



Investment Committee

Item Number 7 – Open Session

Subject: Net Zero Strategy – Progress and Planning Update

Presenter(s): Chairperson

Item Type: Consent Information

Date & Time: January 27, 2022 – 0 minutes

Attachment(s): Attachment 1 – Net Zero Green Team Overview

Attachment 2 – Definition of Greenhouse Gas Emissions Scopes

PowerPoint(s): None

POLICY

The development of the Investment Committee Work Plan and setting annual objectives/projects is covered by the [Board Governance and Administration Policy](#), Teachers' Retirement Board Policy Manual, Section 500, page 17. CalSTRS net zero emissions pledge by 2050 and the accompanying timeline and activities are part of the Investment Committee Work Plan.

This item is also covered as part of the CalSTRS Low-Carbon Investment Belief:

Investment risks associated with climate change and the related economic transition—physical, policy and technology driven—materially impact the value of CalSTRS' investment portfolio.

BACKGROUND

At the June 10, 2021 Investment Committee meeting, the Committee requested that staff evaluate whether aligning the investment portfolio with the goals of the Paris Climate Agreement, by setting a net zero portfolio emissions commitment, would enhance CalSTRS ability to further manage the risks and opportunities associated with climate change and the transition to a low-carbon economy.

At the July 8, 2021 meeting, the Investment Committee approved the Investment Committee Work Plan which included two work streams: 1) Collaborative Model 2.0 and 2) Action Steps Towards the Low-Carbon Future/Plan the Path to Net Zero. As part of the Investment Committee Work Plan, staff provided additional information on a potential net zero strategy for the CalSTRS investment portfolio.

At the September 1, 2021 meeting, staff presented its proposed net zero strategy to the Investment Committee with the recommendation to approve a pledge to move the investment portfolio to net zero emissions by 2050 or sooner. The pledge is a goal (a “North Star”) that represents an evolution

of the existing strategies that the Board, staff and consultants have been developing, refining, and executing for several years to address the foreseeable transition to a lower carbon future. This North Star allows CalSTRS to more comprehensively account for the effects of a decarbonizing economy on its investment portfolio which will impact the delivery of sustainable pension benefits to CalSTRS’ participants and beneficiaries.

The Committee approved staff’s recommendation, as well as a comprehensive year one action plan around the net zero portfolio emissions pledge implementation.

PURPOSE

The purpose of this item is to provide Committee members with an update on progress towards year one goals associated with the net zero portfolio emissions pledge.

CALSTRS NET ZERO PORTFOLIO EMISSIONS PLEDGE

As approved at the September Investment Committee meeting, there are four important steps in our path toward portfolio net zero emissions by 2050 or sooner: 1) Pledge, 2) Plan, 3) Proceed, and 4) Publish. Below is the language that the Committee adopted:

PLEDGE: (Adopted):

CalSTRS recognizes the risks and opportunities presented by the foreseeable transition to a low-carbon economy, as well as the global acceleration towards alignment with the science-based emissions targets of the Paris Climate Agreement. In order to provide sustainable benefits to California’s educators, CalSTRS is committed to achieving a net zero investment portfolio by 2050 or sooner.

PLAN: (In Progress): Implement a commitment through a net zero action plan with three core components:

- **RISK measurement and management:** build on the transition readiness assessments already underway to estimate current portfolio emissions, to establish a baseline for interim emissions reduction goals to 2050.
- **RETURN opportunities:** expand investments in low-carbon solutions that benefit from the transition to net zero and meet CalSTRS risk-return objectives.
- **INFLUENCE:** continue stewardship activities to challenge and engage policy makers and companies, in collaboration with global investor peers, to take actions to achieve a net zero economy by 2050 or sooner.

PROCEED: (In Progress): Establish a set of actions for the next year focused on **five** key areas:

1. Internal governance structures

- a. Adopt decision-making processes to ensure clarity for Investment staff leadership across asset classes.
- b. Leverage, and as necessary re-purpose, the Green Initiative Task Force (or ‘Green Team’) to train and direct staff in operationalizing a path to net zero.

2. Methodologies and frameworks to support net zero commitments

- a. Review all existing methodologies and frameworks to inform the most appropriate net zero strategies for different asset classes.
- b. Determine any required external expertise, including identifying, procuring and hiring expert external consultants as needed, to guide strategy.

3. Portfolio emissions measurement

- a. Estimate current portfolio emissions across asset classes, where possible within the year, to establish a baseline for initial interim goals.

4. Interim goals

- a. Set interim goals, informed by baseline emissions estimates, that support the three components of the net zero action plan (Risk, Return and Influence) and align with CalSTRS investment policies and overall risk-return objectives.

5. Communications

- a. Create a communications plan to effectively educate and inform members, stakeholders and the investment community about CalSTRS net zero path.

PUBLISH: (In Progress): Provide and encourage regular reporting on the progress toward net zero by:

- Leveraging existing reporting mechanisms to report on CalSTRS’ progress implementing a net zero action plan.
- Continuing to advocate for improved corporate climate-related reporting and disclosure in alignment with the recommendations of the Taskforce on Climate-Related Financial Disclosures (TCFD) and the metrics and targets of the Sustainability Accounting Standards Board (SASB), by the Securities and Exchange Commission (SEC) and other global regulators.

NET ZERO PLAN - PROGRESS TO DATE

From September to January, staff has been (1) focused on communicating with our investment partners about their efforts around integrating net zero practices into their investment management efforts and (2) developing methods to establish baseline measurements around CalSTRS carbon emission exposure and investments in climate solutions. To date, staff believes we are on track to meet the one-year goals established at the September 2021 Investment Committee meeting.

(1) Internal Governance Structures:

Status: Established

Leveraging the Investment Branch and CalSTRS’ successful history of establishing cross-asset class and multi-disciplinary teams to implement major projects, staff identified the need for a net zero governance framework with: (1) a Leadership team, (2) an Implementation team, and (3) a Communications team.

Leadership Team: comprised of the CIO, DCIO and the Directors of each asset class. Lead by the CIO, the team’s responsibility is to take the Investment Committee’s vision and translate that into appropriate strategies to manage risk and return alongside determining carbon measurement and reduction goals, investing in climate solutions and investment strategy. The Leadership team is also responsible for providing oversight and direction to the Implementation team and communicating with the Investment Committee and the Board’s consultants on any matters relating to investment policy.

Implementation Team: now known as the CalSTRS ‘Net Zero Green Team’, the Implementation team leverages CalSTRS long history of climate change integration seen through the prior ‘Green Initiative Task Force’ efforts and is focused on developing and implementing action plans that support the strategic direction provided by the Leadership team. The Net Zero Green Team is comprised of at least two representatives from each asset class, including representatives from Operations, Investment Strategy & Risk and Performance & Compliance, and also includes two representatives acting as ‘liaisons’ from the CalSTRS legal department. This team works collaboratively to build institutional knowledge into appropriate action plans and ensure that efforts taken in support of the net zero pledge are coordinated across asset classes and aligned with CalSTRS’ fiduciary duties to our members. A list of members of the Net Zero Green Team can be found in Attachment 1 to this agenda item.

Communications Team: Investment staff, including the CIO, DCIO and Director of SISS, are working together with the Director of Public Affairs, and her staff within the Communications, External Affairs and Government Relations teams, to design and implement strategies that inform members and the investment community about why and how we are pursuing a net zero emissions plan, while also informing interested parties about our progress towards our net zero emissions goals.

(2) Methodologies and Frameworks to Support Net Zero Commitments:

Status: Outreach and Review Completed (learnings will be ongoing)

World Economic Forum/Mercer Consulting Climate Change Self-Assessment

To conduct an initial assessment of our current level of climate risk management integration practices and baseline our positioning relative to several of our global asset owner peers, CalSTRS participated in a World Economic Forum (WEF) and Mercer Consulting climate change self-assessment. The self-assessment allowed staff to better understand where CalSTRS has more advanced climate risk management practices than peers and areas where we can advance.

The WEF/Mercer self-assessment allows participants to rank themselves on their climate risk management efforts over eighty action items across three major themes: Vision, Governance and Implementation. A participant’s self-assessment is then reviewed by WEF/Mercer and compared to those self-assessments of other participants, allowing the participant to understand their progress on the indicators both in an absolute sense and relative to global peers.

Staff reviewed the analysis and is integrating the results of this self-assessment in our net zero workstreams.

Implementation Team Thought Partner Outreach¹

Members of the Net Zero Green Team conducted targeted conversations with trusted investment partners for each asset class to learn about the market landscape that defines the current practice and tools available to facilitate net-zero-aligned investing. **Staff collectively reached out to more than 120 partners.** To increase the collective knowledge and leverage relationships for the broadest educational benefit, staff reported back to Net Zero Green Team during scheduled bi-weekly meetings.

While market practice varies, staff acquired many insights, including the following as they apply to measuring the emissions of the CalSTRS total portfolio:

- Most investors are using absolute emissions and emissions intensity (by revenue) as key metrics to measure and monitor portfolio climate exposure and report on emissions reductions progress.
- Some investors are choosing to set emissions reductions targets for equity and corporate bond portfolios only, where emissions data are more readily available. Private asset class emissions data are much more nascent.
- Most emission measurements include Scope 1 and 2 emissions as Scope 3 emissions measurement data remain limited. Definitions of Scope 1, 2 and 3 Emissions are included in Attachment 2 to this agenda item.
- Most investors who have adopted net zero pledges have set interim targets for 5-year periods beginning 2030.
- Public Equities: actual or estimated emissions data coverage is relatively high for public equities at more than 90% of MSCI ACWI but approximately 40% of the public equity market's total emissions are still estimated due to poor corporate accounting and reporting.
- Fixed Income: a key challenge is the lack of standard methodologies for measuring or estimating securitized or structured products, so most investors exclude these assets from emissions measurement and target setting.
- Real Estate: emissions data are typically estimated when properties are not owned or controlled, as in closed-end funds, or when properties are under development, or for real estate debt investments.
- Private Credit: most managers reported no plans in place today to track emissions. Some indicated they were planning to start in 2022.
- Risk Mitigating Strategies (RMS): challenges include the treatment of short positions and measuring derivatives.
- Inflation Sensitive: most managers are gathering emissions directly from portfolio companies, if available or are outsourcing calculations to a third-party carbon specialist.
- Private Equity: Most GPs focus on buyout fund companies when measuring emissions; emissions data is currently available for approximately only 10-20% of companies.

¹ Additional summary statistics can be found in Attachment 1.

By engaging experienced thought partners, investment staff hope to encourage additional practical efforts to measure and disclose portfolio greenhouse gas emissions. While considerable efforts and innovation are underway, we recognize that achieving net zero goals requires collective action and participation across the global investment industry.

Identifying external resources

Staff is securing outside net zero expertise by utilizing the existing investment consultant pool. We have identified several consultants with climate change experience and will partner with one or more of these consultants to assist us on near term initiatives. We will also be publishing an RFP to establish a consultant pool with more specialized net zero experience to support staff on longer-term initiatives.

(3) Portfolio Emissions Measurement:

Status: In Progress

Staff has completed its research and analysis around data service providers that support public markets carbon foot printing and determined that MSCI's carbon emissions measurement platform is the most appropriate and preferred methodology for measuring portfolio emissions. Staff has secured a license for the platform and is in the process of conducting initial measurement assessments with the expectation of establishing a baseline carbon footprint for our public asset class investments in the next few months. Staff is scheduled to report on the findings of the public market emissions measurement at the May 2022 Investment Committee meeting. The private assets continue to learn about carbon measurement techniques from their partners and advisors. Some asset classes have begun procuring resources and developing emissions measurement processes.

(4) Interim Goals:

Status: Pending Completion of Measurement (Steps 2 & 3)

Risk

As mentioned above, staff is utilizing MSCI's carbon emissions measurement platform for public assets carbon foot printing. Once these baseline measurements are determined, staff will begin considering initial carbon reduction goals. The private asset classes continue to research carbon measurement platforms and methodologies. Staff will also leverage our investment peers and external managers, and monitor emission reduction goals announced through peer investor initiatives such as the Net Zero Asset Owner Alliance (NZAOA) and the Paris Aligned Investment Initiative (PAII) to assist in our goal setting analysis and decision-making.

Return

Staff is working to define and establish a baseline measurement of our current investments in climate-related solutions. This baseline will inform discussions about the optimal ways to increase our level of investment in climate-oriented strategies in alignment with the return goals of the total fund.

Influence

Item 7 of the January 2022 CalSTRS Investment Committee Agenda, Stewardship Priorities, highlights the variety of stewardship efforts that staff are taking to accelerate corporate and regulatory movement towards net zero. As detailed in the agenda item, staff is focused on heightened proxy voting activities, milestones for net zero-focused corporate engagement, collaboration with trusted partners, and increased policy advocacy around climate. These stewardship activities encourage companies and policymakers to more timely respond to climate risk and serve as a foundation of a longer-term stewardship plan that continues to escalate our influence with global companies and policy makers in achieving shared net zero goals.

Summary

For the first half of 2022, staff will continue to establish baselines around exposure to carbon emissions (Risk), existing investments in climate solutions (Return), and standards for corporate alignment with net zero (Influence). Once these baselines are established, staff will begin developing interim goals to reduce emissions exposure, grow investments and engage corporations and policy makers. In line with the agreement to report back on year one progress towards implementing the net zero pledge, staff will be presenting our interim goals on Risk, Return and Influence as part of the September 2022 Investment Committee meeting.

(5) Communications:

Status: Ongoing

Communicating to a range of audiences, including our members, policymakers and the investment community, on the progress of our net zero pledge is an important component of our net zero plan. Ongoing collaboration between Public Affairs and Investment staff continues to better align messaging around the latest net zero developments and establish better channels to inform key audiences.

Net zero achievements are being distributed in blog posts, social media, on [CalSTRS website](#), in both internal and external newsletters and through the quarterly [Value of Engagements](#). They are also shared with member groups in email updates and meetings. In addition, content for the CalSTRS annual Green Initiative Task Force Report has been completed with the final edition due to be designed and published in early 2022. This year's report focuses on how CalSTRS low-carbon economy workplan has evolved into the current net zero climate action plan. Public Affairs and Investments also meet regularly to identify upcoming opportunities to communicate about the net zero pledge and plans.

ADDITIONAL PROGRESS

Staff's advocacy with, and support of, organizations such as the U.S. Security and Exchange Commission (SEC), the U.S. Environmental Protection Agency (EPA), the Financial Stability Oversight Council (FSOC), and the Value Reporting Framework, including the Sustainability Accounting Standards Board (SASB), has already helped influence these organizations to introduce rules and regulations that will promote improved climate risk related disclosures. More detail around these accomplishments can be found in Item 7 of the January 2022 CalSTRS Investment Committee Agenda: Stewardship Priorities.

NEXT STEPS

Staff will continue to provide periodic updates on the net zero portfolio emissions strategy to the Investment Committee as indicated in the year one action plan approved in September 2021.