Seattle City Employees' Retirement System

Environmental, Social and Governance (ESG) Update
First Quarter 2016

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)

- As mentioned in prior ESG updates, California has passed 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 and with indemnification of the boards from actions related to the bill. Several development have occurred since the last ESG update:
  - CalSTRS announced on February 3, 2016, that it will divest from four US thermal coal companies (Cloud Peak Energy, Hallador Energy Company, Peabody Energy Corporation, Westmoreland Coal Company). The impact will be approximately $1.5 million (0.0008%) of their $180 billion plan. SCERS does not have any direct investments in these four companies in its separately managed accounts.[1]
  - CalPERS is pursuing engagement with thermal coal companies instead of divestment at this time. They have updated their Investment Policy regarding divestment requests to address situations such as that made in SB 185. Specifically, the updated Investment Policy states "Implementation of any divestment decisions made pursuant to California state statute shall include a request for the up-front reimbursement by the California state legislature (Legislature) of the anticipated one-time costs of implementation, to include trading costs, staff's analysis and review costs, and the cost of any outside advisers".[2]
- In December 2015 the San Francisco City and County Employees Retirement System Board approved a motion to "prudently divest" from thermal coal companies and "prudently reinvest" in renewables. The Board previously approved a motion to invest $100 million (0.5% of total assets) in an equity fossil fuel-free index fund. SCERS understands that these motions have not yet been fully implemented.[3]

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Membership Organization Activity: Ceres, INCR, CII

Jason Malinowski attended the following INCR-sponsored events in New York on January 26 and 27, 2016:

- **Chief Investment Officer Roundtable** was attended by senior investment staff from CalPERS, CalSTRS, New York State, New York City, Connecticut, Maryland, Maine, San Francisco and several non-public pension institutions. Several of these public pensions are leaders in ESG. Discussion focused on ESG integration, managing climate risks and low-carbon investments. Most attendees had begun integrating ESG considerations into their manager selection process, although there was acknowledgment that ESG is not a highly material factor for every asset class (e.g. fixed income). Two attendees had invested in low carbon strategies in part due to their market view that carbon-intensive equities would underperform. With respect to sustainability investments, there was generally more interest in renewable infrastructure than clean tech or green bonds.
- **INCR Semi-Annual Meeting** included panel discussions on the Department of Labor's recent ESG guidance and carbon footprinting. The panelists commented that the Department of Labor has reverted to a previously issued guidance where ESG issues may be considered where it is relevant to the economic merits of an investment. Carbon footprinting is an analysis to quantify the carbon emissions associated with an investment portfolio. The panelists discussed the challenges associated with carbon footprinting, such as the lack of disclosure by public companies on climate-related risks. A carbon footprinting vendor who participated on the panel mentioned that only 7% of all public companies report this data.
- **Investor Summit on Climate Risk** took place at the United Nations headquarters and included 500 investors. Speakers included Ban Ki-Moon (UN Secretary-General), Christiana Figueres (Executive Secretary, UN Framework Convention on Climate Change), Michael Bloomberg and Al Gore. All speakers felt that the COP21 in Paris was a success that surpassed their expectations. Other key takeaways from the Summit include: (a) a carbon price is essential to prompt the significant amount of investment needed for an economy that is less reliant on fossil fuels; (b) investment in renewables has increased exponentially due primarily to lower construction costs; and, (c) emerging countries, particularly India, have a more pivotal role than developed countries if climate change is to be contained.[4]

Jill Johnson participated in monthly conference calls for the INCR Carbon Asset Risk Working Group and the INCR Policy Working Group. The Carbon Asset Risk Working Group focuses on tactics for engaging fossil fuel energy companies on risks associated with their development of carbon reserves and related capital expenditures, coordinating engagements, annual general meeting debriefs and advancing mainstream financial analysis of these risks. The Policy Working Group focuses on engaging federal and state policy makers on key climate, energy and sustainability issues through a variety of vehicles, including in-person meetings, letters, and op-eds. The group also facilitates international investor collaboration on global investor statements and events.[5]

SCERS Activity

Since February 2015, SCERS's staff has participated in 48 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:

Integrating Climate Change into the Investment Process

- SCERS engaged Mercer to produce an ESG-focused research report on Brookfield Infrastructure Fund III, which was approved by the Investment Committee and is now under consideration by the Board.

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 recommended a commitment of up to $15 million to Brookfield Infrastructure Fund III due to its expected investment return and risk properties. Additionally, the strategy is expected to have a 35% allocation to renewable power investments, primarily in hydroelectric facilities and wind farms.

Appendix

Market Performance
Annualized as of February 29, 2016

	Performance					Std Deviation	
Index	1Y	3Y	5Y	10Y	Since 1/90	10Y	Since 1/90
S&P 500 Index	-6.20%	10.74%	10.12%	6.44%	9.00%	15.15%	14.59%
S&P 500 Index ex Energy	-4.62%	12.59%	11.67%	6.71%	9.05%	15.33%	14.96%
S&P 500 Index ex Fossil Fuels	-4.88%	12.09%	11.41%	7.00%	NA	15.51%	NA

Source: Bloomberg, Fossil Free Indexes, SCERS calculation

SCERS Public Equity Exposure to the Carbon Underground 200
As of February 29, 2016

			Total CU200 Exposure		Coal CU200 Exposure	
Ownership	Account Type	Mkt Value ($m)	$ million	%	$ million	%
Direct	Separate Account	501.1	21.9	4.4%	0.9	0.2%
Indirect	Commingled Fund	582.1	36.7	6.3%	6.5	1.1%
Total		1083.2	58.5	5.4%	7.4	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

[1] http://www.calstrs.com/news-release/calstrs-divests-us-thermal-coal-companies
[2] https://www.calpers.ca.gov/docs/board-agendas/201602/invest/item09a-03.pdf (p20-24)
[3] http://mysfers.org/wp-content/uploads/12-09-15-Minutes.pdf (p9-12)
[4] http://www.ceres.org/investor-network/investor-summit
[5] http://www.ceres.org/investor-network/incr/incr-working-groups