it relates to financially-material ESG issues, including those related to climate change.

The Division’s active ownership framework encompasses three main practices: 1) integration, 2) engagement, and 3) advocacy. These practices, as they relate to climate change, are described more fully below:
Integration

The Division uses a holistic approach for the broad consideration of material climate change factors across the entirety of the Pension Fund, focusing on governance, strategy, risk management, and metrics and targets.

The Division has formed a Climate Change Practice Group, consisting of the Director, the Corporate Governance Officer, the Sustainable Investing Portfolio Manager, and representatives of each asset class as well as operations. Members are appointed by the Director to oversee the ongoing monitoring of risks and opportunities related to climate change.

The Climate Change Practice Group, in consultation with the Division’s other portfolio managers and the Council’s ESG Committee, will identify material risks to, and opportunities for, the Pension Fund over the short-, medium-, and long-term time horizons and propose investment strategies at the portfolio level and with respect to individual investments.

The Division continues to seek greater disclosure from companies regarding financially material climate-related risks so that it may better assess and consider investments and portfolio positioning and manage risks resulting from the ongoing shift towards a low-carbon economy. The Division is in the process of acquiring additional tools and resources to more accurately measure climate-related risk in the portfolio, including an annual analysis of portfolio companies’ greenhouse gas emissions and carbon footprint.

From asset allocation decisions at the portfolio level all the way down through voting specific proxy proposals by individual companies, the Division is integrating its analysis of the implications of climate change.

Engagement

The Division believes corporate engagement and proxy voting are impactful tools at its disposal to help manage the rising risks from climate change. Companies are beginning to identify, disclose, and manage financially material climate-related risks for the benefit of their businesses and investors. Businesses often look to their investors for guidance and the Pension Fund and other asset owners around the world continue to reinforce the need for a constructive framework, such as TCFD, to assess and manage climate-related risks.

The Division engages with companies in a number of ways. It writes letters to company executives on specific issues with follow up conversations and meetings. This method allows the Division to clearly convey relevant issues to a company’s management. The Division is also a member of nonprofit organizations and investor coalitions that work with companies and other investors to address risks and identify opportunities related to climate change. The Division participates in group engagements to improve governance and strengthen climate-related financial disclosures.

Proxy voting is a fundamental shareholder right and an important instrument in shaping corporate behavior. Proxy voting on the election of board members is a means of holding company directors and executives accountable for their actions. Shareholder proposals are an additional means of active engagement that may be considered.

With respect to public companies, the Council adopted a revised Proxy Voting Policy in 2019 that acknowledges its support of environmental proposals that enhance long-term shareholder value. The Council specifically supports proposals “requesting the disclosure of financial, physical, or regulatory risk related to...climate change...and how companies identify, measure, and manage such risks.” In addition, the Division recognizes that a variety of other proposals could be helpful in encouraging corporate
behavior that improves long-term shareholder value. For example, in some circumstances proposals encouraging a company to adopt specific targets, or even to adopt targets generally, might reasonably be used to enhance long-term shareholder value by, for instance, encouraging a company to prepare for anticipated regulatory requirements, adapt to market constraints, or improve efficiency. The Division may consider such proposals to the extent consistent with its fiduciary duties. Proposals are generally consistent with the Division’s fiduciary duties if the Division concludes there is a reasonable expectation that the proposal, by the Pension Fund alone or together with other shareholders, is likely to enhance the value of the Pension Fund’s investment, considering all costs involved.

The Division engages with its investment partners across its private portfolio as well. Alternative investment fund managers are asked to complete the Institutional Limited Partners Association (“ILPA”) due diligence questionnaire on ESG as part of the Division’s diligence on every new investment. This provides the Division with an understanding of the firm’s governance structure and how it identifies and manages material climate-related risks at the firm and across its portfolios. As part of the Division’s ongoing monitoring of its private market investments, the Division is developing ESG integration guidelines, which will include disclosure reports by alternative investment fund managers. The Division will be able to build constructive dialogues with its partners around issues such as climate change and how they can mitigate risk and capture opportunities to drive returns for the Pension Fund.

Advocacy

Many public pension funds and other institutional investors are still in the early stages of developing policies and frameworks that integrate ESG factors, including those relating to climate risk, into their investment decision-making process. In parallel with its effort to engage with companies and with its investment partners, the Division advocates to the investment community at large the need for greater disclosure of financially-material risks related to climate change. Such advocacy, including participation on conference panels and membership in investor coalitions, enables the Division to engage with peers, leverage its resources, and amplify its actions toward advocating for transparency and accountability around climate-related risk and other financially-material ESG issues. In turn, the Division serves as a resource and sounding board for other institutional investors as they adopt their own principles and practices on climate risk and opportunity.

Together, the above principles and practices are intended to encourage companies to fully integrate climate change consideration into their governance and business strategies, as well as to help the Division better understand and appropriately manage the risks and opportunities that arise from climate change, with the goal of maximizing risk-adjusted returns for the Pension Fund.