Vanguard S.O.S.

Solutions to Vanguard's Climate Problems

With over $8 trillion in assets under management (AUM), Vanguard plays a critical role in the transition to a sustainable future. While its pledges may reflect a long overdue shift in thinking within Vanguard, pledges alone are ineffectual without immediate action to curb the climate crisis. Climate risk is investment risk, and Vanguard must uphold its commitments to stronger climate action in multiple spheres.

Unless otherwise specified, all of the following actions should be publicly stated.

Four Pillars of Priorities for Vanguard:

01 Escalate engagement and improve proxy voting

As the largest shareholder of almost every listed company in the US, Vanguard should use its massive power to influence portfolio companies to reduce climate impact and enforce accountability, prioritizing the heaviest emitters and sectors representing high scope 3 emissions, including financial institutions.

- Refined criteria and improved transparency
  - ◊ Adopt investment stewardship guidelines which prioritize decarbonization in line with a 1.5°C pathway, including disclosing climate risk, as well as supporting activities which address and mitigate climate-related business risks.
  - ◊ Communicate the best-in-class industry standards by which portfolio companies have been and will be assessed, how those standards are consistent with limiting warming to 1.5°C, and the proxy voting consequences for companies that fail to meet them.
  - ◊ Provide transparency and focus engagement on a climate universe of companies representing the heaviest emitters from priority sectors, particularly coal, oil and gas, utilities, auto manufacturers and other transportation industries, and steel.
  - ◊ Improve transparency on proxy voting by publishing voting policies and rationales in a timely and user-friendly manner and establish a mechanism to ensure that proxy advisors are voting in line with these policies.

- Voting and engagement should focus on limiting warming to 1.5°C and on supporting the long-term viability of companies
  - ◊ Take an active engagement stance, which includes adopting a default position to vote in favor of viable climate shareholder resolutions and against corporate

boards and directors when a company fails to meet climate performance standards or lacks a clear climate transition plan that aligns with a 1.5°C pathway[1].

    ◊ Set a clear and explicit expectation that all portfolio companies, especially those in priority sectors, not only disclose how they perceive and manage climate risks, but also take action to limit emissions.
    ◊ Align stewardship activities with a 1.5°C pathway by setting clear demands to adopt short- and medium-term objectives to reduce absolute emissions and to end fossil fuel expansion. Effective engagement requires the use of credible threats. For companies not excluded, Vanguard should commit to a time-bound escalation process, ending with capital restrictions if there is no clear action in the short term.

- Work with investors and empower internal capacity to deliver on commitments
    ◊ Prioritize and expand its stewardship team to adequately address Vanguard's climate engagement responsibilities. As of 2021, Vanguard's stewardship team currently has only one staffer per 300 portfolio companies – a figure significantly below that of major competitors like BlackRock and LGIM. Vanguard should immediately begin to increase its stewardship team to effectively monitor and engage with all portfolio companies, with a special emphasis on heavy emitters.

02 Action toward "Net Zero" commitments

As a signatory of the Net Zero Asset Managers Initiative (NZAMI), Vanguard should commit to have 100% of its AUM on track to reach zero emissions[2] by 2050.

- Define and adopt index benchmarks which are compatible with a 1.5°C trajectory for all funds which limit exposure to fossil fuels.
    ◊ Engage with index providers to determine how they plan to integrate climate risk considerations to make indices compatible with a 1.5°C pathway. This includes asking index providers to identify and exclude coal laggards from all standard indices.

- Release its annual Task Force for Climate-related Financial Disclosures (TCFD) progress reports in line with commitments to transparency and accountability as mandated by the NZAMI.

1 We qualify a 1.5°C pathway as one that ensures a phase out of fossil fuels and other climate-harming industries in a way that provides care and repair for workers and communities at the frontlines of that phaseout and the impacts of the climate crisis.

2 The concept of any one company achieving "net zero" emissions removed from the context of global emissions is counter-productive and opens the door for improbable carbon accounting and assumptions which enable continued emissions. Companies should aim to achieve "zero first", meaning they should aim to reduce emissions to an absolute zero by 2050. And as an universal owner of the global economy, Vanguard plays a critical role in helping achieve a "planetary net zero" but the company must avoid the pitfalls around "net" highlighted in section three of this document.

- Set and announce an interim target that 100% of portfolio companies – prioritizing heavy emitters and sectors with high scope 3 emissions, including financial institutions – have credible and just transition plans which lead to 50% absolute emissions reductions by 2030 and zero emissions by 2050 in order to remain in Vanguard's portfolio.

- Redouble efforts with investor initiatives in order to participate in and benefit from accountability frameworks and set hard consequences for no or substandard action.

- Ensure that corporate "Net Zero" plans are actually on a 1.5°C pathway.
    - ◊ Portfolio companies must commit to a swift reduction of fossil fuel production, and an immediate end to new or expanding fossil fuel extraction projects. Companies continuing exploration and development of new fossil reserves require immediate intervention, either through voting or exclusion.
        - ◊ Offsets, carbon removals, and nature-based solutions cannot replace emission reductions and should not be counted in net zero calculations.
        - ◊ Utilities and auto manufacturers must also include step-down targets in line with coal and gas plants, and Internal Combustion Engine (ICE) phase-out dates that align with the IEA's net zero roadmap.

03 Fundamentally shift investment policy

As a universal owner of the economy with immense fossil fuel exposure, Vanguard should urgently work to decarbonize its portfolio according to science-based targets and to expand sustainable investment options.

- Adopt and apply rigorous climate risk criteria and analysis across its entire portfolio. All new investment products should be on a zero emissions pathway, and Vanguard should expand offerings which are 1.5°C-aligned.

- Shift capital away from sectors which present significant physical and transition climate risks to clients.
    - ◊ Apply a strict decarbonization mandate to all primary market investments which continue to inject new capital into the real economy that can potentially create carbon lock-in and the risk of stranded assets.
    - ◊ Exclude fossil fuels and deforestation-linked commodities from all active funds and sustainable funds, including those externally managed by subadvisors, when those companies fail to demonstrate viable 1.5°C transition plans, actively pursue fossil fuel expansion, or continue to directly or indirectly lobby against climate regulation.
    - ◊ **COAL EXCLUSION POLICY:** Commit to progressively phase out thermal coal from all portfolios, with a priority on any firms still expanding coal mines or coal power capacity.

- ◊ Immediately divest from all thermal coal companies following the Global Coal Exit List in all discretionary funds targeting a complete exit by 2030. Divestment should cover all AUM and be applied by default.
- ◊ Commit neither to launch any new product without robust coal exclusion criteria nor to renew coal investments in passively managed bond funds.
- ◊ Offer climate-safe funds with robust coal exclusion criteria as the default option for all clients across all product offerings. Existing default funds should be switched to climate-safe equivalents.

- Expand responsible investment options
    - ◊ With only one actively managed ESG fund and four ESG index funds accounting for less than 0.3% of its total AUM, Vanguard should offer more climate-safe[3], fossil-free, deforestation-free products as the default offering for all clients and investors across all products and portfolios.

04 Integrate climate justice into business decisions

Vanguard's role as one of the biggest global investors in the climate crisis entails significant risk and enormous responsibility – not only to its clients, but to the planet and especially to those most impacted by its harmful investments.

- Expand the in-house climate team and prioritize hiring climate experts, including champions of climate justice, at the governance and accountability level.

- Adopt a universal human rights policy that prioritizes justice, protects social and economic rights, and recognizes Indigenous sovereignty[4]. This policy should be applied across all extractive sectors that threaten Indigenous rights, traditional landowners, and local communities around the world who bear the brunt of the climate crisis.

- Require all portfolio companies to adopt no-deforestation policies.[5]

3 Vanguard should screen extractive and exploitative sectors and corporations, especially those that perpetuate environmental racism and disproportionately harm frontline communities, from its ESG funds.

4 Vanguard should center justice when addressing the long-lasting consequences of climate change, stemming from the direct or indirect effects of its investments in fossil fuel and deforestation, on the economic and social rights and standard of living of vulnerable groups, especially in resource-poor regions.

5 See Forests and Human Rights: Principles for Asset Managers for guidelines.