

MEMORANDUM

TO: Investment Committee, CalSTRS
FROM: Stephen McCourt, Allan Emkin, Sarah Bernstein, Mika Malone, Eric White
Meketa Investment Group
CC: Christopher Ailman
DATE: August 31, 2022
RE: Item 3A – CalSTRS Net Zero Strategy First Year Progress and Planning Update

In Agenda Item 3A, Staff updates the Investment Committee on the first year of the CalSTRS Net Zero Strategy progress and planning. Staff seeks the Investment Committee’s approval of four actions to further implement the CalSTRS Net Zero Strategy. After independently assessing each of the recommendations, **Meketa supports Staff’s proposed recommendations and next steps as outlined in Item 3A. We believe the recommendations represent a well-structured approach that embodies a best fit integration of a Net Zero Strategy into CalSTRS overall investments.**

In this agenda item, Staff makes four recommendations:

- 1) Set a 2030 Interim Emissions Reduction Goal for the total CalSTRS portfolio of. reducing Scope 1 and 2 combined carbon emissions by 50% by 2030, to align CalSTRS with the time horizon for global, science-based goals to stabilize the climate.
- 2) Adopt a Net Zero Investment Decision Making Process that incorporates a comprehensive analysis of the impact on risk, return, emissions, and funding status associated with any investment decision that is presented to the Investment Committee, with analysis and decisions reviewed annually and adapted as necessary as part of the on-going monitoring of the progress of CalSTRS’ Net Zero Pledge implementation and broader decarbonization of the global economy.
- 3) Reduce emissions in Public Equity by adopting a target allocation of 20% to the MSCI ACWI Low Carbon Target Index to begin realizing emissions reductions.
- 4) Integrate Climate Scenarios into the CalSTRS Asset-Liability Management (“ALM”) Framework.

Recommendation 1 – Interim Emissions Reductions Targets: We concur with Staff that interim carbon emissions reduction targets are essential to implementing a net zero strategy, and we support setting the goals of emissions reductions by 50% by 2030, which we view as current best practice to align with science-based goals. Because staff also recommends regular annual reviews, should market realities, and/or science-based targets shift, CalSTRS will be well-positioned to consider potential adjustments to the implementation of its net zero pledge that might be made to best support the retirement security of CalSTRS beneficiaries. We expect that in this rapidly shifting environment, asset owner leaders on climate, such as CalSTRS, will need to continue evolving their approach.



Recommendation 2 – Net Zero Decision Making Process: Staff’s recommendation to broaden CalSTRS’ current prudent investment decision making processes to incorporate decisions on emissions reductions and impacts of climate on the CalSTRS portfolio, and to institute an annual review process, in our opinion, allows CalSTRS to implement its Net Zero Strategy and remain flexible through annual reviews to accommodate adjustments, if needed, in what is a rapidly changing environment.

Staff’s inclusion of an effort to develop methods to track the transition is, from our perspective, both generally new globally among asset owners, and has the potential to be highly valuable to CalSTRS and to any asset owner that is focused on real economy reductions in carbon emissions, not just reductions investment portfolio GHG emissions in the implementation of a net zero strategy.

Recommendation 3 – Reduce Emissions in Public Equity by Adopting a 20% Target Allocation to the MSCI ACWI Low Carbon Index: Staff’s recommendation of a 20% Target Allocation to the MSCI ACWI Low Carbon Index represents a material step forward in reducing CalSTRS emissions, while supporting CalSTRS’ companion elements in its Net Zero Pledge of using CalSTRS’ influence to accelerate the integration of net zero considerations across global financial markets to promote an orderly and just transition, and to increase CalSTRS exposure to low-carbon investments, without undermining CalSTRS’ overall investment strategy approach. We believe the explicit integration of the low carbon target allocation with Climate Scenarios into the CalSTRS ALM is a critical component to being able to analyze and assess the potential impacts of such shifts.

Recommendation 4 – Integrate Climate Scenarios into the CalSTRS Asset-Liability Management Study: We concur with Staff that this field of analysis is new, rapidly changing, requires significant assumptions, and can be helpful in gaining overall portfolio insights into future risk-return dynamics and liability-related risks. We expect that today’s climate scenarios will continue to evolve. The staff’s selection of the NGFS (Network for Greening the Financial System) top-down scenario analyses, which includes physical and transition climate risks, represents a leading practice in a rapidly changing environment of climate investment analytic tools.

Conclusion

In our opinion, Staff’s recommendations for moving forward with CalSTRS implementation of its Net Zero Pledge represent consistent and material next steps in CalSTRS Net Zero Strategy planning and implementation.

We support the clear articulation of the difficulties and uncertainties that are present today in implementing a net zero pledge and concur with Staff’s recommendations, including that implementation should require annual reviews to allow CalSTRS to evolve best practices as the market changes.

If you have questions, please feel free to contact us at (760) 795-3450.

SB/SPM/AE/jls