BILL NUMBER: SB 261 (Stern) as introduced January 30, 2023

SUMMARY

SB 261 requires a covered entity, as defined, to annually report their climate-related financial risks in accordance with the Task Force on Climate-Related Financial Disclosures' (TCFD) recommendations commencing on or before December 31, 2024. The bill also requires the Climate-Related Risk Disclosure Advisory Group to review and analyze those reports, identify inadequate reports, propose policy changes to implement best practices relating to disclosure, convene representatives to offer input on disclosure and monitor certain federal regulatory actions.

RECOMMENDATION

Support. The board's policy is to support legislation that is consistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan.

REASON FOR THE BILL

As stated in the findings and declarations of the bill, climate change affects the California economy, and failure to adequately plan for and adapt to climate-related financial risks will lead to negative consequences for financial institutions and the broader economy. Current disclosure standards related to climate-related financial risks are voluntary and, therefore, inadequate to address rapidly increasing climate risks. Mandatory disclosures from all major economic actors are needed to address the climate crisis and ensure a sustainable future for California.

ANALYSIS

Existing Law:

Under provisions of Chapter 731, Statutes of 2018 (SB 964−Allen), CalSTRS and CalPERS are required to report to the California Legislature every three years on their efforts to measure and manage climate-related financial risk in their public market investment portfolios. The Addressing Climate-Related Financial Risk Report focuses on CalSTRS' investment-related activities addressing climate risk across the fund, including proxy voting, corporate engagement and investment in climate solutions. It also analyzes CalSTRS' Public Equity and Corporate Credit portfolios' alignment with the goals of the Paris Climate Agreement.

Additionally, on September 20, 2019, Governor Gavin Newsom issued Executive Order N-19-19, which directed the Department of Finance to develop a Climate Investment Framework in collaboration with CalSTRS, CalPERS and the University of California Retirement Program. The framework was published on September 24, 2020, and recommended the Governor create a climate risk disclosure working group, the state sign onto the Coalition for Climate Resilient Investment, and the state's pension funds invest additional funds in low-carbon strategies. The California Climate-Related Risk Disclosure Advisory Group was created as a follow-up to Executive Order N-19-19, to address and mitigate the impacts of climate change with a focus on identifying the best practices regarding climate-related financial risk disclosures. The Developing Climate Risk Disclosure Practices for the State of California report was released by the advisory group on September 2021 and builds upon the TCFD framework. Although various companies voluntarily

follow the TCFD framework to report their climate-related financial risks, there is no law requiring public or private companies to report or verify their disclosures.

This Bill:

Specifically, SB 261:

- Among other terms, defines "covered entity" as a corporation, partnership, limited liability company or other business entity formed in the U.S. with total annual revenues in excess of $500 million and that does business in California. "Covered entity" does not include a business entity that is in the business of insurance.
- Commencing on or before December 31, 2024, requires a covered entity to annually report its climate-related financial risks in accordance with the TCFD recommended framework and disclosures, along with its measures adopted to reduce and adapt to those risks.
- Requires the report to be publicized on the covered entity's website and submitted to the California State Air Resources Board (CARB), along with a statement to the Secretary of State affirming, not under penalty of perjury, that the report makes disclosures as required.
- Requires the Climate-Related Risk Disclosure Advisory Group to review and analyze the reports, identify inadequate reports, propose policy changes to implement best practices regarding disclosure, convene representatives to offer input on disclosure and monitor certain federal regulatory actions.
- Specifies that the Office of Planning and Research serves as the administrative staff for the advisory group.

Discussion

Using the TCFD framework as the basis for requiring corporate issuers to provide more comparable disclosures would facilitate CalSTRS' ongoing efforts to more easily compare companies' approach to climate risk management in a timelier fashion, through a common channel and format, and with the same degree of detail. Consistent and complete disclosures about companies' climate-related financial risks would support CalSTRS' work to meet its pledge to achieve a net zero portfolio by 2050 or sooner. CalSTRS actively engages companies and regulators, including through collective efforts with Climate Action 100+, to adopt the recommendations of the TCFD in order to help investors price climate risk and reward climate innovation.

CalSTRS has identified climate change as a key factor in its Investment Policy for Mitigating Environmental, Social and Governance Risks. CalSTRS expects external fund managers and internal investment staff to evaluate climate change risk for potential and current investments. As fiduciaries, CalSTRS is charged with understanding the potential economic impacts to plan assets in financial terms and, thus, has advocated for greater climate disclosure for years; however, slow market uptake has made it difficult to assess climate risks across the U.S. market. Staff believe a regulatory power to require fuller, consistent and vetted disclosures from covered entities, as defined, would improve CalSTRS' ability to measure portfolio risk from climate change.

PROGRAM BACKGROUND

Task Force on Climate-related Financial Disclosures (TCFD)

The Financial Stability Board created the TCFD in 2015, and the TCFD issued a report containing climate-related financial disclosure recommendations in 2017. The recommendations fall into four

thematic areas: governance, strategy, risk management and metrics. As of 2022, more than 1,500 financial institutions have expressed support for the TCFD framework, and 92 of the 100 largest public companies either support the TCFD, report in line with the TCFD recommendations or both.

ESG Policy

CalSTRS has its own well-established and longstanding process for thoroughly vetting the ESG risks of potential investments. The board adopted its Statement of Investment Responsibility in 1978, making CalSTRS an industry leader as one of the first pension funds to adopt a written policy to navigate these complex issues. As a key component of that process, the board has developed a list of risk factors as part of its Investment Policy for Mitigating ESG Risks. The ESG Risk Factors help the board to identify and evaluate investment risks relating to the existence of certain conditions, such as recognition of the rule of law, shareholder rights, human rights, the environment, acts of terrorism and other unsustainable practices and governance crises with the potential to hurt long-term profits.

Net Zero Pledge

In September 2021, the board adopted a Net Zero Pledge that commits to achieve a net zero portfolio by 2050 or sooner. 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. The net zero portfolio emissions pledge is the continuation of CalSTRS' long history of climate risk integration into the investment portfolio. In August 2022, the board authorized a package of investment actions to accelerate its efforts to achieve a net zero investment portfolio:

1. The reduction of greenhouse gas emissions across the investment portfolio by 50% by 2030.
2. The adoption of processes to incorporate greenhouse gas emissions into investment decisions as part of traditional risk-and-return analyses and their potential impacts on the CalSTRS Funding Plan.
3. The allocation of 20% of the Public Equity portfolio to a low-carbon index. This index is designed to significantly reduce portfolio emissions while managing active risk by allocating more money to companies with low-carbon emissions. This shift alone could reduce portfolio emissions by as much as 14%.
4. The incorporation of future climate-related scenarios into CalSTRS' asset-liability modeling framework to help guide CalSTRS' investment allocations.

CalSTRS Expands Investments in Climate Solutions

Since 2004, CalSTRS has been actively integrating climate-oriented solutions into our portfolio and has invested more than $20 billion in low-carbon solutions. Examples of these investments include:

- $18.3 billion in LEED-certified buildings in the Real Estate Portfolio.
- $8.9 billion in the Total Sustainable Investments and Stewardship Strategies Portfolio.
- $1.8 billion in renewable power, agriculture, timberland and LEED-certified structure investments in the Inflation Sensitive Portfolio.
- $306 million in green bonds in the Fixed Income Portfolio.

Climate Action 100+ (CA100)

CalSTRS is a lead signatory of the Climate Action 100+ (CA100), an initiative of more than 700 investors with a goal to mitigate investment exposure to climate risk and secure ongoing sustainable returns for their beneficiaries. Since CA100 launched, 119 companies have made commitments to reduce emissions, which equates to over a quarter of the global greenhouse gas emissions today.

Sustainability Accounting Standards Board (SASB)

CalSTRS was an inaugural board member and continues to be a critical participant and supporter of the SASB. SASB was formed to fill a void in corporate reporting to identify the financial impacts of sustainability issues. The work of SASB has pushed the market towards greater climate related disclosure. While these standards are voluntary, more than 50% of companies in the S&P Global 1200 use them. The International Financial Reporting Standards Foundation created the International Sustainability Standards Board, which will integrate and build on the work of SASB in establishing globally required sustainability reporting standards.

FISCAL IMPACT

Program Cost – None.

Administrative Costs/Savings – None.

SUPPORT

Ceres (Sponsor)

OPPOSITION

None known.

ARGUMENTS

Pro: Facilitates CalSTRS' ongoing corporate engagement efforts and stewardship priorities.

Provides CalSTRS and other investors additional clarity on climate-related financial risk, which is a key input to assessing climate risk to the portfolio.

Creates greater public understanding and access to information on climate-related financial risk.

Con: May create challenges for covered entities attempting to write disclosures based around the TCFD.

Creates a large reporting burden on the Climate-Related Risk Disclosure Advisory Group.