

March 13, 2017**Item Name:** ESG Asset Class Integration**Program:** Total Fund**Item Type:** Information**Executive Summary**

This agenda item provides a deeper look into Environmental, Social, and Governance (ESG) integration for each asset class. The item provides a summary of work being done, lessons learned and proposed next steps.

Strategic Plan

This agenda item supports the goal of CalPERS' Strategic Plan to improve long-term pension and health benefit sustainability. The update supports the Investment Committee in its oversight role to monitor performance, initiatives, and contributions to the System's investment objectives.

Investment Beliefs

The integration of ESG expectations for internal and external managers across the Total Fund aligns with CalPERS' Investment Beliefs, in particular:

Investment Belief 4:

Long-term value creation requires effective management of three forms of capital: financial, physical and human.

Investment Belief 9: Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.

Background

In May 2015, staff presented a project on ESG Manager Expectations to the IC, which was intended to ensure clarity and consistency in aligning asset class practices with the Investment Beliefs, Global Governance Principles and United Nations - Principles of Responsible Investment (UN PRI). The plan included a review of definitions, data sources and taking stock of current practices of internal and external managers. These were benchmarked against external sources such as the UN PRI, International Corporate Governance Network guidelines, and global peers.

Following the review of best practices, each asset class developed a set of draft Sustainable Investment Practice guidelines which reflected their particular strategies. These guidelines utilized common governance elements applied across the total fund, such as the Investment Beliefs and Global Governance Principles, as well as adapted to the particular strategies of each asset class. The objective was to ensure that sustainable investment considerations were appropriately included throughout the life cycle of investments by internal and external managers, including: selection, contracting, monitoring and management.

In January 2016, the Investment Committee embarked on a six-month process to develop CalPERS' new 5-year ESG Strategy (Strategy). In August 2016, the IC approved the Strategy which included six key initiatives, one of which is the Manager Expectations. This agenda item provides a summary of the work that was done during the 18-month pilot program as well as proposed next steps to meet the object within the Strategy.

Analysis

Each asset class has conducted a pilot of its own sustainable investment practice guidelines. Lessons learned are being incorporated into the Manager Expectations as the project evolves. Next steps include continued monitoring by the Governance & Sustainability Subcommittee of the Investment Office's Investment Strategy Group.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The benefits of integrating ESG into manager expectations across the Total Fund are to ensure clarity and consistency of alignment of our manager's investment activities with CalPERS' Investment Beliefs and Global Governance Principles. The risks include precipitate development of guidelines in the absence of sufficient quality and quantity of data around the materiality of various ESG factors.

Attachments

Attachment 1 – Presentation - ESG Asset Class Integration

Attachment 2 – CalPERS Global Equity Sustainable Investment Practice Guidelines

Attachment 3 – CalPERS Global Fixed Income Sustainable Investment Practice Guidelines

Attachment 4 – CalPERS Private Equity Sustainable Investment Practice Guidelines

Attachment 5 – CalPERS Real Assets Sustainable Investment Practice Guidelines

Dan Bienvenue

Managing Investment Director
Global Equity

Theodore Eliopoulos

Chief Investment Officer