



SFERS

San Francisco Employees' Retirement System

City and County of San Francisco
Employees' Retirement System

Office of the Executive Director

May 16, 2017

Supervisor Aaron Peskin
Board of Supervisors
Room 244, City Hall
1 Dr. Carlton B. Goodlett Pl.
San Francisco, CA 94102

Angela Calvillo
Clerk of the Board
Board of Supervisors
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Erica Major
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Board of Supervisors
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Re: File No. 170305 – Resolution urging the Retirement Board to Renew its Commitment to Divest from Fossil Fuel Companies

Dear Supervisor Peskin, Ms. Calvillo and Ms. Major,

The Retirement System acknowledges receipt of notice of the above referenced proposed resolution urging the San Francisco Employees' Retirement System (SFERS) Board to renew its commitment to divest from fossil fuel companies and receipt of a set of interrogatories from Supervisor Peskin dated May 9, 2017.

To assist the Committee in its consideration of the proposed resolution, I am providing the department's response to the interrogatories posed by Supervisor Peskin.

1. What actions have been taken by the Board and any of its committees relative to divestment from fossil fuel companies?

October 9, 2013: Retirement Board considered BOS Resolution #126-13 and voted to direct staff to prepare an analysis and report regarding Level I and Level II engagement of fossil fuel companies under the Retirement Board's *Social Investment Policy and Procedures*.

February 19, 2014: Retirement staff presented its analysis and report regarding a Level I and Level II engagement of fossil fuel companies under the Retirement Board's *Social Investment Policy and Procedures* and the Board approved a Level I (active proxy voting) engagement of the fossil fuel companies.

April, May and June 2014: Retirement staff presented its report on SFERS' 2014 proxy season votes related to fossil fuels and greenhouse gas issues. .

June 18, 2014: Retirement Board received various educational presentations, organized through Supervisor Avalos' office, on issues related to investment in fossil fuel companies, including the impact of divestment.

January 2015: SFERS joined the CERES' Investor Network on Climate Risk (INCR).

March 11, 2015: Retirement staff presented its analysis and report regarding Level II engagement of fossil fuel companies under the Retirement Board's *Social Investment Policy and Procedures* and the Board approved a Level II (active corporate engagement) engagement of fossil fuel companies. The Board also directed staff to bring an analysis and report on possible investment in a passive ex-fossil fuels index fund.

April 8, 2015: Retirement staff presented its preliminary analysis and report regarding possible investment in a passive ex-fossil fuels index fund and the Board directed staff to complete its due diligence and bring a recommendation to the Board at a later date. The Board also approved creation of a standing Environmental, Social and Governance (ESG) Committee to review and define the Board's values and policies related to ESG issues.

May and June 2015: Retirement staff provided 2015 proxy season vote updates to the Board related to fossil fuels and greenhouse gas issues.

July 8, 2015: Retirement staff presented its analysis and recommendation regarding investment in a passive ex-fossil fuels index fund and the Board approved staff's recommendation to invest \$100 million in a passive ex-fossil fuels index fund. The Board also approved amending its existing proxy voting policy by adopting the *Policy on Environmental-related Shareholder Proposals* which created a first-level screen for support for resolutions that provides additional information related to environmental issues; that require corporate actions beyond reporting of environmental issues; and that establish special corporate committees to address broad corporate policies related to environmental issues.

December 9, 2015: Retirement staff presented information to the Board related to SB-185: Public Divestiture of Thermal Coal Companies that was signed by Governor Brown on October 8, 2015 which when fully implemented will prohibit both CalPERS and CalSTRS from owning publicly issued stock, corporate bonds or other debt instruments issued by a company that generates 50% or more of its revenue from the mining of thermal coal. Staff reported on SFERS' holdings in companies that have coal mining operations that could be potentially fall under the SB-185 restriction. Staff identified a total of 8 holdings with a market value of \$21.1 million as of December 2015. The list provided to the Board included holdings that would not fit under the restrictions imposed by SB-185, namely, global mining firms - BHP Billiton, Rio Tinto, Vale and Glencore – which have multiple lines of business and for which thermal coal mining represents less than 10% of the firms' revenues.

The Retirement Board approved the prudent divestment from thermal coal companies and the reinvestment of the proceeds in renewables and directed staff to prepare an implementation plan for implementing the divestment from thermal coal companies.

January 2016: Retirement staff completed investment of \$100 million in MSCI USA Ex-Fossil Fuels index as approved by the Retirement Board in July 2015.

May, June and July 2016: Retirement staff provided monthly 2016 proxy season vote updates to the Board related to fossil fuels and greenhouse gas issues (INCR sponsored resolutions).

July 13, 2016: Retirement staff presented its analysis and recommendation for implementing the Board's December 9, 2015 determination to divest from its thermal coal holdings. The Retirement Board referred this item to the ESG Committee for consideration and possible recommendation for action to the full Retirement Board.

September 14, 2016: Retirement staff's analysis and recommendation for implementing the Board's December 9, 2015 determination to divest from its thermal coal holdings was presented to the ESG Committee and was continued to its next meeting.

April 19, 2017: Retirement staff's analysis and recommendation for implementing the Board's December 9, 2015 determination to divest from its thermal coal holdings was again presented to the ESG Committee and the committee approved staff's recommendation to divest from certain thermal coal companies and forwarded it to the full Board with its recommendation to approve.

May 17, 2017: The ESG Committee recommendation and Retirement staff's analysis and recommendation for implementing the Board's December 9, 2015 determination to divest from its thermal coal holdings including the recommendation to divest from certain thermal coal companies will be heard by the full Board.

2. What actions has SFERS taken as part of Level 1 engagement with fossil fuel companies to actively vote its proxies shareholder resolution related to climate change?

July 8, 2015: The Board also approved amending its existing proxy voting policy by adopting the *Policy on Environmental-related Shareholder Proposals* which created a first-level screen for support for resolutions that provides additional information related to environmental issues; that require corporate actions beyond reporting of environmental issues; and that establish special corporate committees to address broad corporate policies related to environmental issues.

a. How many shareholder resolutions related to climate change has SFERS voted against?

Since the Board amended its proxy voting policy in July 2015, SFERS voted against one INCR-sponsored climate change resolution out of 57 climate risk resolutions voted during the 2016 proxy season.

b. Which of those resolutions were sponsored by members of the CERES' Investor Network on Climate Risk (INCR), which SFERS joined in January 2015?

During the 2016 proxy season, the only climate risk resolution sponsored by INCR members that SFERS voted against was a shareholder resolution to adjust executive compensation for reserves write-downs.

c. For which of those resolutions did the SFERS Retirement Board authorize the vote against the shareholder resolution related to climate change?

None; SFERS engages Institutional Shareholder Services Inc. to vote its proxies in accordance with the Proxy Voting Policy approved by the Retirement Board.

3. What actions has SFERS taken to implement Level 2 active shareholder engagement with fossil fuel companies?

As indicated above, SFERS joined CERES' Investor Network to engage and collaborate on environmental, social and governance issues. The CERES Investor Network on Climate Risk and Sustainability comprises more than 130 institutional investors, collectively managing more than \$17 trillion in assets, advancing leading investment practices, corporate engagement strategies and policy solutions to build an equitable, sustainable global economy and planet. CERES works with investors specifically to better manage carbon risks and to ramp up global investments in clean energy. In addition, the CERES Investor Network members collaboratively pressure stock exchanges and capital market regulators to improve climate and sustainability risk disclosure.

SFERS is also a long-standing member of Council of Institutional Investors (CII) which includes more than 120 pension and other benefit funds with \$3 trillion in combined assets under management. CII's primary focus is providing unbiased information about best practices in corporate governance which is an important risk factor for investment portfolios. CII provides members up-to-date information on governance trends and critical financial regulations and advocating for best practices on behalf of investors.

Through its affiliation with both CERES and CII, SFERS has frequent opportunities to sign onto letters to companies, regulators, legislators and world leaders to advocate for issues related to climate risk. For example, most recently through CII, SFERS has had the opportunity to sign on to a letter to members of the U.S House of Representatives to oppose provisions of the Financial CHOICE Act of 2017 which is currently being considered by the U.S. House of Representatives directly related to severely restricting access to shareholder proposals. In addition, through CERES, SFERS had the opportunity to sign onto a letter from global investors representing more than \$10 trillion in assets to the governments of the G7 and G20 nations conveying our strong support for the Paris Agreement and urging governments to continue to support and fully implement the Agreement.

What is the status of the Retirement Board's March 2015 motion to "direct staff" to prepare an implementation plan and timeline to the Retirement Board for its consideration and approval?

SFERS had already joined the CERES Investor Network on Climate Risk and Sustainability (INCR) at the time of the March 2015 directive to staff. At the July 8, 2015 Retirement Board meeting, staff presented a recommendation to amend its existing proxy voting policy by adopting the *Policy on Environmental-related Shareholder Proposals* which created a first-level screen for support for resolutions that provides additional information related to environmental issues; that require corporate actions beyond reporting of environmental issues; and that establish special corporate committees to address broad corporate policies related to environmental issues. This recommendation was targeted at Level II engagement for climate risk shareholder proposals initiated through and in collaboration with INCR and/or its members. Included in this recommendation was staff's responsibility to report out to the Retirement Board its votes on each INCR-sponsored resolution during each proxy season. Retirement staff has provided proxy season vote updates to the Board related to INCR sponsored resolutions addressing fossil fuels and greenhouse gas issues during the 2016 and 2017 proxy seasons.

In addition, SFERS staff participated in the 2016 Investor Summit on Climate Risk at the United Nations along with over 500 other global investors shortly after the historic international climate agreement in Paris to

begin mobilizing the trillions of dollars of assets under management to accelerate the shift to a global clean energy future and tackle the risks posed by climate change.

4. What steps have been taken to identify the “worst of the worst” fossil fuel companies?

The Retirement Board’s consideration of the “worst of the worst” fossil fuel companies has focused on investment risk. At the time of the Retirement Board’s consideration of thermal coal divestment in 2015, thermal coal companies had been a drag on SFERS investment performance for the previous decade. From 2008 to 2015, the coal industry had plummeted in stock value and led the Retirement Board to consider Level III engagement (investment restrictions) based on the “worst of the worst” criteria as reflected in the action that the Board took at its December 9, 2015 Board meeting. This action was taken at the same meeting in which Retirement staff briefed the Retirement Board on SB-185: Public Divestiture of Thermal Coal Companies that was signed by Governor Brown on October 8, 2015 which prohibits CalPERS and CalSTRS from investing in thermal coal companies.

The Retirement Board will be voting on the ESG Committee’s recommendation for investment restrictions on certain thermal coal companies at its May 17, 2017 Retirement Board meeting.

What variables are being used to assess the corporate behavior of fossil fuel companies?

Mitigating considerations for Level III divestment from thermal coal companies have included whether the company is transitioning its business model to adapt to clean energy generation such as through a decrease in its reliance on thermal coal as a revenue source and whether companies have provided enhanced transparency on the impact of potential stranded thermal coal assets in their corporate business plans.

Additional mitigating considerations, as set forth in the SFERS *Policy on Environmental Related Shareholder Proposals*, include a company’s adoption and implementation of policies to encourage sustainability and environmental initiatives such as the use of renewable energy.

5. What steps has SFERS taken to implement the Retirement Board’s December 2015 motion to prudently divest from thermal coal companies held in the portfolio consistent with the Board’s Social Investment Policy and to prudently reinvest in renewables?

The Retirement Board will be voting on the ESG Committee’s recommendation for investment restrictions on certain thermal coal companies at its May 17, 2017 Retirement Board meeting. Previous steps leading up to this vote included:

July 13, 2016: Retirement staff presented its analysis and recommendation for implementing the Board’s December 9, 2015 determination to divest from its thermal coal holdings. The Retirement Board referred this item to the ESG Committee for consideration and possible recommendation for action to the full Retirement Board.

September 14, 2016: Retirement staff’s analysis and recommendation for implementing the Board’s December 9, 2015 determination to divest from its thermal coal holdings was presented to the ESG Committee and was continued to its next meeting.

April 19, 2017: Retirement staff's analysis and recommendation for implementing the Board's December 9, 2015 determination to divest from its thermal coal holdings was again presented to the ESG Committee and the committee approved staff's recommendation to divest from certain thermal coal companies and forwarded it to the full Board with its recommendation to approve.

Even before this recommendation is officially approved by the Retirement Board, SFERS has invested in excess of \$9 million in renewable energy companies in the Public Markets portfolio of the SFERS Trust since December 2015.

6. What initiative has SFERS taken to invest in a fossil-free index fund?

July 8, 2015: Retirement staff presented its analysis and recommendation regarding investment in a passive ex-fossil fuels index fund and the Board approved staff's recommendation to invest \$100 million in a passive ex-fossil fuels index fund.

January 2016: Retirement staff completed investment of \$100 million in MSCI USA Ex-Fossil Fuels index as approved by the Retirement Board in July 2015.

How much has been invested in that fund, and what are SFERS' specific plans to increase that investment?

SFERS invested \$100 million in the MSCI USA Ex-Fossil Fuels index. Retirement staff is monitoring this investment's performance against other passive investment strategies through a complete business cycle (typically 3 – 5 years) before making a recommendation to the Board to increase, remain at the current level, or terminate this investment.

Representatives of SFERS will appear at the Government Audit and Oversight Committee hearing on this subject and be available to address any questions of the Committee members.

Best regards,



Jay Huish
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cc: President London Breed
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