

Institutional Investor Dialogues: CalPERS' Sustainable Investment Program

Christine Chardonens:

Welcome to this episode of MSCI Investor Dialogues. My name is Christine Chardonens, I am an Executive Director for Global ESG Index Product at MSCI. Today I will be talking to Anne Simpson. Hello, Anne, and welcome. So, Anne, you are a Managing Investment Director for Board Governance & Sustainability at CalPERS, the largest pension plan in the U.S. and a longtime leader on issues such as ESG and Climate. You are also responsible for strategic initiatives across the fund, including climate change and the Net-Zero Asset Owner Alliance. In 2019, you were named by Time Magazine as one of the 15 women leading the global fight on climate change. So we're excited to have you with us today.

Anne Simpson:

Well thank you very much for including CalPERS and Christine, I'm de-lighted to be here.

Christine Chardonens:

So, Anne, CalPERS' ESG strategic plan was developed in 2015. What was some of the challenges to get alignment on that strategy internally but also externally, for example, with asset managers, and, how did you overcome those challenges?

Anne Simpson:

So, the way we approached this was each asset class building up, a set of sustainable investment practice guidelines, you can find these on our website, which say, given our strategy, our goals, our risk tolerance, our... fiduciary duty, in each of these asset classes, what are we expecting? And that tool has been extremely important in terms of getting alignment with our managers, both internally and externally.

Christine Chardonens:

You mentioned reporting, can you tell us about the evolution of your sustainability reporting, for example, in relation to climate change and whether and how this reporting has contributed to risk management or help identify new investment opportunities?

Anne Simpson:

Yeah, no, thanks Christine, it's a very good question. We made one of our six priorities in the CalPERS strategic plan on sustainable investment specifically around data on corporate reporting. So, we've worked very hard at the SCC, also, on the international front, through the International Accounting Standards Board, Advisory Council for IFRS, where CalPERS represents the Council of Institutional Investors. We are pushing hard for sustainability reporting to be integrated into corporate reporting through the formal process of standard-setting. For our own reporting, I think you can take a look at our first response to the task force on climate-related financial disclosure, otherwise known as the TCFD. That came out in July of 2020. And what we did was use that TCFD framework to go right through our portfolio. The real benefit of doing this work is that we identified that about 20% of our portfolio is exposed to transition and to physical risk, but we were also, I'm glad to report, able to show the opportunities.

Christine Chardonens:

Yes, and talking about that, could you tell us more about Cal-PERS' corporate engagement strategy, including the Climate Action 100 initiative?

Anne Simpson:

The sustainable investment strategy, investment strategy, that we developed identified 3 channels for us to be effective in executing on that plan. One was advocacy, and that's our work with regulators and policy-makers. Second was integration, which we've just talked about. How do you get this understanding of risk and return on sustainability integrated into our decisions, as an investor. But the central area was engagement. But what we've been able to do through building our Climate Action 100+ is say, look, there's 3 things that every single, what we call systemically important carbon emitters, every single one of these companies needs to do 3 things: One, take responsibility at the Board level, so we can hold directors accountable. Two, set targets in line with achieving net-zero emissions by 2050. Three, disclosure. Just as we were saying, we want that TCFD report, with this beautiful framework, governance, strategy, targets and metrics, and of course, scenarios, very, very helpful, for looking ahead.

Christine Chardonens:

Thanks, so how are you assessing your portfolio managers in relation to sustainability, and in that context, has your thinking about benchmarks, I have to ask, changed with the advancement of your ESG strategy?

Anne Simpson:

In terms of managers, we look at this in a common manner, for both our internal managers and our external managers. And the way we've designed our appraisal is through this manager expectations project that's part of our strategic plan on sustainable investment. This allows each asset class to identify the relevant factors to monitor, and also commit to integrating consideration of sustainability factors across the decision-making process. So we set ourselves a target of having 100% raw processes reflecting sustainable investment considerations as part of our strategic plan. So, in the context of asset liability modeling we have to remind ourselves that for a fund like CalPERS, our target rate of return, if you like, is implied by our discount rate, which is 7%. So the benchmark that CalPERS might need for each of its asset classes is going to reflect that discount rate, it's also going to reflect our size, and it's going to reflect our risk budget. So, the construction of a benchmark is not something that can be done in a vacuum, separate from these underlying fiduciary duties to generate investment returns.

Christine Chardonens:

What additional steps are you planning for 2021 in terms of ESG integration, climate change or diversity?

Anne Simpson:

Yeah, the big piece of work for us this year is to sign-off the first 5 years of our strategic plan on sustainable investment. We'll be reporting to our Board on progress against the KPIs that we identified, and by and large we've made a lot of progress. The next issue will be what's the focus for the coming years. And I have no doubt that climate change will continue to be vitally important, because the situation, if anything, over these 5 years has become more urgent and more challenging. However, we're also showing the route to progress through engagement and through advocacy and also through integration in our strategy, because we're finding these opportunities to deploy capital, it's not all about doom and gloom. Climate change and the energy transition bring a lot of opportunities for investors as well. The other thing I would flag is we're re-freshing our research process through, round 3, the Sustainable Investment Research Initiative, we've got two requests for information out there, if anyone would like to look, it's all in our website. And we're seeking a research partner, both for climate change and capital allocation. And on human capital management, specifically, to look at the areas that have been misconsidered on diversity. That research this year is going to be extremely important for us, in informing the next stage of our strategic plan on sustainable investment.

Christine Chardonens:

Well, we certainly look forward to following these develop-ments. Thank you, Anne, for being with us today.

Anne Simpson:

It's my pleasure. Thank you for inviting me.

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