



SFERS


San Francisco Employees' Retirement System

City and County of San Francisco
Employees' Retirement System

RETIREMENT BOARD CALENDAR SHEET


Retirement Board Meeting of March 11, 2020

To: Retirement Board

Through: Jay Huish 
Executive Director

From: Andrew Collins 
Director of ESG Investing

William J. Coaker Jr., CFA, MBA 
Chief Investment Officer

Kurt Braitberg, CFA, CAIA 
Managing Director, Public Markets

Anna Langs, CFA, FRM
Managing Director, Asset Allocation, Risk
Management, and Innovative Solutions

David Francl, CFA, MBA
Managing-Director, Absolute Return

Tanya Kemp, CFA, CAIA
Managing Director, Private Markets

Date: March 11, 2020

Agenda Item:

SFERS Climate Action Plan and Net Zero Carbon Emissions by 2050 Ambition

Background:

Climate change poses significant risk as well as creates opportunities for long-term investors like SFERS, including those arising from:

- The transition from a fossil-fuel based economy to a low-carbon economy;
- The inevitable regulatory, political, and legal liability responses to climate change;
- The physical impacts of climate change.

SFERS has taken a variety of steps to manage climate transition risks in its portfolio, including addressing risks to the Oil & Gas and Utilities sectors in its public markets portfolio, allocating to carbon-constrained and low-carbon technology opportunities, engaging directly with companies that display high climate risk, restricting investment in certain industries and companies with unmitigated climate transition risk, and advocating for sustainable public policy efforts.

Due to the breadth of potential ways climate risk can manifest (transition, regulatory, and physical) and climate change's ability to have impacts across geographic regions, sectors, and asset classes, Staff believe it appropriate to adopt a Plan-wide approach for consideration of climate risk.

The 2015 Paris Agreement puts forth a downwards emissions trajectory, reaching net zero global carbon emissions in 2050, as the appropriate target in order to avoid catastrophic effects of climate change. Staff believes it is prudent, therefore, and consistent with fiduciary duty to acknowledge and evaluate the risks arising from global progress towards the goals outlined in the Paris agreement.

Staff recommends a plan-wide policy statement of the following ambition: **That the SFERS Trust has Net-Zero Carbon Emissions by 2050**

This ambition will be supported by a Climate Action Plan which will:

- Outline steps to integrate considerations of climate risk across asset classes and achieve net zero carbon emissions by 2050 (including establishing interim timelines);
- Build on existing SFERS' climate strategy (i.e., Six Strategies to Address Climate Risks, Climate Transition Risk Framework for Oil & Gas, Climate Transition Risk Framework for Utilities);
- Be consistent with SFERS' 3 Pillar ESG Platform, by incorporating proxy voting, shareholder engagement, and policy advocacy efforts alongside investment related actions.

Recommendation:

Staff recommends the Board approve the following motion:

- Adopt a "Net Zero Carbon Emissions by 2050" Ambition and direct Staff to develop and implement a Climate Action Plan that outlines how SFERS can achieve this ambition.

Attachment:

Staff Presentation



SFERS
San Francisco Employees' Retirement System

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Climate Action Plan – Net Zero by 2050

William Coaker Jr., CFA, CFP, MBA – Chief Investment Officer
Anna Langs, CFA, FRM – Managing Director, Asset Allocation, Risk Management, and Innovative Solutions
David Francl, CFA, MBA – Managing Director, Absolute Return
Kurt Braitberg, CFA, CAIA – Managing Director, Public Markets
Tanya Kemp, CFA, CAIA – Managing Director, Private Markets
Andrew Collins – Director of ESG Investing

March 11, 2020

Background

- *Climate change poses significant risk as well as creates opportunities for long-term investors like SFERS, including those arising from:*
 - *The transition from a fossil-fuel based economy to a low-carbon economy;*
 - *The increasingly inevitable regulatory, political, and legal liability responses to climate change;*
 - *The physical impacts of climate change.*
- *These pose specific/idiosyncratic risks to certain companies, industries, and commodities and are understood by academics, global investors, financial regulators, and others to pose systematic or market risk. Further, macroprudential regulators and others also identify the possibility that climate risk may be a systemic risk.*
- *SFERS has taken a variety of steps to manage climate transition risks in its portfolio, including addressing risks to the Oil & Gas and Utilities sectors in its public markets portfolio, allocating to carbon-constrained and low-carbon technology opportunities, engaging directly with companies that display high climate risk, restricting investment in certain industries and companies with unmitigated climate transition risk, and advocating for sustainable public policy efforts.*

Background

- *Due to the breadth of potential ways climate risk can manifest (transition, regulatory, and physical) and climate change's ability to have impacts across geographic regions, sectors, and asset classes, Staff believe it appropriate to adopt a Plan-wide approach for consideration of climate risk.*
- *The 2015 Paris Agreement puts forth a downwards emissions trajectory, reaching net zero global carbon emissions in 2050, as the appropriate target in order to avoid catastrophic effects of climate change. As the 187 countries to the Paris Agreement enact policies to meet this target, a variety of other entities (corporations, states, municipalities) are putting in place ambitions to reduce their carbon emissions along the same trajectory and timeline.*
- *Staff believes it is prudent, therefore, and consistent with fiduciary duty to acknowledge and evaluate the risks arising from global progress towards the goals outlined in the Paris agreement.*
- *All else equal, Staff believes that investors that are able to successfully navigate the risks and opportunities arising from climate policy, the energy transition, and physical climate risks are likely to increase returns and reduce risk.*



Statement: Net Zero by 2050

- *Staff recommends a plan-wide policy statement of the following **ambition**:*
 - ***That the SFERS Trust has net-zero carbon emissions by 2050***
- *This ambition will be supported by a Climate Action Plan which will:*
 1. *Outline steps to integrate considerations of climate risk across asset classes and achieve net zero carbon emissions by 2050 (including establishing interim timelines)*
 2. *Build on existing SFERS' climate strategy (6 Strategies to Address Climate Risks, Climate Transition Risk Framework for Oil & Gas, Climate Transition Risk Framework for Utilities)*
 3. *Be consistent with SFERS' 3 Pillar ESG Platform, by incorporating proxy voting, shareholder engagement, and policy advocacy efforts alongside investment related actions*

Statement: Net Zero by 2050

- *SFERS views “net zero by 2050” as an “ambition” rather than a goal or target so as to not drive investment decision making that is otherwise inconsistent with achieving superior risk-adjusted returns.*
- *Staff expects that implementing this plan will involve ensuring investments are viable and not at risk in the transition to a low carbon economy. If this is done appropriately, it should be consistent with net zero by 2050 (assuming that countries, states, local municipalities, businesses and consumers across the economy do their part to similarly decarbonize).*

Net Zero by 2050: Why Now?

- *Investment-related climate risks are increasing, not decreasing, so it is consistent with fiduciary responsibilities to expand SFERS' climate strategy to include a plan-wide approach.*
- *SFERS has a unique opportunity to be first/early mover and take a leadership position in ambitiously, but prudently managing climate risk across a complex investment platform.*
- *SFERS can proactively help define and identify the methodologies and frameworks for asset owners to put in place to assess climate risk and measure progress towards "net zero" ambitions. SFERS can partner with and be supported by Ceres, which is beginning to organize asset owners globally to make similar commitments.*
- *Globally, the Net Zero Asset Owner Alliance is being convened by the UN Environment Programme Finance Initiative (UNEP-FI) with primarily European investors participating (CalPERS being the sole US member).*

Net Zero by 2050: SFERS Initiatives to Get There

Active Ownership

- *Significant decarbonization is likely to occur due to technological progress and countries, states, local municipalities, and companies implementing their own net zero by 2050 targets. Therefore, Active Ownership is desirable to use our voice and vote to ensure companies continue this progress and to better manage SFERS portfolio risks.*

Managing Investment Risk

- *Within its public markets portfolio, SFERS will continue to strengthen and apply its Oil & Gas and Utilities climate-risk frameworks. Staff will consider if additional frameworks for other high emitting sectors are necessary (e.g., the Materials sector). The Public Equity portfolio is currently 22% less carbon intensive than its benchmark and 40% less carbon intensive than it was 10 years ago.*
- *For alternative asset classes, the first steps will be developing a process to assess carbon risk exposure and carbon footprint given the current lack of available greenhouse gas emissions data. Then, Staff will follow a risk-based process similar to that used in public markets and apply frameworks to ensure SFERS invests in underlying companies and assets that are aligning their business model with the objectives of the Paris agreement.*

Low Carbon Investing Opportunities

- *To get to net-zero, SFERS will continue to consider investments in climate solutions (e.g., low-carbon and negative carbon technologies). Again these investments will only be pursued when they meet SFERS's risk-return expectations.*

Where Do SFERS' Current Emissions Come From?

- SFERS' Public Equity portfolio has 22.4% less carbon emissions than its benchmark, the MSCI ACWI IMI.
- SFERS' less carbon intensive footprint is due to an underweight to Energy, Materials, and Utilities, and an overweight to Technology and Health Care.
- Carbon emissions in publicly traded companies are generated primarily from three sectors: Energy, Materials, and Utilities.
- Carbon emissions in Alternative assets are assumed to similarly be concentrated in the Energy, Materials, and Utilities sectors.

Chart 1. SFERS Public Equity Carbon Footprint

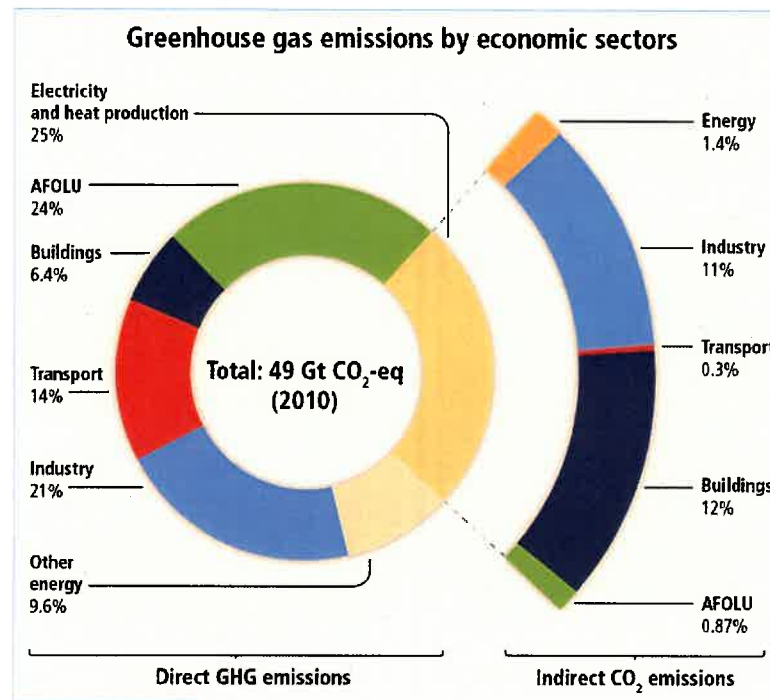
SFERS Public Equity vs MSCI ACWI IMI	Portfolio Weight	Active Weight*	t CO2e / \$M Sales		Percentage Attribution			
			Portfolio Wtd Ave Intensity	Benchmark Wtd Ave Intensity	Sector Allocation	Stock Selection	Interaction	Total
Financials	13.8%	-2.7%	50.5	16.4	2.5%	2.9%	-0.5%	4.9%
Industrials	10.0%	-1.3%	140.0	134.5	0.4%	0.3%	0.0%	0.7%
Real Estate	3.3%	-1.0%	86.3	93.3	0.5%	-0.2%	0.0%	0.4%
Consumer Staples	7.8%	-0.3%	62.0	64.5	0.2%	-0.1%	0.0%	0.1%
Communication Services	8.0%	-0.2%	23.1	26.3	0.2%	-0.1%	0.0%	0.0%
Consumer Discretionary	11.9%	1.0%	51.8	45.7	-0.7%	0.3%	0.0%	-0.4%
Energy	3.7%	-1.9%	497.4	523.8	-3.2%	-0.8%	0.3%	-3.7%
Information Technology	19.8%	4.4%	35.5	36.6	-3.6%	-0.1%	0.0%	-3.7%
Health Care	15.6%	4.2%	22.3	24.5	-3.7%	-0.1%	0.0%	-3.9%
Materials	3.0%	-1.9%	1,140.3	952.4	-7.2%	4.6%	-1.8%	-4.3%
Utilities	3.0%	-0.3%	1,761.8	2,345.1	-3.6%	-9.9%	1.0%	-12.5%
Total	100%		153.0	197.3	-18.3%	-3.1%	-1.1%	-22%

Source: MSCI; holdings as of June 30, 2019

Where Do Global Current Emissions Come From?

SFERS' concentration of emissions in the Utilities, Energy, and Materials sectors is largely consistent with where emissions occur across the broader global economy. SFERS has relatively little direct investment exposure to the Agriculture, Forestry, and Other Land Use and the Transportation Sector.

Chart 2. Global Direct GHG Emissions by Economic Sector



Source: IPCC Working Group III via climatecentral.org

Structure of Net Zero by 2050

What is the basic structure of a Net Zero by 2050 Climate Action Plan?

It would follow the same framework as SFERS' ESG Platform and expand SFERS' risk-based climate frameworks for public markets Oil & Gas and Utilities

Net-Zero by 2050 Climate Action Plan

Active Ownership

Engagement

- Through Climate Action 100+, Ceres Carbon Asset Risk (CAR) Working Group, and direct SFERS efforts, continue to engage with companies on strategy and risks associated with transition to low carbon economy. Encourage companies, where relevant, to set Paris-aligned and "Net Zero by 2050" targets

Proxy Voting

- Continue to support appropriate shareholder proposals related to climate risk
- File shareholder proposals when appropriate

ESG Investment Management

- Primary focus on Energy, Utilities, and Materials Sectors
- Define sector and asset class/sub-asset class climate-risk guidelines to set expectations and provide climate investing "guardrails" (i.e., which investments we prioritize and which avoid due to climate considerations)
 - Over time, only invest with managers and companies that are actively embedding climate risks into their investment process and have Paris-aligned portfolios
- Develop analytics tools to measure carbon footprint in alternative asset classes (focusing first on private equity and real assets)
- Continue to monitor and measure carbon footprint of public equity managers and look into steps to reduce it
- Engage with public equity and fixed income managers on integration of climate risks
- Develop tools to measure physical climate risk scenarios
- Continue to consider commitments to low and no-carbon climate solutions

ESG Collaboration & Communication

When opportunities arise, vocalize support for carbon pricing schemes, enhanced climate-related disclosure by public companies (i.e., the Task Force on Climate-related Financial Disclosures), and other relevant legislative efforts

Next Steps

- Board Approval of the Climate Action Plan and the ambition of Net Zero by 2050
- October 2020 – Report on Climate Action Plan Progress including the initiatives described on pages 7 and 11 herein
- Annual Update each October reporting on progress, status and initiatives
- Every five years (consistent with Paris Agreement reporting frequency) – re-evaluate plan and targets and reaffirm Climate Action Plan