



Investment Committee

Agenda Item 11b

November 18, 2019

Item Name: CalPERS' Strategy on Sustainability

Program: Investment and Executive Offices

Item Type: Information

Executive Summary

CalPERS' Board adopted a five-year strategic plan for sustainable investment in 2016. This agenda item provides an overview of progress to date. It also sets out a new organizational structure for implementation in which the Executive Office will take the lead on external facing relationships through partnerships and advocacy, allowing the Investment Office to focus its resources on engagement and integration.

Strategic Plan

CalPERS' Enterprise [Strategic Plan](#) (2017-2022) sets out a goal to improve fund sustainability, including a commitment to include environmental, social and governance (ESG) factors relevant to risk and return in 100% of policies and procedures across in the Investment Office.

Investment Beliefs

CalPERS' strategy on sustainability reflects the [Investment Beliefs](#), including:

2. A long time investment horizon is a responsibility and an advantage.
3. CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.
4. Long-term value creation requires effective management of three forms of capital: financial, physical and human.
9. Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.
10. Strong processes and teamwork and deep resources are needed to achieve CalPERS' goals and objectives. Diversity of talent...at all levels (Board, staff, external managers, corporate boards) is important.

Background

CalPERS' commitment to sustainability reflects the system's need to ensure repeatability of returns to pay pensions and health benefits across generations at the least possible cost to employers. Sustainability over the long term is a vital component of investment strategy, to ensure both current and future liabilities can be met, in line with CalPERS' fiduciary duty.

In 2012 CalPERS commissioned an independent [academic review](#) of published research to assess the evidence on the environmental, social and governance dimensions of sustainability. The Sustainable Investment Research Initiative (SIRI) reviewed close to 1,000 published research papers highlighting themes that were relevant to long term value creation and investment risk. The findings contributed to the development of CalPERS' Investment Beliefs which were adopted the following year. The SIRI also provided the research evidence for development of a five-year strategic plan for sustainable investment with six strategic priorities:

- climate change;
- diversity and inclusion;
- data and corporate reporting;
- alignment of interest in private equity;
- manager expectations;
- research.

The [strategic plan](#) for sustainable investment sets out the three channels through which CalPERS pursues its priorities. First, advocacy to ensure that CalPERS' goals are clearly articulated to regulators and policy makers. Second, engagement using CalPERS' position as a provider of financial capital to companies and managers, to foster alignment with the strategic priorities. Third, integration so that relevant issues in environmental, social and governance (ESG) would be included across investment decision making of the total fund. In the CalPERS' model, each of these three channels is supported through partnerships to enable CalPERS to share resources, gain insight and pool influence with fellow long-term investors.

Analysis

CalPERS has a reputation for leadership in the field of sustainability. One example is the nomination to the Principles for Responsible Investment's Global Leaders Group, which includes CalPERS as the only US signatory. Another signal is the range of high-level invitations for CalPERS to participate internationally on sustainability issues. Examples include the invitation from the UN Secretary General to join the Net Zero Asset Owner Alliance, plus the Global Investors for Sustainable Development and also Vatican Council on Inclusive Capitalism. CalPERS has been ranked each year since the adoption of its strategic plan as the most influential investor globally on sustainability, in the annual Extel financial analyst survey.

CalPERS has launched advocacy, engagement and integration work for each of its strategic priorities, building on partnerships which include industry associations (such as PRI, CERES, CII, ICGN) and regulatory bodies (including SEC, PCAOB, IFRS, FASAC, CFTC).

A new organizational structure has been adopted in order to strengthen implementation of the strategic plan on sustainability. CalPERS' advocacy and partnerships have been elevated to the Executive Office, in order to provide a broader enterprise wide scope of work. The engagement channel will continue to be led by the corporate governance team, within Global Equity in the

Investment Office. CalPERS integration work will be led by the Sustainable Investments program within the Investment Office.

The presentation attached provides an update on two of the strategic priorities – Climate Change and Diversity and Inclusion.

Climate Change

The Climate Action 100+ initiative now has over 370 signatories with over \$35 trillion in assets under management. CalPERS is leading engagements on 22 portfolio companies globally, including 6 of 10 Japanese companies on the list of 161 focus companies. The engagements have led to notable successes at companies such as BP, Shell, Glencore, and Equinor, amongst others that have publicly committed to implementing the engagement goals of the initiative. Companies such as HeidelbergCement, Duke Energy, Nestle, Daimler, VW, Thyssenkrupp, ArcelorMittal, BHP Billiton and Centrica, have made “net-zero” emissions commitments.

Approximately 70% of focus companies have set long-term emissions reduction targets, although only 9% of the companies have targets that are in line with the goals of the Paris Agreement. Approximately 40% of companies undertake and disclose climate scenario analysis and 30% of companies have formally supported recommendations of the Taskforce on Climate-Related Financial Disclosures (TCFD), while 8% of companies have policies in place to ensure their lobbying activity is aligned with necessary action on climate change

The work of Climate Action 100 and CalPERS has also received favorable media coverage, including stories in the Financial Times, The Economist and Time Magazine.

Diversity & Inclusion

Since the adoption of the strategic plan, company engagement regarding diversity and inclusion has made significant strides.

Results of this effort have included the appointment of women to boards, and more than half of engaged companies adding diverse directors to their board. Specifically, 53% of companies engaged since July 2017 added a diverse director to their boards (361 of 682 companies). Our current engagement efforts are focused on improving board diversity at Russell 3000 companies. In line with the strategic plan KPI, the engagement will expand to include all public companies in which CalPERS invests.

Women now occupy 20% of Russell 3000 board seats as of June 2019, compared to 17% in March 2018 and 15% in January 2017.

CalPERS met its 3-year KPI for all S&P 500 companies to have at least one female director on their boards as of July 2019.

CalPERS also voted “against” 255 directors at 97 companies where diversity engagements did not result in constructive outcomes. In 2018, we voted against 468 directors at 145 companies due to lack of progress on diversity engagements.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The benefits of the CalPERS' strategic plan on sustainable investment are to provide an evidence-based focus on risk and return which leverages the strengths of the system providing clarity on goals and performance measures.

The risks of the CalPERS' strategic plan on sustainable investment are that systemic issues like climate change may impact the portfolio in complex and unanticipated ways, whilst other risks from geopolitical or wider economic events outpace our ability to respond effectively.

Attachments

Attachment 1 – CalPERS Strategy on Sustainability - PPT

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