



City and County of San Francisco
Employees' Retirement System
**SPECIAL RETIREMENT BOARD
MEETING MINUTES**

Wednesday, February 19, 2014

101 Grove Street, Room 300
San Francisco, CA 94102
2:00 p.m.

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Executive Director

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OPENING CALENDAR

President Makras opened the meeting at 2:00 PM

Pledge of Allegiance

Roll Call:

Commissioner Leona Bridges	2:00
Commissioner Malia Cohen	2:00
Commissioner Joseph D. Driscoll	2:00
Commissioner Victor Makras	2:00
Commissioner Herb Meiberger	2:00
Commissioner Wendy Paskin-Jordan	Absent
Commissioner Brian Stansbury	2:00

General Public Comment: President Makras called for general public comment.

There were no comments from the public.

02192014-01 Discussion item **Educational Presentation on Opportunities & Risks in Global Private Markets - 2:00 PM Time Certain Item**

Documents provided to the Board prior to the current meeting: Presentation Materials from The Carlyle Group

William J. Coaker, Chief Investment Officer, and Art Wang, Managing Director for Private Markets, introduced David Rubenstein, Co-Founder and Chief Executive Officer, The Carlyle Group.

Mr. Rubenstein presented an educational session on Opportunities & Risks in Global Private Markets. This included:

- An overview of the current political environment in Washington, D.C.;
- An overview of current market conditions in the United States, Europe, and China;
- An overview of global private equity markets and market conditions;
- A review of major changes seen in the private equity industry since the last recession, including increased focus on General Partner/Limited Partner alignment, changes in fund terms (management and transaction fees, American v. European carry waterfall, carried interest and preferred return hurdle);
- General Partner transparency has increased as private equity firms have gone public;
- Sovereign wealth funds have become a more important source of capital;

- Individual investors have increased their commitments to private equity;
- Emerging markets have increased as both a source of and destination for capital;
- Managed accounts have become more common;
- Generationally low interest rates have driven investor demand for alternative credit products with higher yield potential;
- Investors are increasing commitments to global alternative asset managers;
- Allocations to private equity have gone up across-the-board;
- Returns have come down over the past 20 years;
- Top quartile private equity funds have significantly outperformed public market equities over a variety of time horizons;
- Reviewed anticipated changes in the private equity industry going forward (further increase in high net worth investor participation, involvement of smaller individual non-accredited investors, increased emerging market activity, growth of sector-specific investments, and further increases in allocations to alternatives); and,
- Reviewed characteristics to focus on when picking a General Partner.

The Board engaged in a question and answer session.

Commissioner Stansbury discussed the growing competitiveness of the U.S. private equity market. Mr. Rubenstein noted the importance of due diligence and the manager selection process in order to meet return objectives.

Commissioner Driscoll discussed hedge funds. Mr. Rubenstein noted that his area of expertise was with private equity.

Commissioner Meiberger discussed investment in China, specifically the renminbi (RMB), the official currency of China and measurement of GDP. Mr. Rubenstein noted that the RMB is not currently a reserve currency and is not freely transferable.

Commissioner Meiberger inquired regarding the impact of quantitative easing. Mr. Rubenstein noted the benefits of historically low interest rates and availability of credit.

Commissioner Bridges discussed income inequality and social mobility. Mr. Rubenstein noted the impact of education on social mobility.

Commissioner Bridges discussed accredited and non-accredited investors in private equity. Mr. Rubenstein noted

that the Securities and Exchange Commission is currently reviewing regulations regarding non-accredited investors.

Commissioner Cohen discussed the potential impact of raising the minimum wage on income inequality and social mobility. Mr. Rubenstein noted that the issue of raising the minimum wage would likely be addressed by Congress within the next year.

Action: This was a discussion only item

02192014-02 Action item

Staff Report related to Level I and Level II Engagement on Fossil Fuel under Board Social Investment Policy - 3:00 PM Time Certain Item

Documents provided to the Board prior to the current meeting: Staff Memorandum

Jay Huish, Executive Director, presented an oral and written report on this item.

Mr. Huish reported that on April 23, 2013, the San Francisco Board of Supervisors unanimously passed Resolution #126-13, which urges the Retirement Board to divest from the top 200 fossil fuel companies on the *Carbon Tracker* list.

At its October 9, 2013 meeting, the Retirement Board unanimously voted to direct staff to:

- 1) prepare a report on Level I engagement of fossil fuel companies to include analysis of current proxy voting policies and guidelines related to issues of climate risk, climate risk disclosure, political lobbying and sustainability related to SFERS holdings in companies included on the Carbon Tracker list to present to the Board for its consideration and approval; and
- 2) prepare a report on Level II engagement of fossil fuel companies to include proactively advocating that companies, investors and governments consider the benefit of climate change mitigation in formulating business strategies, disclosure requirements, corporate values and behavior, including direct communication with the Carbon Tracker companies in the SFERS portfolio and/or participation in collaborative initiatives such as Investor Network on Climate Risk (INCR) to present to the Board for its consideration and approval.

As of December 31, 2013, SFERS' public holdings in the Carbon Tracker listed fossil fuel companies were as follows:

Public Markets

Public Equities:

Total:	\$10,331,113,903
Fossil Fuels:	\$565,967,740 This is a total of 84 holdings
Percentage:	5.48% of Public Equities

Public Fixed Income:

Total:	\$4,359,335,098
Fossil Fuels:	\$50,459,262 This is a total of 41 holdings
Percentage:	1.16% of Public Fixed Income

Public Markets Combined:

Total:	\$14,690,449,001 This represents 78.9% of Plan Assets
Fossil Fuels:	\$616,427,002
Percentage:	4.2% of Public Market assets.

The \$616,427,002 is 3.3% of Total Plan assets. Included in this total are \$253.9 million in holdings in the following passive separate accounts:

S&P 500 Passive (\$1,658.6 million):	7.8%
(\$127.2 million) are in the fossil fuel 200 list	

Russell 1000 Value (\$1,007.9 million):	12.8%
(\$126.7 million) are in the fossil fuel 200 list	

A complete listing of the *Carbon Footprint 200 List* companies held in the SFERS public equity portfolio on December 31, 2013 and one-, three- and five-year performance information was provided to the Board.

Mr. Huish noted that the SFERS *Social Investment Policies and Procedures* provide that adequate recognition must be given to the social consequences of corporate actions and investment decisions to achieve maximum long term investment return from Trust assets. But the policy recognizes that in no event may the policy take precedence over the fiduciary responsibility of producing investment returns for the exclusive benefit of the members and beneficiaries. Social concerns addressed through the policy will follow the order of action outlined in the policy except where the Retirement Board determines that action contemplated in an earlier step has been initiated prior to consideration of action under the policy and found to be ineffective or non-relevant.

The *SFERS Social Investment Policies and Procedures* outline three levels of action that the Retirement Board can direct staff to implement to engage companies on social issues of concern:

Level I – Shareholder Voting: SFERS’ shareholder voting rights will be exercised reflecting specific Board social investment considerations and directions or by authorization under procedures which reflect the Retirement Board’s directions on social issues.

Level II – Promoting Social Rights and Interests: SFERS will proactively promote social interests individually or in concert with other shareholders to assure proper recognition of social interests with the goal of influencing corporate activities or policies. Activities at this level may include direct communication with the company and/or initiation of shareholder resolutions, individually or in concert with other shareholders.

Level III – Investment Restrictions: In the event that Level I and Level II engagement has not provided the Retirement Board’s desired results and alternatives to the restricted holdings are available which do not compromise investment return and risk, the Retirement Board may direct staff to restrict investment activities in specific areas to promote the interest of the SFERS Trust members and beneficiaries. Under Level III engagement, Retirement staff would provide directions to the investment managers that could include restricting purchase of additional shares of the targeted securities and directing the managers to research alternative securities to replace the targeted holdings that would provide comparable investment return with comparable risk.

Mr. Huish reviewed the fiduciary duties of Board members to SFERS Trust members and beneficiaries, particularly as provided under the California Constitution Article XVI §17 and San Francisco Charter §12.100, §12.103.

These duties require the Board to weigh potential risks and returns, choosing an investment mix most likely to fulfill the System’s obligations to ensure it provides the promised benefits to its members and beneficiaries.

The Retirement Board and SFERS staff are also required to invest the SFERS Trust "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims." California Constitution, Art. XVI, §17(c). The prudence requirements are generally satisfied if, in the analysis, the Retirement Board and staff are guided principally by economic and business factors. Whether an investment benefits a social goal may be a

secondary consideration.

Mr. Huish further noted that to date, no public pension plan has approved divestment from fossil fuel securities.

Mr. Huish provided a report on fossil fuel related resolutions in the 2013 proxy voting season; 29 fossil fuel resolutions were voted on in 23 Carbon Tracker listed companies held by SFERS.

Mr. Huish further reported that there are a number of institutional investor coalitions whose primary focus is to address the risks and opportunities resulting from climate change and other sustainability challenges. Two of the most prominent institutional investor efforts related to fossil fuels are: the Investor Network on Climate Risk (INCR) and the Carbon Asset Risk (CAR) initiative.

Finally, Mr. Huish noted that the decision whether to engage fossil fuel companies at Level I or Level II through the *SFERS Social Investment Policies and Procedures* is a policy decision solely in the purview of the Retirement Board. Accordingly, Retirement staff did not provide a recommendation regarding the prudence of directing engagement under the policy. However, should the Retirement Board determine that engagement of the fossil fuel companies through its policy is prudent and consistent with its fiduciary duty to members and their beneficiaries, Retirement staff provided the following alternative motions representing Level I and Level II engagement under the *SFERS Social Investment Policies and Procedures*:

Level I Engagement

Motion to direct staff to engage companies included on the Carbon Tracker list in which SFERS is a shareholder through the exercise of SFERS' shareholder voting rights at Level I engagement under the *SFERS Social Investment Policies and Procedures* and prepare an implementation plan and timeline to present to the Retirement Board for its consideration and approval that would include reporting back to the Retirement Board on a semiannual basis on the Retirement staff efforts and results of such engagement.

Level II Engagement

Motion to direct staff to engage companies included on the Carbon Tracker list in which SFERS is a shareholder through proactive advocacy at Level II engagement under the *SFERS Social Investment Policies and Procedures* and prepare an implementation plan and timeline to present to the Retirement Board for its consideration and approval that would include reporting back to the Retirement Board on a semiannual basis on the Retirement staff efforts and results of such engagement.

In addition, Retirement staff recommends the Retirement Board consider the following action as alternative or complementary:

Alternative or Complementary Action

Motion to direct staff to review SFERS existing policy and approach to evaluating environmental, social and governance issues in our overall investment process: how do investment managers consider issues like climate risk in their investment selection processes, measure the carbon intensity of their portfolios, or tilt portfolios towards more sustainable assets and prepare an implementation plan and timeline to present to the Retirement Board for its consideration.

President Makras called for general public comment:

Jed Holtzman, 350 San Francisco/Fossil Free SF, addressed the Board regarding the risk of fossil fuel holdings, including the risk of stranded assets, the fiduciary duties of the Board, and the limitations of the shareholder engagement process. He urged enactment of Level I and Level II restrictions with a specific timeline.

Will Lana, Investment Manager and Partner with Trillium Asset Management, urged enactment of Level I and Level II restrictions, noted the limitations of the shareholder engagement process, noted the risk of stranded assets, and supported the formation of an environmental, social, and governance (ESG) committee to review the risk of fossil fuels to the SFERS portfolio.

Shilpa Andalkar, Investment Advisor with HIP Investor, urged the Board to consider the importance of reviewing the risk of fossil fuel holdings, to underweight fossil fuels as part of a five year divestment strategy, noted the limitations of the shareholder engagement process, and encouraged investment in clean energy technology.

Ruth Maginnis, retired librarian, urged the Board to consider socially responsible investments, including divestment from fossil fuels.

Brett Fleishman, Senior Analyst with 350.org, encouraged the Board to engage with audience members to gain additional information, to allocate additional resources to explore the risk of fossil fuel holdings to the SFERS portfolio, supported the formation of an ESG committee to review the risk of fossil fuels to the SFERS portfolio, and noted that certain Nordic pension funds have divested from oil and coal holdings due to the risk of stranded assets.

Pat Gerber, Research Analyst in the field of peak oil, noted that San Francisco is a coastal city likely to be impacted early by the impact of climate change.

Supervisor John Avalos addressed the Board regarding the Board of Supervisors' resolution urging divestment from fossil fuels. He supported strong shareholder engagement, including Level II engagement under the Board's Social Investment Policy. He noted that extensive fossil fuels holdings were not required to engage in the shareholder advocacy process, and urged the Board to initiate a divestment process. He urged the Board to consider the impact of climate change, including the risk of a carbon fuel bubble, on the SFERS portfolio.

He noted recent conversations with Commissioner Bridges, and the Bloomberg organization, regarding the possibility of holding informational meetings to gather additional information on the risk of fossil fuels to the SFERS portfolio. He offered the support of his office to assist in organizing informational meetings.

Kathy Setian, member of Fossil Free SF and retired environmental engineer, addressed the Board regarding their fiduciary duty to consider the impact and risk of global warming to the SFERS portfolio. She noted the recent conference on divestment held in the Bay Area, and supported the Board holding additional informational sessions.

Erin Gray, with Green Century Fund, which offers fossil free mutual funds, addressed the Board regarding their fiduciary duty to consider the impact and risk of global warming to the SFERS portfolio. She noted the limitations of the shareholder engagement process, as a lengthy and often voluntary process, and urged the Board to take timely action to address the risk of climate change.

Ryan Smith, Fossil Free SFSU, urged divestment from fossil fuels and reinvestment in renewable energy such as solar and wind. He noted the potential impact of renewable energy in increasing employment opportunities and minimizing income inequality.

Adam Sherman, Chairman of Fossil Free SFSU, urged divestment from fossil fuels and reinvestment in renewable energy sources.

Ana Zacapa, director of the California office of CERES, spoke. She said that CERES was a non-profit organization working with the Investor Network on Climate Risk, a network of institutional investors committed to accelerating the adoption of investment and business practices to address global sustainability challenges such as climate change, cleaner energy and water scarcity. She noted the

risk of fossil fuels, particularly stranded carbon assets, to the SFERS portfolio. She further noted that CALPERS is also considering the impact of climate change and offered to work with the Board in planning informational sessions.

Jean Thomas, retiree, spoke in support of Level I and II engagement under the Board's Social Investment Policy, and in opposition of divestment from fossil fuels. She noted the potential impact of divestment on the SFERS investment return and on contribution rates for the City, active employees, and taxpayers. She noted the lack of support for divestment among retirees.

Rebecca Solnit, resident of San Francisco, addressed the Board regarding the impact of climate change and spoke in support of divestment from fossil fuels.

The Board engaged in a question and answer session.

Commissioner Stansbury expressed his appreciation to the individuals who spoke before the Board. He noted that the Board has a fiduciary obligation to SFERS Trust members and beneficiaries as outlined in the staff memorandum. This fiduciary duty includes weighing potential risks and returns, and choosing an investment mix most likely to fulfill the System's obligations to ensure it provides the promised benefits to its members and beneficiaries.

He noted that there is an increasing demand for fossil fuels and they are likely to be a part of any balanced portfolio. He reviewed the process for implementing Level I restrictions.

Mr. Huish noted that the 2014 proxy season has begun, but reported that staff could identify upcoming fossil fuel related proxy items in companies where SFERS has holdings and bring those to the Board in advance of any vote. Current Board policy is to vote these items on a case-by-case basis.

Commissioner Stansbury indicated that he would be prepared to support Level I engagement at this time based on the information presented to the Board, but not Level II or III.

Commissioner Driscoll noted the potential limitations of shareholder engagement, as SFERS is not currently an activist investor. The Board's fiduciary obligations require careful consideration before any potential divestment, and will require substantial research by staff.

Commissioner Meiberger expressed his appreciation to the public comment participants and addressed some of the concerns raised:

- He noted that the Board members were not securities analysts, and the determination as to

whether specific stocks are under or over-valued has been delegated to staff and consultants.

- He noted that the Securities and Exchange Commission does play a role in proxy votes and this could serve to limit the shareholder engagement process.
- He noted that in the long term, alternative energy sources will have to be developed as an alternative to fossil fuels.
- The determination as whether to underweight fossil fuel stocks would have to be based on the recommendation of staff and the Board's money managers and investment consultants.
- In regard to the allegation that fossil fuel stocks are overvalued, he urged the presentation of additional analysis from reputable investment managers.
- He noted that there was no information presented on the inflationary impact of divestment, as energy stocks are inflation sensitive. He specifically noted that information on the impact of divestment on the inflation protection offered by energy stocks would have to be presented to the Board before he could consider possible divestment of fossil fuel holdings.
- He agreed that San Francisco is a coastal city that would likely be impacted by climate change; however, the Board's specific fiduciary duty is to the members and beneficiaries of the SFERS Trust.
- He supported the suggestion by Supervisor Avalos to hold additional informational sessions on the impact of divestment, particularly in regard to the reinvestment of assets gained from selling energy stocks.
- He addressed the Board's fiduciary duties to the members and beneficiaries of the SFERS Trust, and noted that the Board members are personally liable as fiduciaries.
- He noted that he had attended the recent divestment conference held in Berkeley, and noted that if SFERS sold its holding in energy stocks they would simply be purchased by other investors – and it was not clear how that would serve to reduce the impact of climate change.
- He noted that any underperformance as a result of divestment would have to be made up by the City, taxpayers, and active employees.
- He noted the success of Zipcar and related companies in developing alternative strategies to reduce the impact of climate change.
- He indicated that he would be prepared to support Level II shareholder engagement in collaboration with other organizations, such as the Investor Network on Climate Risk and CALPERS, and urged participants to develop greater alliances within the investment community.

Commissioner Bridges recommended that the Board explore opportunities to gather additional information as fiduciaries, and spoke in support of the formation of an Environmental, Social and Governance Committee.

Commissioner Cohen spoke in support of informational sessions to better educate the Board, staff and community in regard to the potential impact of fossil fuel divestment on the SFERS portfolio, particularly in regard to the reinvestment of assets gained from selling energy stocks.

She noted the potential impact of divestment on the SFERS investment return and on contribution rates for the City, active employees, and taxpayers.

Finally, she spoke in support of the formation of an Environmental, Social and Governance Committee.

In response to a question from Commissioner Stansbury, Mr. Huish noted that staff could identify the entire range of fossil fuel related proxy items where SFERS has holdings and bring upcoming resolutions to the Board in advance of any vote in the 2014 proxy season. Current Board policy is to vote these items on a case-by-case basis.

Action: Moved by Commissioner Meiberger, Seconded by Commissioner Driscoll to direct staff to engage companies included on the Carbon Tracker list in which SFERS is a shareholder through the exercise of SFERS' shareholder voting rights at Level I engagement under the *SFERS Social Investment Policies and Procedures* and to prepare an implementation plan and timeline to present to the Retirement Board for its consideration and approval that would include reporting back to the Retirement Board on a semiannual basis on the Retirement staff efforts and results of such engagement.

Approved by the following vote:

Ayes: Bridges, Cohen, Driscoll, Makras,
Meiberger, Stansbury
Absent: Paskin-Jordan

In response to a question from Commissioner Meiberger, Commissioner Bridges indicated that she was not prepared to consider Level II engagement without gathering additional information.

Action: Moved by Commissioner Bridges, Seconded by Commissioner Cohen to direct staff to develop and bring back to the Board a schedule within 60 days to conduct educational sessions with Bloomberg and others.

Approved by the following vote:

Ayes: Bridges, Cohen, Driscoll, Makras,
Meiberger, Stansbury

Absent: Paskin-Jordan

In response to a question from Commissioner Meiberger, Mr. Huish noted that the 2014 proxy season has begun and noted that the Board may wish to consider the establishment of a committee to review pending proxy votes.

Commissioner Makras noted that staff has already begun the process of reviewing these votes.

Action: Moved by Commissioner Driscoll, Seconded by Commissioner Meiberger to review SFERS' existing policy and approach to evaluating environmental, social and governance issues in our overall investment process with the assistance of Institutional Shareholder Services: how do investment managers consider issues like climate risk in their investment selection processes, measure the carbon intensity of their portfolios, or tilt portfolios towards more sustainable assets.

Approved by the following vote:

Ayes: Bridges, Cohen, Driscoll, Makras,
Meiberger, Stansbury

Absent: Paskin-Jordan

- 02192014-03 Discussion item **General Public Comment:**

President Makras called for general public comment.

There were no comments from the public.

- 02192014-04 **Adjournment**

There being no further business, the Board adjourned its meeting at 4:35 PM.

Respectfully submitted,

Jay Huish
Executive Director