



# Seattle City Employees' Retirement System

## Environmental, Social and Governance (ESG) Update Third Quarter 2016

### Purpose

This update is required by the following motion adopted by the Board on February 12, 2015:

*The Retirement Board of Administration directed that the Seattle City Employees' Retirement System (SCERS) pursue corporate engagement on climate change and other environmental issues, as presented by staff in their January 26, 2015 memorandum; and pursue, as appropriate, investments that are expected to produce investment results consistent with SCERS's fiduciary duty to its members and, if possible, also positively address climate change and other environmental issues. The Board recognizes that these types of investments (e.g. renewable energy, cleantech, and green bonds) are relatively new and limited in availability and will need to be considered prudently as SCERS pursues investments in its asset class (e.g. real assets, private equity, fixed income). **SCERS's staff and advisers will provide quarterly updates regarding Environmental, Social and Governance (ESG) investment issues** and incorporate ESG into SCERS's work plan. The Board directs SCERS's staff to engage with trade associations such as Coalition for Environmentally Responsible Economics (Ceres) and other pensions to examine an approach to ESG investments, and also to consider engaging with an independent consultant to assist in this review.*

Staff has focused on the environmental issue of climate change. At the Board's direction, other ESG matters may be considered in future updates.

### Activity Directed to SCERS

- The **Seattle Human Rights Commission** passed a resolution calling on SCERS to “divest from companies that profit from or supply a product directly or indirectly used in war crimes or crimes against humanity, or create a product to allow a state body to commit a war crime or a crime against humanity, or directly commit a crime against humanity.” The resolution further calls on SCERS to “work with the newly established advisory board [of community members] and [the Seattle Human Rights] Commission to establish guidelines and criteria to prevent future investments in these companies.” A formal ESG investment proposal has not been submitted.<sup>1</sup>
- **Friends of the Earth** sent a letter to SCERS that reiterated their concerns with Dimensional Fund Advisors' investments in palm oil companies and requested that the manager meet its commitments to the UN Principles for Responsible Investment, develop a policy on deforestation and exclude the worst offending companies from their portfolios. A formal ESG investment proposal has not been submitted.

## Industry Developments

- **CalSTRS** decided to commit up to \$2.5 billion in an internally-managed low carbon index strategy within their public equity portfolio, representing approximately 1% of total assets. The strategy will be benchmarked to the MSCI Low Carbon Target Index and is “expected to benefit if carbon or emissions taxes become prevalent.”<sup>2</sup>
- Proxy season 2016 saw an increase in shareholder proposals on the issue of climate change. Proxy votes supporting 2 degree stress testing at the Annual General Meetings of both **ExxonMobil** and **Chevron** both garnered close to 40%, which was more than any contested climate-related proposals in the history of these two US oil giants. Yet, these votes fell short of similar resolutions filed in 2015 with **BP** (98.3%) and **Royal Dutch Shell** (99.8%). In response, “The Missing 60%” movement began to engage with the 60% of shareholders who did not support these resolutions.

## Membership Organization Activity

- Jill Johnson participated in **Ceres**’ monthly conference calls and frequent list serve activity for their *INCR Carbon Asset Risk Working Group*, the *INCR Policy Working Group* and the *Shareholder Initiative on Climate and Sustainability*.

## SCERS Positive Action Strategy

Since February 2015, SCERS’s staff has participated in 56 events, meetings and calls devoted to ESG with institutional investors, investment managers, consultants and/or membership organizations. The purpose of these interactions is to learn best practices and industry developments that may apply to the three areas of the positive action strategy that the Board has embraced:

### **Corporate Engagement**

- SCERS joined with other members of Ceres’ Investor Network on Climate Risk (INCR) in a letter to the Securities and Exchange Commission (SEC). The letter expressed concern over the SEC’s lack of action to improve climate risk disclosure in recent years.<sup>3</sup>
- SCERS joined INCR members in another letter to the SEC to provide feedback on the specific types of disclosure that should be required and enforced.<sup>4</sup>
- Jill Johnson and Jason Malinowski met with Michelle Edkins, **BlackRock**’s Head of Investment Stewardship, in their San Francisco offices. We inquired about the apparent inconsistency between their proxy voting record and comments by Blackrock’s CEO, Larry Fink, that ESG considerations, including climate change, are important to generate sustainable returns. Ms. Edkins stated Blackrock’s policy preferring engagement as opposed to supporting shareholder resolutions.
- Jill Johnson and Jason Malinowski met with Rahki Kumar, **State Street Global Advisor**’s Head of Corporate Governance, to learn about their proxy voting and engagement practices.

### **Integrating Climate Change into the Investment Process**

- SCERS Staff developed a manager questionnaire that asks of their practices regarding diversity/inclusion and other ESG items. The questionnaire is partially adapted from a survey that CalPERS conducts of its managers. It will be completed by those managers being recommended to the Investment Committee and was first used at the July meeting.

## **Sustainability Investments**

Motion: “... *The Board recognizes that these types of investments (e.g. renewable energy, cleantech, and green bonds) are relatively new and limited in availability and will need to be considered prudently as SCERS pursues investments in its asset class (e.g. real assets, private equity, fixed income)...*”

- No updates.

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<sup>1</sup> <http://www.seattle.gov/Documents/Departments/SeattleHumanRightsCommission/SHRC-Resolution-16-01.pdf>

<sup>2</sup> <http://www.calstrs.com/news-release/calstrs-commits-25-billion-low-carbon-index>

<sup>3</sup> <http://www.ceres.org/files/incr-letter-to-sec>

<sup>4</sup> <https://www.ceres.org/files/sec-concept-release-letter>

## Appendix A

### **SCERS Public Equity Exposure to the Carbon Underground 200**

*As of August 31, 2016*

Ownership	Account Type	Market Value	Total CU200 Exposure		Coal CU200 Exposure	
		\$ million	\$ million	%	\$ million	%
Direct	Separate Account	613.9	30.6	5.0%	1.5	0.2%
Indirect	Commingled Fund	669.7	45.8	6.8%	10.1	1.5%
<b>Total</b>		<b>1,283.6</b>	<b>76.4</b>	<b>5.9%</b>	<b>11.6</b>	<b>0.9%</b>

Source: Bloomberg, Fossil Free Indexes, SCERS calculation; excludes overlay program, transition holdings

Note: Coal CU 200 exposure excludes a limited number of companies that are on both the coal and oil & gas lists; CU200 constituents as of July 2016