Seattle City Employees' Retirement System

Environmental, Social and Governance (ESG) Update
Fourth Quarter 2015

Purpose

This update is required by the following motion adopted by the Board at its meeting 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.

Industry Developments

Institutional Investors (with a focus on US Public Pensions)

- California's Governor signed SB 185 that requires CalPERS and CalSTRS to divest from investments in thermal coal companies by July 2017 unless their boards determine that it is inconsistent with their fiduciary responsibilities. The bill indemnifies the boards from actions related to the bill. CalPERS and CalSTRS are currently assessing their exposure and proceeding with an initial step of corporate engagement, as required by the bill. CalPERS and CalSTRS have not yet announced whether they plan to divest from thermal coal companies. [link]
- In November 2015, a bill was introduced requesting that the DC Retirement Board divest from the 100 companies with the largest oil and gas reserves and 100 companies with the largest coal reserves. The bill indemnifies the board from actions related to the bill. A similar bill was introduced in 2013, but was not voted on. The DC Retirement Board opposed the 2013 bill and is expected to do so again, preferring instead to pursue a number of positive actions. [link]
- In July 2015, the Board of Investment Commissioners for the City of Providence, RI, acted to divest from the top 15 US carbon emitting coal companies, known as the "filthy fifteen," in its $290 million public pension fund. [link]
- In September, New York City's Mayor, Bill de Blasio, supported by NYC Comptroller, Scott Stringer, asked the five NYC retirement systems to divest from coal investments and to develop a long-term investment strategy that evaluates all fossil fuel investments. Each retirement system has an independent Board, which will determine how they will interpret the Mayor's request. [link]

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- New York State Comptroller Thomas DiNapoli announced at the COP21 event in Paris on December 4, 2015, that the New York State Common Retirement Fund ($184.5 billion in assets) had created a $2 billion low carbon index portfolio in partnership with Goldman Sachs Asset Management. Mr. DiNapoli is the sole trustee of the pension fund. The new index portfolio will exclude or reduce investments in companies that are large contributors to carbon emissions like the coal mining industry, and increase investments in companies that are lower emitters. [link]

Investment Managers, Service Providers and Other Participants

- In October 2015, the Department of Labor issued updated guidance regarding where it is permissible for fiduciaries to incorporate ESG considerations in investment practices. In doing so, they reinstituted language from an earlier 1994 guidance. The Department of Labor sought to clarify their 2008 Interpretive Bulletin, which they felt had been misinterpreted. The updated guidance clarifies that ESG considerations may be used as a tie-breaker or when it has a direct impact on expected investment return or risk. As SCERS's counsel has opined, SCERS's ESG Policy was and remains consistent with the Department of Labor's updated guidance. [link]
- Corporate Knights and South Pole released a free tool that calculates performance over the past three years if an investment portfolio had been divested of fossil fuel companies. SCERS Staff spoke with Corporate Knights and utilized the tool on SCERS's public equity separate accounts (results in Appendix). SCERS Staff identified several limitations, such as its short timeframe and exclusive reliance on historical performance, and did not feel that it provided any information that Staff and NEPC had not reported previously, including in the Appendix of this Update. [link]
- State Street Global Advisors launched an ETF that excludes fossil fuel companies from the S&P 500 Index. [link]
- Barclays released a credit research paper, "The Cost of Being Green," which found that green bonds have lower expected returns compared to non-green bonds. [link]

Membership Organization Activity: Ceres, INCR, CII

- Ken Nakatsu attended an INCR roundtable for plan sponsors and investment consultants, "Implementing Sustainable investing – Progress and Challenges." A summary of the event can be found in the Appendix.
- SCERS rejoined the Council of Institutional Investors (CII). Jill Johnson attended the CII Fall conference. This was a 3 day conference with a diverse set of speakers and a broad range of topics. As a member of this Council, SCERS will be able to join with other pension plans to effect change in corporate governance and other related topics.
- Jill Johnson attended an Impact Investing forum in Seattle that was attended by several investment managers and consultants. [link]

SCERS Activity

Since February 2015, SCERS's staff has participated in 41 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 rejoined the Council of Institutional Investors (mentioned earlier).
- SCERS began instructing its public equity separate account managers to vote the proxies of its shares according to the Institutional Shareholders Services (ISS) Public Funds policy, when practicable. Previously, SCERS had delegated proxy voting to its investment managers. ISS's Public Funds policy is more in line with SCERS's goals for corporate governance and stronger ESG accountability.
- SCERS joined 400 other investors in signing the Global Investor Statement on Climate Change that calls on governments to reach a robust global agreement to combat climate change. [link]

Integrating Climate Change into the Investment Process

- SCERS hired Mercer to produce ESG-focused research reports on the infrastructure finalist candidates so that the Board and Staff could consider their approaches to ESG risks in making selections.

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)…*"

- Staff and NEPC continue to evaluate the investment merits of respondents to its infrastructure RFP and expect to make subsequent recommendation(s) in the first quarter.

Seattle City Employees' Retirement System

Appendix

Market Performance

Annualized as of November 30, 2015

	Performance					Std Deviation	
Index	1Y	3Y	5Y	10Y	Since 1/90	10Y	Since 1/90
S&P 500 Index	2.74%	16.08%	14.39%	7.48%	9.38%	15.04%	14.60%
S&P 500 Index ex Energy	4.08%	17.72%	15.51%	7.66%	9.40%	15.22%	14.99%
S&P 500 Index ex Fossil Fuels	3.85%	17.71%	15.30%	8.03%	NA	15.40%	NA

Source: Bloomberg, Fossil Free Indexes, SCERS calculation

SCERS Public Equity Exposure to the Carbon Underground 200

As of November 30, 2015

			Total CU200 Exposure		Coal CU200 Exposure	
Ownership	Account Type	Mkt Value ($m)	$ million	%	$ million	%
Direct	Separate Account	530.0	23.9	4.5%	0.9	0.2%
Indirect	Commingled Fund	647.4	41.0	6.3%	6.8	1.1%
Total		1177.5	64.9	5.5%	7.7	0.7%

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