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Mayor of the City of Los Angeles

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April 28, 2021

The Honorable Members of the Budget and Finance Committee
c/o Office of the City Clerk
City Hall, Room 395
Los Angeles, CA 90012

Attention: Holly L. Wolcott, City Clerk

COUNCIL TRANSMITTAL: LOS ANGELES CITY EMPLOYEES' RETIREMENT SYSTEM'S RESPONSE TO CITY COUNCIL MOTION 19-1577 CLIMATE TRANSITION

Honorable Members:

Please see attached document regarding LACERS' response to the City Council Motion 19-1577, for your consideration.

Sincerely,

A handwritten signature in blue ink that reads "Neil M. Guglielmo".

NEIL M. GUGLIELMO, General Manager
Los Angeles City Employees' Retirement System

Attachment

c: Jeanne Holm, Deputy Mayor, Mayor's Office
Richard H. Llewellyn, City Administrative Officer
Jennifer Lopez, Office of the City Administrative Officer



REPORT TO BOARD OF ADMINISTRATION
From: Neil M. Guglielmo, General Manager

MEETING: APRIL 27, 2021
ITEM: XI – C

Neil M. Guglielmo

**SUBJECT: RESPONSE TO CITY COUNCIL MOTION 19-1577 REGARDING CLIMATE
TRANSITION FRAMEWORK AND POSSIBLE BOARD ACTION**

ACTION: CLOSED: CONSENT: RECEIVE & FILE:

Recommendation

That the Board:

1. Approve the LACERS ESG Risk Framework substantially as presented.
2. Authorize the General Manager to transmit the ESG Risk Framework to the City Council Budget & Finance Committee.

Executive Summary

LACERS has long recognized the importance of addressing Environmental, Social, and Governance (ESG) risk factors through policies established within the Board’s Investment Policy. LACERS continues to consider ESG risk factors as an additional lens by which to evaluate LACERS’ Investment Program at the policy and strategic levels down to portfolio holdings levels to better understand, assess, and possibly mitigate such risk factors. Accordingly, LACERS staff presents an ESG Risk Framework that provides a comprehensive oversight structure and process for addressing ESG risk factors that complies with the Board’s fiduciary responsibilities.

Discussion

Background

On December 2, 2020, the Los Angeles City Council approved a motion (C.F. 19-1577) requesting the LACERS Board to provide a report addressing certain climate risks. The motion specifically requested the following:

1. Recommendations on the feasibility for the LACERS Board to adopt a similar Climate Transition Risk Framework to San Francisco Employees’ Retirement System to identify investments in fossil fuel companies that pose an environmental and financial risk;

2. Options to create a climate-change watch list that will report the riskiest investments in fossil fuel companies and develop a strategy to engage with the respective companies to reduce their oil and gas reserves and increase their efforts to move towards renewables and address climate change;
3. A plan to divest from uncooperative fossil fuel companies and appropriately reinvest capital; and
4. A watch list to identify other LACERS investments such as in tobacco and firearm companies that contradict the City Council's official positions and goal to provide a healthy and secure future for Angelenos.

This report provides a background on LACERS' history of addressing risk factors that have been deemed harmful to LACERS' ability to manage a sustainable and performance-driven investment portfolio. It addresses the City Council request through the development of a framework, use of a fossil-fuel watch list, a plan to divest, and a watch list of other companies such as tobacco and firearms. The proposed ESG Risk Framework (Framework) comprehensively addresses various forms of ESG risks, including climate change, in a systematic manner consistent with LACERS' investment policy goals and objectives and fiduciary obligations to its members and beneficiaries.

LACERS Investment Policy

Environmental, Social, and Governance factors refer to the three broad categories of non-financial risk factors that measure the sustainability and societal impact of an investment. Incorporating such factors into the decision-making process leads to enhanced comprehensive investment analyses, better-informed investment decisions, and lasting sustainable, long-term risk-adjusted returns. Examples of ESG risk factors include climate change, respect for human rights, and corporate board diversity.

LACERS has long recognized the importance of addressing ESG risks through sub-policies established within the Board's Investment Policy. The Investment Policy guides the investment management of the System's assets and assists the Board and staff in effectively supervising and monitoring the investments of the System. As established by law and the Investment Policy, LACERS has a fiduciary duty to act in the best long-term interests of the System's beneficiaries, and to prioritize this duty over any other duty. In this fiduciary role, LACERS is sensitive to concerns that ESG risks may affect the performance of the investment portfolio and has adopted various sub-policies to address these risks including:

- Geopolitical Risk Policy – Addresses geopolitical risk factors that may impact investment performance and provides a robust process for identifying and mitigating such risks to the LACERS portfolio.
- Proxy Voting Policy – Promotes sound ESG practices at publicly held companies through LACERS' proxy voting activity in order to enhance shareholder value.
- Emerging Investment Manager Policy – Establishes a framework to identify emerging investment firms with the potential to add value to the LACERS' investment portfolio that would otherwise not be identified by the standard LACERS institutional investment manager search process.

Additionally, staff is currently developing a Responsible Investment Policy to provide guidance on integrating ESG risk factors more fully and comprehensively within the LACERS Investment Program. Staff anticipates this policy will be brought forth for the Board's consideration in Fiscal Year 2021-2022.

History of LACERS ESG Activities

LACERS has a history of pursuing various avenues to understand and mitigate ESG risks in the investment portfolio as described in further detail in the following sections.

Engagement

LACERS has directly engaged companies, investment managers, and regulatory bodies to communicate concerns about ESG-related issues, advocate change, support well-functioning investment markets, and protect shareholder value. A few examples of LACERS' past engagement activities include:

- August 2006 – Issued letters to 21 “bad actor” companies known to conduct business that supported genocide in Sudan and voiced concern over their operations.
- November 2014 – Issued letter to a private equity general partner to express concern about a labor dispute at a portfolio holding company that conducts business in the Port of Los Angeles.
- February 2020 – Issued a comment letter to the U.S. Securities Exchange Commission to oppose proposed amendments to regulate proxy voting advice and shareholder proposal thresholds that would adversely impact shareholders' ability to encourage good governance practices at public companies.

Collaboration and Information Sharing

LACERS has collaborated with like-minded institutional investors and organizations to create a more powerful, collective voice to promote change and protect investors' interest. Current and past collaboration partners include:

- Council of Institutional Investors (CII) - An international organization representing the voice of corporate governance that supports effective corporate governance practices and strong shareholder rights.
- Principles for Responsible Investment (PRI) - LACERS became a signatory to the PRI in September 2019 joining a cohort of over 3,000 institutional investors who have committed to understanding the investment implications of ESG factors and incorporating these factors into their investment decisions.
- State and local pension plans such as Los Angeles County Employees Retirement Association, San Francisco Employees' Retirement System, and Seattle City Employees' Retirement System to understand their ESG programs and initiatives for insights on developing a more robust program at LACERS.

Research and Education

To stay apprised of ESG-related matters, LACERS leverages its relationships with industry organizations such as CII, PRI, C40 Cities, investment managers (many who are themselves PRI signatories), LACERS' investment consultants (all of whom are PRI signatories), and peer pension

plans. LACERS has actively participated in a number of ESG conferences, discussions, and working groups to better understand the ESG landscape, forward looking trends, and industry best practices.

LACERS also obtains current ESG research from its investment advisory partners including NEPC, LLC (general fund consultant), The Townsend Group (real estate consultant), and Aksia TorreyCove Partners LLC (private equity consultant); and its membership organizations including the Pension Real Estate Association (PREA), the Institutional Limited Partnership Association (ILPA), and the Pacific Center for Asset Management (PCAM).

A detailed discussion of LACERS' policies and history of ESG activities is found in Attachment 1.

Proposed ESG Framework

While LACERS has a long history of addressing ESG risks, there was no comprehensive plan in place to coordinate initiatives related to ESG risk issues. The proposed Framework is designed to manage ESG risk factors.

The Framework is structured around five key focal points:

1. **Investment Policy and ESG Governance** - Expanding and improving the existing policy framework to integrate ESG more fully and comprehensively within LACERS investment management program.
2. **Integration of PRI** – To become a more responsible investor, LACERS commits to integrating the six PRI principles into its investment analysis and decision-making, engaging with other asset owners, seeking more transparent disclosure, reporting on investment program activities, and collaborating with other like-minded investors to promote ESG factors within the investment industry.
3. **ESG Risk Exposures** – LACERS is developing a process for identifying, monitoring, and mitigating ESG risks within the LACERS portfolio in order to support its position as a financially sustainable and performance-driven pension plan. Mitigation measures may include the use of watch lists, corporate engagement, and possible asset exclusion and/or transition initiatives.
4. **ESG-Focused Investing** – Identifying and assessing new investment approaches and strategies to better align the LACERS investment portfolio with the goals of responsible investing while remaining steadfast to a performance-driven investment program.
5. **ESG Risk Framework Action Plan** – Executing on feasible, time-bound initiatives that support the vision articulated in LACERS' Responsible Investment Policy.

A more detailed presentation of the Proposed ESG Risk Framework is found in Attachment 2.

Conclusion

LACERS believes a wider perspective and more inclusive approach, which this ESG Risk Framework represents, more accurately reflects the Board's understanding of its fiduciary responsibility to its members and beneficiaries by addressing a broad array of risk factors that may impact the long-term value of its Investment Program. The proposed Framework is a forward-facing, structured plan that provides staff with clear direction and works to realize the Board's vision of furthering its role as a more responsible investor. The Framework is built on existing policies and current practices that address ESG issues, but it also consolidates and coordinates ongoing ESG practices under the leadership of the LACERS management team.

The Framework is a dynamic document, subject to changes based on economic outlook, market assumptions, and the Board's sensitivity and prioritization of ESG issues. As LACERS continues to integrate and assess ESG factors through this critical risk lens, staff will continue to adopt best practices and recommend to the Board appropriate Framework adjustments to keep its Investment Program and ESG initiatives focused squarely on the best interests of LACERS members and beneficiaries.

Strategic Alignment

The proposed LACERS ESG Risk Framework aligns with the Strategic Plan goals of optimizing long-term risk adjusted investment returns (Goal IV); upholding good governance practices which affirm transparency, accountability, and fiduciary duty (Goal V); and maximizing organizational effectiveness and efficiency (Goal VI).

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Attachments:

1. LACERS' Investment Policy Overview and History of ESG Activities
2. Proposed ESG Risk Framework
3. City Council Motion (C.F. 19-1577)

LACERS Investment Policy Overview

Introduction

The ESG Risk Framework (Framework) is LACERS' management plan that reflects the approach and beliefs on how to best meet the retirement benefits of its members while helping to build a responsible investment program. The Framework must also comply with the existing, and any future amendments to, the LACERS Investment Policy, which in itself defines five key objectives regarding the management of the System's assets:

- A. The general goals of the Investment Program;
- B. The policies and procedures for the management of the investments;
- C. Specific asset allocations, rebalancing procedures, and investment guidelines;
- D. Performance objectives; and
- E. Responsible parties.

Legal and Governance Framework

The System established the Investment Policy in accordance with Section 1106 of the Charter of the City of Los Angeles and Article XVI, Section 17 of the California Constitution for the systematic administration of the City Employees' Retirement Fund. Since its creation, the Board's activities have been directed toward fulfilling the required purpose of the System, as mandated by the City Charter:

“(1) to provide benefits to system participants and their beneficiaries and to assure prompt delivery of those benefits and related services; (2) to minimize City contributions; and (3) to defray the reasonable expenses of administering the system.”¹

The Board's “duty to system participants and their beneficiaries shall take precedence over any other duty.”² In furtherance of this purpose, the Board shall have “sole and exclusive fiduciary responsibility over the assets of its system which are held in trust for the exclusive purposes of: (1) providing benefits to system participants and their beneficiaries; and (2) defraying the reasonable expenses of administering the system.”³

The System is a department of the City government and is governed by a seven member Board of Administration and assisted by a general manager. In the formation of the Investment Policy, the primary consideration of the Board has been its implementation of the stated purpose of the System. The Board's investment activities are designed and executed in a manner that will fulfill these goals.

The Investment Policy is designed to allow for sufficient flexibility in the management oversight process to allow the Investment Program to participate in appropriate

¹ L.A. Charter § 1106(a); Cal. Const. Art. XVI, §17(b).

² L.A. Charter § 1106(a); Cal. Const. Art. XVI, §17(b).

³ L.A. Charter § 1106(b); Cal. Const. Art. XVI, §17(a).

investment opportunities as they may occur, while setting forth reasonable parameters to ensure that prudence and care is taken in the execution of the Investment Program.

Investment Goals

The System's general investment goals are broad in nature. The following goals are adopted to be consistent with the above described purpose, the City Charter, the State Constitution, and applicable federal law:

- A. The overall purpose of the System's investment assets is to serve as a source of funding to provide plan participants with post-retirement benefits as set forth in the System documents. This will be accomplished through a carefully planned and executed investment program.
- B. A parallel and secondary objective is to achieve an investment return that will allow the percentage of covered payroll the City must contribute to the System to be maintained or reduced, and will provide for an increased funding of the System's liabilities.
- C. All investment actions will be for the sole benefit of the System's participants and beneficiaries and for the exclusive purpose of providing benefits to them and defraying reasonable administrative expenses associated with the System.⁴
- D. The System's assets will be managed on a total return basis. While the System recognizes the importance of the preservation of capital, it also adheres to the principle that varying degrees of investment risk are generally rewarded with commensurate returns. The Board's Investment Policy has been designed to produce a total portfolio, long-term real (greater than the rate of inflation) positive return greater than the Policy benchmark on a net-of-fee basis as referenced in the quarterly Portfolio Performance Review (PPR). Consequently, prudent risk-taking is warranted within the context of overall portfolio diversification. As a result, investment strategies are considered primarily in light of their impacts on total plan assets subject to the provisions set forth in Section 1106 of the City Charter with consideration of the Board's responsibility and authority as established by Article XVI, Section 17 of the California State Constitution.
- E. The System's Investment Program shall, at all times, comply with existing applicable local, state, and federal regulations.
- F. The System has a long-term investment horizon that employs an asset allocation approach, which encompasses a strategic, long-run perspective of capital markets. It is recognized that a strategic long-run asset allocation plan implemented in a consistent and disciplined manner will be the major determinant of the System's investment performance.

⁴ L.A. Charter § 1106(a); Cal. Const. Art. XVI, §17(b).

G. Investment actions are expected to comply with the “prudent person” standard, with all duties discharged:

“...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”⁵

This standard will encompass investment and management decisions evaluated not in isolation but rather in the context of the portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably assigned. The circumstances that the System may consider in investing and managing the investment assets include any of the following:

1. General economic conditions;
2. The possible effect of inflation or deflation;
3. The role that each investment or course of actions plays within the overall portfolio;
4. The expected total return from income and the appreciation of capital;
5. Needs for liquidity, regularity of income, and preservation or appreciation of capital;
6. A reasonable effort to verify facts relevant to the investment and management of assets.

H. The System is required to “[d]iversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.”⁶

LACERS History with ESG

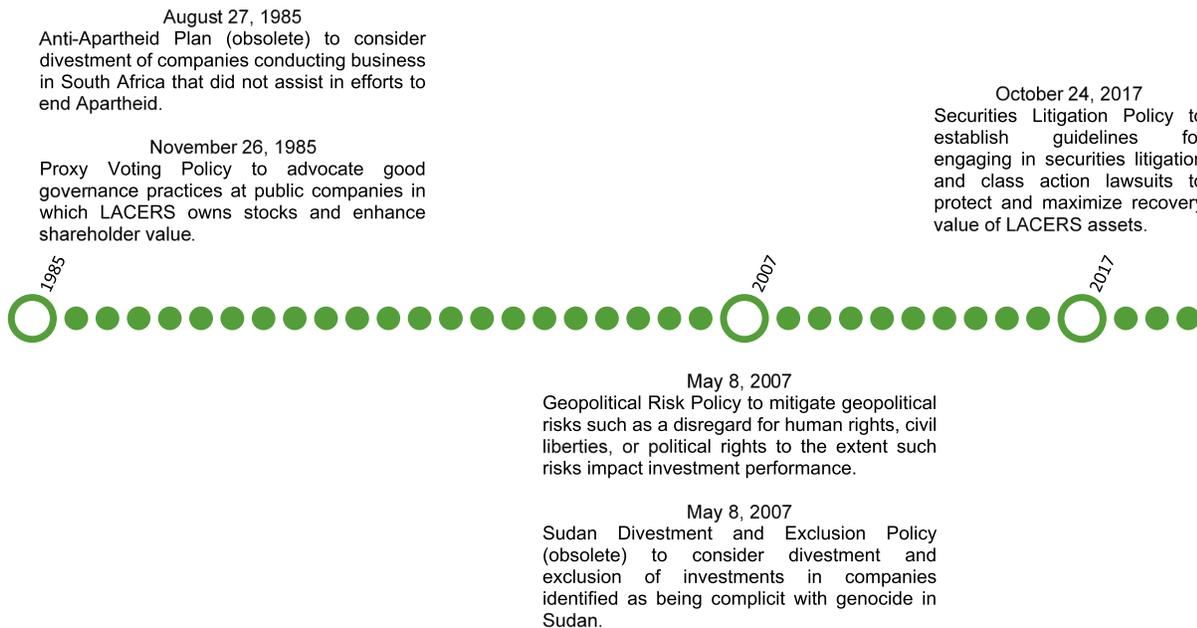
LACERS has long recognized the importance of addressing environmental, social, and governance (ESG) risks in order to protect and enhance investment returns of the portfolio. Since the mid-1980s, LACERS has adopted policies to address ESG risks; engaged with held companies, its own investment managers, regulatory bodies, and membership organizations to improve ESG-related practices; and collaborated with like-minded institutional investors to better understand and mitigate ESG risks. The following sections further detail LACERS’ history and experience with ESG.

⁵L.A. Charter § 1106(c); Cal. Const. Art. XVI, §17(c); ERISA § 404(a)(1)(B).

⁶ L.A. Charter § 1106(d); Cal. Const. Art. XVI, §17(d).

Policies Addressing ESG Risks

LACERS has a long history of addressing ESG matters through policies established within the Investment Policy. Through the years, the Board has adopted various sub-policies to address ESG risks, including its Geopolitical Risk Policy, Proxy Voting Policy, and Securities Litigation Policy, which continue to guide and help navigate LACERS through a myriad of ESG risk factors. A summary of LACERS’ ESG-related policies and adoption dates is presented in the following timeline. The Board and Staff routinely review and revise all policies to ensure they address matters relevant in the current economic, market, regulatory environment.



Principles for Responsible Investment

In 2018, the LACERS Board began exploration of becoming a signatory to the Principles for Responsible Investment (PRI). PRI is the leading global advocacy organization that promotes and encourages its signatories to become more responsible investors through greater practice of ESG within each signatory’s investment program. The PRI defines responsible investment as a strategy and practice to incorporate ESG factors in investment decisions and active ownership.

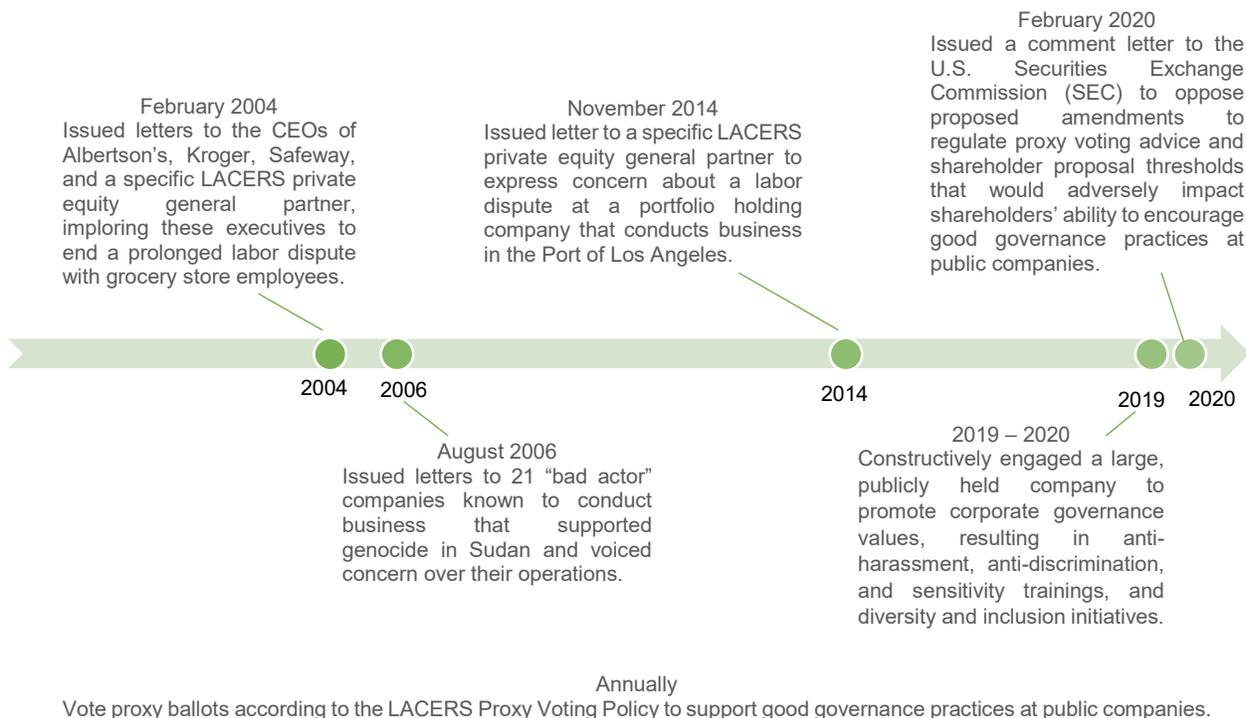
Upon the Board’s completion of an extensive educational series that included carefully procured experts and practitioners from the investment, governance, public pension, and ESG communities, plus education from the City Attorney’s Office, the Board authorized staff on April 9, 2019, to apply for PRI signatory status. Staff submitted the PRI signatory application on June 25, 2019 and LACERS was granted signatory status by PRI on September 3, 2019, thus ushering in a new era of ESG integration and responsibility for

LACERS and its Investment Program. PRI signatories make this commitment as stated in the opening statement of the official PRI Signatories' Commitment:

“As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).”

Implementation of Policy

Primarily based on the Geopolitical Risk Policy, LACERS has long believed that direct engagement is an effective tool for addressing ESG risks with companies, investment managers, and regulatory bodies. Engagement allows LACERS to directly communicate concerns about ESG-related issues, advocate change, support well-functioning investment markets, and protect shareholder value. The following timeline provides examples of LACERS' past engagement activities:



To further support the spirit of the Geopolitical Risk Policy, LACERS has also collaborated with like-minded institutional investors and organizations to create a more powerful, collective voice to promote change and protect investors' interest. In 1985, LACERS became one of the 21 founding members of the Council of Institutional Investors (CII), an international organization representing the voice of corporate governance, supporting effective corporate governance practices and strong shareowner rights. Today, CII membership includes over 140 U.S. public, union and corporate employee benefit plans, endowments and foundations. In February 2020, LACERS collaborated with other CII

members to oppose the SEC's proposed amendments to regulate proxy voting advice and shareholder proposal thresholds.

LACERS also proactively collaborates with state and local pension plans to share ESG policies, initiatives, and research. For example, LACERS has worked with plans such as Los Angeles County Employees Retirement Association, San Francisco Employees' Retirement System and Seattle City Employees' Retirement System to understand their ESG programs and initiatives for insights on developing a more robust program at LACERS.

To keep further apprised of ESG-related matters, LACERS leverages its relationships with industry organizations such as CII, PRI, C40 Cities, investment managers (many who are themselves PRI signatories), investment consultants, and peer pension plans. LACERS has actively participated in a number of ESG conferences and discussions hosted or sponsored by organizations such as C40, PRI, CII, and Pension Bridge to better understand the ESG landscape, forward looking trends, and industry best practices. Additionally, LACERS has participated in working groups to research ESG issues such as diversity within the investment industry and the impact of regulatory reform on corporate governance and shareholders.

LACERS also obtains current ESG research from several of its investment advisory partners including NEPC, LLC (general investment consultant), The Townsend Group (real estate consultant), Aksia TorreyCove Partners LLC (private equity consultant); and its membership organizations including the Pension Real Estate Association (PREA), the Institutional Limited Partnership Association (ILPA), and the Pacific Center for Asset Management (PCAM).

Responsible Investment Policy Development

LACERS staff is developing a Responsible Investment Policy with the assistance of its general investment consultant. This particular policy is envisioned to be a comprehensive but well-defined policy structure that will expand its reach to all material facets of ESG and related risk factors. Once developed and approved by the Board, the Responsible Investment Policy will serve as the primary source of ESG guidance for LACERS' Investment Program. Staff estimates that the Responsible Investment Policy will be ready for Board consideration later this year.

PROPOSED ESG RISK FRAMEWORK

As an evolving and progressive responsible investor, the Los Angeles City Employees' Retirement System (LACERS), recognizes that environmental, social, and governance (ESG) risk factors can impact portfolio performance. LACERS' ESG Risk Framework is designed as a comprehensive, integrated approach to considering and addressing ESG risk factors within the LACERS Investment Program with an emphasis on guidance and implementation activities and initiatives at the operational level.

The Framework presents a methodical process and step-based approach around five key priority points:

1. Investment Policy and ESG Governance
2. Integration of the Principles for Responsible Investment
3. ESG Risk Exposures
4. ESG-Focused Investing
5. ESG Risk Framework Action Plan

Priority 1 – Investment Policy and ESG Governance¹

The Framework shall be designed and implemented according to LACERS' Investment Policy.

I. LACERS Investment Policy

The Investment Policy guides the investment management of plan assets. It is a living document that is regularly reviewed and updated to address emerging risks, new market opportunities, and changes to laws and regulations. The Investment Policy includes several focused sub-policies that address specific investment considerations. The four sub-policies named below are most closely linked to LACERS' ESG Risk Framework.

A. Geopolitical Risk Policy

The Geopolitical Risk Policy is intended to provide a framework, based on the role of nation-states in the world, to address certain ESG-related geopolitical risk factors such as climate change, discrimination, and workers' rights. This policy outlines a process for identifying and mitigating such risks within the LACERS portfolio.

B. Proxy Voting Policy

The Proxy Voting Policy provides LACERS' position and rationale for shareholder votes regarding ESG issues. Additionally, the System's current proxy voting agent, Institutional Shareholder Services (ISS), is a signatory to the PRI and incorporates these principles into its proxy analysis process. Therefore, when considering how

¹ Detailed information regarding the policies mentioned in Priority 1 can be found in the LACERS Board Manual located at the following link: https://www.lacers.org/sites/main/files/file-attachments/lacers_board_manual.pdf?1616608481

to vote on certain ESG proposals not specifically addressed by LACERS' Proxy Voting Policy, investment staff relies on the research expertise and voting recommendations of ISS.

C. Emerging Investment Manager Policy

The objective of the Emerging Investment Manager Policy is to identify investment firms with the potential to add value to the LACERS investment portfolio that would otherwise not be identified by the standard LACERS investment manager search process. While these managers may not have as fully formalized ESG processes, LACERS' investment with such managers along with appropriate oversight of the portfolio will assist in formalizing and improving risk management for all key risks, including ESG risk factors.

D. Responsible Investment Policy (under development)

Staff, working with its general investment consultant, is developing a comprehensive Responsible Investment Policy. Staff envisions this policy to provide program guidance on integrating ESG more fully and comprehensively within LACERS' Investment Program including (but not limited to) defining roles and responsibilities including possible committee oversight; establishing aspirational goals and measurable program objectives; integration of the Principles for Responsible Investment within the LACERS organization, investment manager selection and monitoring, and due diligence standards; ESG impact measurement; defining standards and developing processes for LACERS' investment portfolios undergoing climate transition, and reporting standards and frequency. Staff anticipates the Responsible Investment Policy to be presented to the Board for consideration in FY2021-22.

Priority 2 – Integration of Principles for Responsible Investment (PRI)

LACERS became a PRI signatory on September 3, 2019, making a commitment to incorporate ESG risk factors into its decision-making process. LACERS has a duty to act in the best long-term interests of its plan beneficiaries. To ensure that LACERS continues to progress and further evolve its ESG program, an operational PRI Action Plan (Plan) was reviewed and approved by the Board on November 12, 2019 with a revised Plan approved on August 11, 2020. The Plan outlines administrative, operational, and policy initiatives that support the six PRI principles over a rolling three-year forward calendar. Many of these initiatives have been completed or are pending completion within the Investment Program.

Implementation of ESG under the PRI structure does not end with LACERS alone; LACERS is taking a multi-faceted approach to responsible investment through coordination with its investment partners. For example, many LACERS' public market investment managers are also PRI signatories; these managers are also actively working

to improve their identification and management of ESG risks in order to enhance portfolio returns. In addition, all three of LACERS' investment consultants are PRI signatories. By leveraging its relationships with firms that are PRI signatories, LACERS is able to magnify its ESG impact more efficiently and effectively across a wider portion of its Investment Program.

Priority 3 – ESG Risk Exposures

LACERS' Investment Program is managed according to industry best-practices, which is articulated in its Investment Policy. LACERS believes that considering and managing ESG risk factors is consistent with its fiduciary duties. Exposures to certain industry sectors or portions of industry sectors may expose LACERS to risk factors that are inadequately valued or misaligned with LACERS current policies.

LACERS has identified a number of risk exposures through its Geopolitical Risk Policy and Proxy Voting Policy that can be segregated along E, S, and G categories (see expanded versions of these policies at https://www.lacers.org/sites/main/files/file-attachments/lacers_board_manual.pdf?1616608481).

Environmental Risk Factors: include quality of air and water, climate change, and land protections.

Social Risk Factors: include human rights, civil liberties, respect for political rights, discrimination, and workers' rights.

Governance Risk Factors: include (but not limited to) boards, audit, compensation, shareholder rights and takeover defenses, capital structure, corporate restructuring, social and environmental issues.

LACERS plans to review its Proxy Voting Policy in FY2021-22 to ensure that its voting positions are aligned with the goals and objectives of its pending Responsible Investment Policy.

I. Responsibilities of Managing ESG Risk Factors

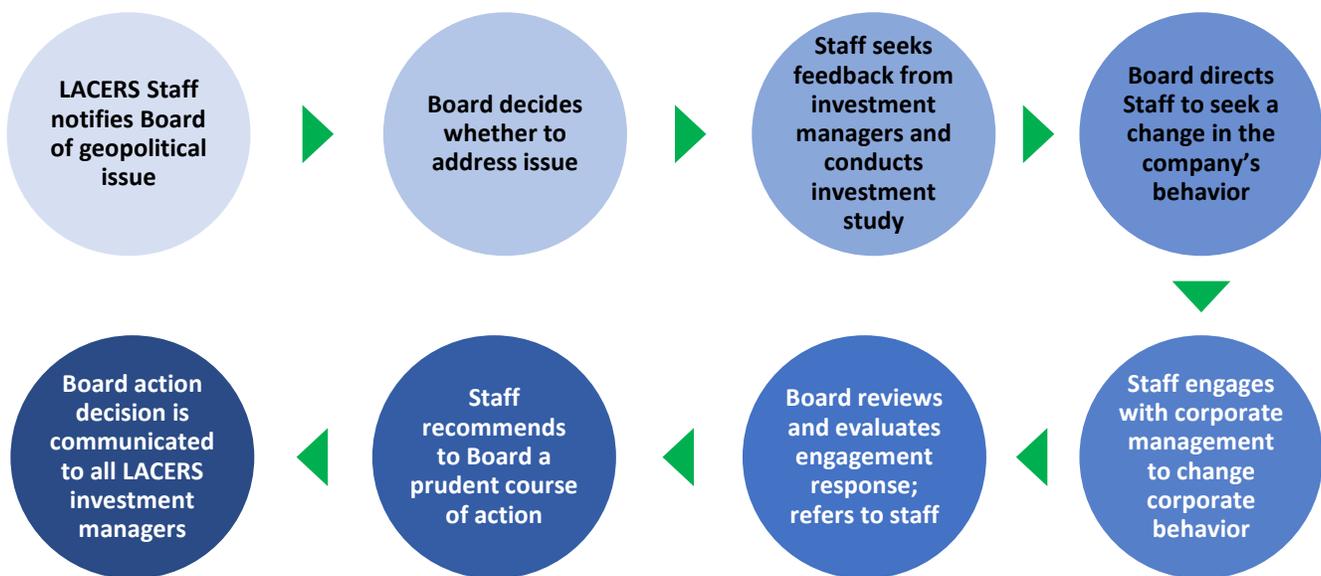
ESG risk factors must be managed continually and professionally in order to realize appropriate risk mitigation in an effective and resource-efficient manner. The following table provides for a delegation of responsibilities to support ESG risk factor management.

Board	Staff	Consultant	Bank Custodian
<p>Develop appropriate policies to ensure that ESG risk factors and investment opportunities are appropriately considered as part of the LACERS' investment processes</p> <p>Review ESG status reports and provide further direction to staff</p> <p>Consider staff-recommended actions to address ESG risk factors that cannot be mitigated through existing delegated authority</p>	<p>Integrate ESG risk factors within current and to-be-developed policy frameworks</p> <p>Continue development of a Responsible Investment Policy</p> <p>Communicate with investment consultants and investment managers regarding compliance with Responsible Investment Policy and PRI Action Plan</p> <p>Consider use of watch lists to assist with identification of high-level risk factor companies</p>	<p>Provide ESG education to the Board and staff</p> <p>Assist in the development of a Responsible Investment Policy</p> <p>Furnish research reports, customized reports, and other tools to understand current trends in ESG</p> <p>Provide methodology to rank external investment managers during a procurement solicitation</p>	<p>Place rules and parameters in place to capture and flag risky assets held in the Fund's portfolio</p> <p>Help implement a watch list and security identification for risky assets</p> <p>Provide options on reports available for ESG related alerts</p>

II. ESG Risk Mitigation Process

Some ESG risk factors can be addressed and mitigated using a variety of policy, management, and Framework tools. Other ESG risk factors may require Board intervention and guidance, especially in situations regarding heightened levels of corporate engagement or other issues that are not addressable by existing delegated authority. The diagram below summarizes an eight step process as articulated in the Geopolitical Risk Policy.

Summarized Process for Identifying and Mitigating Corporate Governance Geopolitical Risks²



² A detailed description of the process can be found on pages 197-198 of the LACERS Board Manual. https://www.lacers.org/sites/main/files/file-attachments/lacers_board_manual.pdf?1616608481

III. Previous Divestment and Engagement Actions

LACERS has previously engaged with companies and investment managers that have been identified as being misaligned with LACERS' Investment Policy according to the aforementioned geopolitical risk mitigation process. Engagement activities with companies and other misaligned organizations have primarily been realized through a combination of heightened communication with companies, collaboration with like-minded investors, or presentations to the Board.

IV. Climate Transition

LACERS recognizes that a structured and methodical approach to climate transition is an important acknowledgment to a significant risk factor that could impact long-term risk-adjusted performance returns and financial sustainability. LACERS will evaluate its climate transition decisions upon five non-mutually exclusive actions:

A. Engagement – This action focuses on specific actions requested by LACERS of individual companies related to their governance; or advocating specific actions with government agencies to develop appropriate regulatory policies that support climate transition initiatives or positions.

B. Collaboration – This action leverages the collective knowledge, experiences, clout, and asset base of like-minded investors to effectuate climate transition with specific companies or groups of similar companies. This path may be used in conjunction with engagement efforts to create a multi-pronged front of like-minded shareholders with a common climate transition cause and desired outcome.

C. Research – This action distinguishes facts from unproven beliefs, to answer questions related to the impact of ESG risk factors and climate transition, and integrates such facts and findings into discussions and deliberations that help facilitate Board investment decisions.

D. Strategic Asset Transition Initiatives - This action identifies specific investment strategies, mandates, or programs that facilitate LACERS' ability to effectuate change in its investment portfolio through asset transition based primarily on economic considerations, which may include tilts away from certain investment exposures, adding attractive opportunities that support ESG investment objectives, and/or exclusion of certain asset types from future investment.

E. Responsible Investment Oversight and Periodic Reporting – Oversight and reporting keep the Board and staff apprised of progress and challenges facing the implementation and ongoing management of LACERS' ESG integration and responsible investing actions including corporate engagement and climate transition.

V. Coal Exposure

LACERS recognizes that thermal coal is a weakening segment of the energy industry whose growth prospects are in decline. LACERS believes that its limited holdings of

thermal coal companies (defined as companies with thermal coal activities that constitute revenue dollars greater than 10% of the company’s total revenue) would be an appropriate starting point for corporate engagement as outlined in the aforementioned Climate Transition section.

A. LACERS Exposure and Historical Performance

As of December 31, 2020, the LACERS investment portfolio held 36 publicly traded companies that derive at least 10% of revenues from thermal coal activities; these holdings represented approximately \$14.3 million in total market value, or approximately 0.07% of the total investment portfolio. As detailed in the following charts, a majority of this exposure was held in actively managed equity investment strategies. Over the last five years, these holdings have been additive to LACERS total investment portfolio performance returns; this is likely attributed to the ability of active managers to identify undervalued investments and/or those with continued growth and revenue prospects.

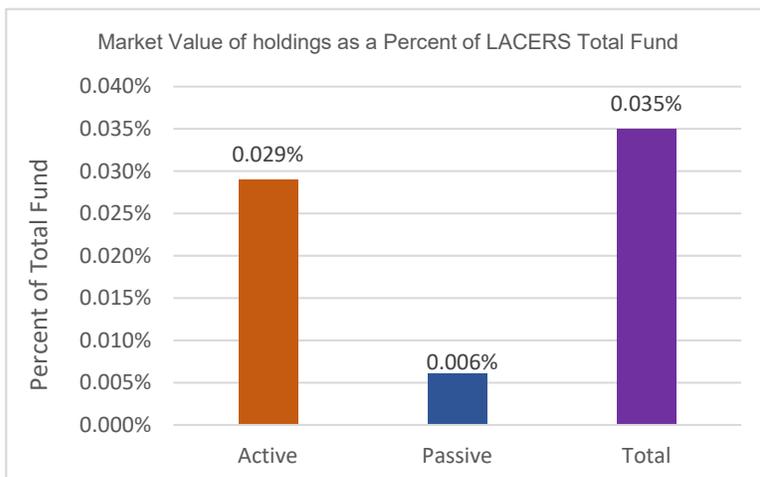
**Public Equity Coal Holdings
 Contribution to LACERS Total Fund Returns
 As of December 31, 2020**

	1-Year	3-Years	5-Years
Actively Managed Holdings	1/500 of 1%	-1/1000 of 1%	1/250 of 1%
Passively Managed Holdings	-1/1000 of 1%	-1/500 of 1%	0.000%
Total Contribution to LACERS Returns	1/1000 of 1%	-1/333 of 1%	1/250 of 1%

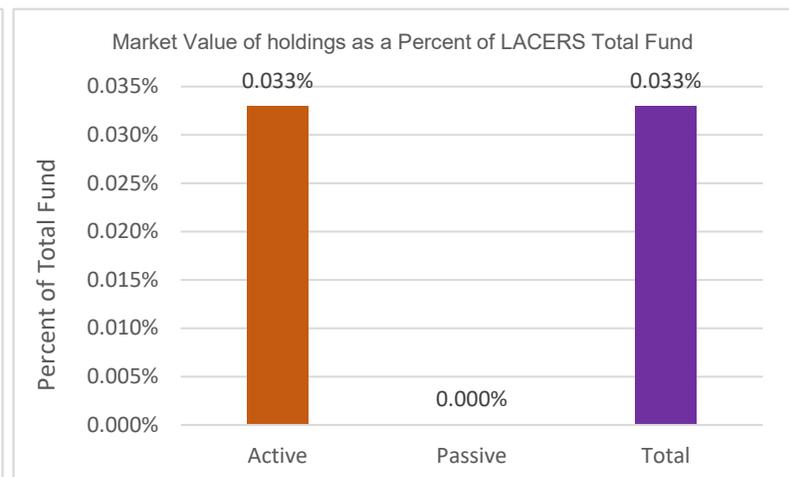
**Public Fixed Income Coal Holdings
 Contribution to LACERS Total Fund Returns
 As of December 31, 2020**

	1-Year	3-Years	5-Years
Actively Managed Holdings	1/333 of 1%	1/500 of 1%	1/1000 of 1%
Passively Managed Holdings	N/A	N/A	N/A
Total Contribution to LACERS Returns	1/333 of 1%	1/500 of 1%	1/1000 of 1%

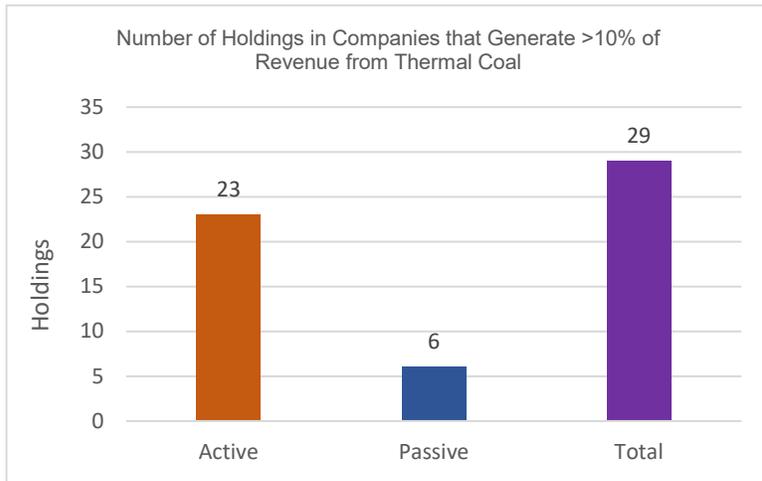
Public Equity Coal Exposure



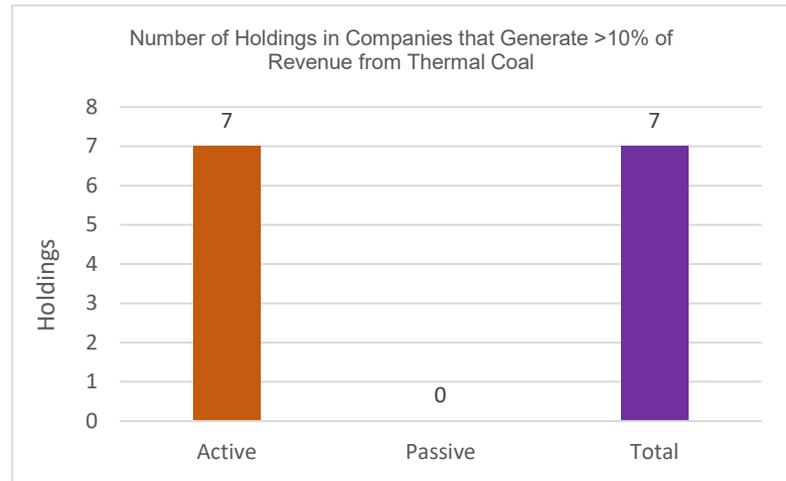
Public Fixed Income Coal Exposure



Public Equity Coal Exposure



Public Fixed Income Coal Exposure



B. Coal Exposure Assessment

Staff, working with LACERS’ investment consultant, will routinely assess on a quarterly basis the LACERS investment portfolio for holdings of publicly traded companies that generate at least 10% of revenues from thermal coal, evaluate the financial risks stemming from such investments, and then engage with such companies that pose the greatest risk to LACERS investment portfolio. LACERS will also discuss with its actively-managed investment managers what plans are in place to transition thermal coal holdings within the LACERS portfolio. Depending on the proposed actions of these investment managers, LACERS will determine an appropriate course of action based on its fiduciary responsibilities and provision of the Responsible Investment Policy.

Priority 4 – ESG-Focused Investing

LACERS believes that any consideration of a climate-based asset transition is in fact a two sided transaction – a replacement of one asset or set of assets traded for another asset or set of assets. LACERS may find it economically desirable to increase its ESG exposure to either offset questionable holdings or non ESG-related assets with one or more ESG-sensitive investment mandates or approaches, as described below.

I. Active Approaches to ESG

A key component of sustainable investing is active engagement with investee companies with the aim of encouraging and persuading companies to improve their ESG practices in order to provide better outcomes for all stakeholders. Additionally, active investment management permits the investor to establish various criteria to include (but not limited to) the number of holdings, style preferences, weightings, and capitalization parameters.

In active sustainable fixed-income investing the argument is broadly the same. While debt investors do not own shares in companies, they often provide the primary or only source

of capital to a company in the private sector, and even for certain countries. This gives active fixed income investors a better chance of effecting positive change.

II. Passive Approaches to ESG

Passive investment management is a rules-based approach that seeks to replicate the risk-return characteristics of a market index such as the S&P 500 and does not involve discretionary investment decisions. Staff recommends that full-replication passive strategies be exempt from security name exclusion due to portfolio management complexity and cost factors.

III. ESG-Focused Strategies

ESG-focused strategies refer to any investment strategy that makes ESG considerations an important factor when deciding whether or not to invest. LACERS, together with its investment consultants, will consider the appropriateness of such strategies through an economic risk lens and the financial impact on the LACERS Investment Program. Examples of such strategies may include portfolios that certify to standards such as sustainability, climate-focused, or ESG.

IV. Green Technology

LACERS has the ability to back venture capital managers who seek to place capital in carbon-reduction technologies, renewable energy, and other sustainability investment endeavors.

V. Emerging Investment Manager Program

Emerging investment managers refer to investment managers who have formed new investment management firms. Such managers are expected to meet the same rigorous investment criteria and standards such as a verifiable history of generating outsized performance, experienced senior investment team, proven and repeatable investment process, etc. LACERS will take into account other risk factors such as smaller staffing sizes, limited transaction sourcing, number of portfolio realizations, and access to capital raising networks.

VI. ESG Integration in the Interim

Forward-thinking, sophisticated investment managers already consider the impact of ESG factors as an enhancement to their investment process, and already build client investment portfolios with varying magnitudes of sustainability even when the client does not mandate it. This is a passive and interim solution that still provides a limited amount of ESG risk factor consideration until LACERS is able to realize a more fully integrated ESG risk program.

Priority 5 - ESG Risk Framework Action Plan

LACERS has initiated several actions over the past several decades that reflect sensitivity towards ESG concerns and issues. In 2019, LACERS became an official signatory to the PRI. As a result of that signatory status, LACERS has developed investment manager selection questionnaires and due diligence checklists to more fully engage with prospective investment managers and those currently under contract.

In 2021, LACERS appointed an ESG Risk Officer to spearhead ESG priorities and to ensure a coordinated implementation of ESG risk factors among LACERS investment staff, investment managers, bank custodian, and other support vendors. This undertaking requires a carefully constructed plan to navigate a myriad of significant and material initiatives and practices to help achieve full implementation of ESG. LACERS will rely on its Framework to guide and facilitate the implementation and management of ESG within its Investment Program. The ESG Risk Framework Action Plans for Fiscal Year 2021-22 and Fiscal Year 2022-23 are presented on the following pages.

LACERS Fiscal Year 2021-22 ESG Risk Framework Proposed Action Plan

Board-Level Priorities	Staff-Level Priorities		
	Policy and Programs	Operational	ESG Collaboration
<p>Review and Approve LACERS Responsible Investment Policy</p> <p>Review and Approve proposed changes to ESG Risk Framework Action Plan</p> <p>Review and approve modifications to the Proxy Voting Policy</p> <p>Support partnership with organizations and entities that are aligned with LACERS beliefs regarding responsible investment, sustainability, and ESG risk factors</p> <p>Consider engagements with companies to effectuate company-level climate transition using LACERS' influence and clout as a multi-billion dollar asset owner</p> <p>Support greater transparency and reporting around ESG corporate reporting</p> <p>Support greater corporate reporting transparency on ESG risk factors</p> <p>Support greater corporate board diversity</p>	<p>Develop LACERS Responsible Investment Policy in consultation with investment consultants and ESG experts and practitioners</p> <p>Review ESG Risk Framework Action Plan and include updates; present to Board for review and approval</p> <p>Review Proxy Voting Policy; propose modifications for Committee and Board review and approval</p> <p>Develop a policy and procedure to address companies that may be subject to proposed climate transition provisions of LACERS Responsible Investment Policy</p> <p>Update PRI Action Plan</p>	<p>Incorporate ESG Risk Factors into the investment manager selection process including RFP questionnaires, scoring of proposals, due diligence, and monitoring</p> <p>Develop specific Responsible Investment Statements for each asset class and Responsible Investment Guidelines for each LACERS investment manager, as appropriate</p> <p>Conduct study to determine effectiveness of ESG-focused investing to include (but not limited to) index strategies ex-fossil fuels and actively-managed investment strategies that pursue renewable energy sources and/or reduce reliance on thermal coal and thermal coal-related businesses</p> <p>Explore third-party watch lists of companies that are deemed by the Board to be misaligned with LACERS Responsible Investment Policy or other Board directives including exposure to thermal coal</p> <p>Track and monitor exposure to investment holdings that may be misaligned with LACERS Responsible Investment Policy</p> <p>Request investment managers to report ESG activity as provided in LACERS Responsible Investment Policy and PRI reporting requirements; encourage private markets general partners to adopt ESG decision-making frameworks</p> <p>Monitor shareholder and governance issues</p> <p>Track proxy votes in accordance with PRI reporting requirements</p> <p>Provide PRI Action Plan progress report to the Board</p>	<p>Collaborate with partner ESG organizations including PRI and Pacific Center for Asset Management at the University of California at San Diego</p> <p>Actively participate in ESG industry events</p> <p>Engage in shareholder advocacy and collaborate on specific shareholder issues and proposals as needed</p> <p>Collaborate with members of the Los Angeles Diversity & Inclusion Roundtable</p>

LACERS Fiscal Year 2022-23 ESG Risk Framework Proposed Action Plan

Board-Level Priorities	Staff-Level Priorities		
	Policy and Programs	Operational	ESG Collaboration
<p>Review and approve updates to LACERS ESG Risk Framework for FY 2022-23</p> <p>Review and approve proposed changes to LACERS Responsible Investment Policy</p> <p>Continue to support and seek new partnership with organizations and entities that are aligned with LACERS beliefs regarding responsible investment, sustainability, and ESG risk factors</p> <p>Continue to engage with companies to effectuate company-level climate transition</p> <p>Advocate for continued support of ESG investment factors and transparency around corporate ESG reporting</p>	<p>Provide ESG Risk Framework and PRI Action Plan progress reports to the Board</p> <p>Revise ESG Action Plan based on ESG Consultant and staff recommendations</p> <p>Review LACERS Responsible Investment Policy; recommend possible changes</p> <p>Present findings of internal study on the appropriateness of ESG-focused investing to include (but not limited to) index strategies ex-fossil fuels and actively-managed investment strategies that pursue renewable energy sources and/or reduced reliance on thermal coal and thermal coal-related businesses</p> <p>Consider the application of Diversity, Equity & Inclusion factors in the LACERS Investment Program</p>	<p>Continue to track and monitor exposure to investment holdings that may be misaligned with LACERS Responsible Investment Policy</p> <p>Continue to request investment managers to report ESG activity as provided in LACERS Responsible Investment Policy and PRI reporting requirements</p> <p>Distribute and collect ESG survey of current private equity and real estate holdings and new partnerships on an ongoing basis</p> <p>Incorporate ESG into investment analysis and decision making plus integration and scoring of ESG risk responses in actively managed investment mandates</p> <p>Continue to explore impact investment strategies to include (but not limited to) ESG-focused index strategies and actively-managed investment strategies that pursue renewable energy sources and/or reduce reliance on coal and coal-related businesses</p> <p>Implement provisions of the LACERS Responsible Investment Policy to address companies that may be subject to climate transition provisions</p> <p>Work with consultant to determine how to evaluate effectiveness of ESG strategies and fiscal impact</p> <p>Continue to track proxy votes in accordance with PRI reporting requirements</p> <p>Develop measurement approaches to determine ESG impact on the investment portfolio</p> <p>Prepare and submit ESG Risk Framework progress report to the Board</p>	<p>Continue to collaborate with partner ESG organizations including PRI and Pacific Center for Asset Management at the University of California at San Diego</p> <p>Continue to actively participate in ESG industry events</p> <p>Continue to engage with other PRI signatories and like-minded organizations that support ESG issues</p> <p>Collaborate with members of the Los Angeles Diversity & Inclusion Roundtable</p>

File No. [19-1577](#)

BUDGET AND FINANCE COMMITTEE REPORT relative to the feasibility of developing a Climate Transition Risk Framework and related actions.

Recommendation for Council action, as initiated by Motion (Blumenfield - Bonin - et al.):

REQUEST that the Board of the Los Angeles City Employees' Retirement System (LACERS), with the assistance of the City Administrative Officer (CAO), report in six months with the following:

- a. Recommendations on the feasibility for the LACERS Board to adopt a similar Climate Transition Risk Framework to San Francisco Employees' Retirement System to identify investments in fossil fuel companies that pose an environmental and financial risk.
- b. Options to create a climate-change watch list that will report the riskiest investments in fossil fuel companies and develop a strategy to engage with the respective companies to reduce their oil and gas reserves and increase their efforts to move towards renewables and address climate change.
- c. A plan to divest from uncooperative fossil fuel companies and appropriately reinvest capital.
- d. A watch list to identify other LACERS investments such as in tobacco and firearm companies that contradict the City Council official positions and goal to provide a healthy and secure future for Angelenos.

Fiscal Impact Statement: Neither the CAO nor the Chief Legislative Analyst has completed a financial analysis of this report.

Community Impact Statement: Yes.

For: Wilshire Center-Koreatown
Mar Vista Community Council
Eagle Rock Neighborhood Council
East Hollywood Neighborhood Council
Los Feliz Neighborhood Council

SUMMARY

At its regular meeting held on November 23, 2020, the Budget and Finance Committee considered Motion (Blumenfield - Bonin - et al.) relative to requesting that the LACERS Board, with the assistance of the CAO, report with the feasibility to develop a Climate Transition Risk Framework and other related actions.

After providing an opportunity for public comment, the Committee approved the recommendations in the Motion. This matter is now forwarded to the Council for its consideration.

Respectfully Submitted,

BUDGET AND FINANCE COMMITTEE

<u>MEMBER</u>	<u>VOTE</u>
KREKORIAN:	YES
PRICE:	YES
KORETZ:	YES
BLUMENFIELD:	YES
BONIN:	YES

MM11-23-20 Council file No. 19-1577

-NOT OFFICIAL UNTIL COUNCIL ACTS-