BILL NUMBER: SB 261 (Stern) as amended September 8, 2023

SUMMARY

SB 261 requires a covered entity, as defined, to biennially report their climate-related financial risks in accordance with the Task Force on Climate-Related Financial Disclosures' (TCFD) recommendations commencing on or before January 1, 2026. The bill also requires a climate reporting organization, as defined, to review and analyze a subset of the reports, identify inadequate reports, convene representatives to offer input on disclosure and monitor certain federal regulatory actions. In addition, SB 261 requires covered entities to pay an annual fee to cover the California Air Resources Board's (CARB) costs to administer and implement this bill and requires CARB to seek administrative penalties of up to $50,000 per reporting year from covered entities that are found to violate the requirements of the bill.

BOARD POSITION

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.

SUMMARY OF AMENDMENTS

The July 12, 2023, amendments:

- Clarify that the revenue threshold for a covered entity is based on U.S. dollars and earnings during the prior fiscal year.
- Specify the climate reporting organization is responsible for ensuring disclosures remain consistent with evolving TCFD guidance.

The September 1, 2023, amendments:

- Remove the requirement for covered entities to submit a statement to the Secretary of State affirming, not under penalty of perjury, that the report makes required disclosures.
- Remove the requirement for the climate reporting organization to ensure disclosures remain consistent with evolving TCFD guidance.
- Require covered entities to explain any reporting gaps in incomplete disclosures and describe their steps to prepare complete disclosures by December 31, 2029.
- Permit a covered entity to submit a report at the parent company level, even if a subsidiary company independently qualifies as a covered entity.

- Specify that a covered entity satisfies the requirements of this bill if it prepares a climate-related financial risk disclosure as required by any regulated exchange, national government, or other governmental entity.
- Require covered entities to pay an annual fee determined by CARB for the administration and implementation of this bill and establish the Climate-Related Financial Risk Disclosure Fund.
- Require the climate reporting organization to convene with standard-setting organizations and labor representatives of impacted sectors to provide input on best practices for the disclosures.

The September 8, 2023, amendments:

- Delay the submission of reports by covered entities to on or before January 1, 2026, and require submission biennially instead of annually thereafter.
- Remove the December 31, 2029, date by which covered entities must complete disclosures.
- Require the climate reporting organization to prepare its report biennially instead of annually and to convene with climate and corporate sustainability organizations to provide input on best practices for the disclosures.
- Reduce the cap on administrative penalties from $500,000 to $50,000.

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 January 1, 2026, requires a covered entity to biennially 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 covered entities to explain any reporting gaps in incomplete disclosures and describe their steps to prepare complete disclosures.
- Permits a covered entity to submit a report at the parent company level, even if a subsidiary company independently qualifies as a covered entity.
- Specifies that a covered entity satisfies the requirements of this bill if it prepares a climate-related financial risk disclosure as required by any regulated exchange, national government, or other governmental entity such as, but not limited to, the United States government or the International Sustainability Standards Board.
- Requires the report to be publicized on the covered entity's website.
- Requires covered entities to pay an annual fee determined by CARB for the administration and implementation of this bill and establishes the Climate-Related Financial Risk Disclosure Fund.
- Requires CARB to contract with a climate reporting organization, as defined, that is responsible for reviewing and analyzing a subset of the reports by industry, identifying inadequate reports, convening representatives to offer input on disclosure and monitoring certain federal regulatory actions.
- Requires CARB to seek administrative penalties of up to $50,000 per reporting year from a covered entity that is found to violate the requirements of this bill.

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.

LEGISLATIVE HISTORY

SB 449 (Stern, 2021) would have required a covered entity to prepare annual climate-related financial risk disclosure reports and would have required 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 and convene representatives to offer input on disclosure. This bill was held in the Senate Appropriations Committee.

SB 964 (Allen, Chapter 731, Statutes of 2018) required the CalSTRS and CalPERS boards to analyze and report the material climate-related financial risks of their public market portfolios every three years.

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.

International Sustainability Standards Board (ISSB)

The International Financial Reporting Standards Foundation created the ISSB in 2021 with the purpose of establishing international sustainability-related financial disclosures and climate-related disclosures by consolidating a variety of existing disclosure frameworks. In June 2023, the ISSB released its first two disclosure standards that consolidate a variety of existing reporting standards such as, but not limited to, the TCFD's recommendations. The integration of the TCFD's recommendations into the ISSB's standards completes the work of the TCFD and transfers their responsibilities to the ISSB.

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)
1000 Grandmothers for Future Generations
350: Bay Area Action; Conejo/San Fernando Valley; Humboldt; Juneau; Marin; Sacramento; South Bay Los Angeles; Southland Legislative Alliance; and Ventura County Climate Hub
Active San Gabriel Valley
Alter Eco
Americans for Financial Reform
Atlassian
Avocado Green Brands
Ban Sup (Single Use Plastic)
Bonterra Organic Estates
California Environmental Voters (formerly CLCV)
CalSTRS
CalPIRG
Catholic Network US (Colorado)
Center for Biological Diversity
Citizens Climate Lobby Sacramento / Roseville Chapter
Climate 911
Climate Action California
Climate Action Campaign, Humboldt
Climate Hawks Vote
Climate Reality Project: Los Angeles and San Fernando Valley
Climate Reality San Fernando Valley Chapter
Coalition for Clean Air
Coastside Jewish Community
Colorado Businesses for a Livable Climate
Community for Sustainable Energy
Conejo Climate Coalition
Cool Planet Group of First Presbyterian Church, Palo Alto
Culver City Democratic Club
Divest Oregon
Dsm North America
E2
East Valley Indivisibles
Eileen Fisher
Elders Climate Action, Norcal and Socal Chapters
Environment California
Environmental Defense Fund
Everlane
Extinction Rebellion San Francisco Bay Area
Fellowship’s Climate Action Campaign
Fossil Free California
Friends Committee on Legislation of California
Friends of The Earth
Giniw Collective
Glendale Environmental Coalition

Greater New Orleans Housing Alliance
Grove Collaborative
Honor the Earth
Humboldt Unitarian Universalist Fellowship's Climate Action Campaign
Ikea Supply AG
Indivisible: Alta Pasadena; Ambassadors (Colorado); California Green Team; and California: StateStrong
Leading Change Consulting and Coaching
Littleton Business Alliance
Mental Health & Inclusion Ministries
Microsoft Corporation
Mind Eye World
Mothers Out Front California
Natural Resources Defense Council
Nextgen California
North Range Concerned Citizens
Oil & Gas Action Network
Patagonia
Peninsula Interfaith Climate Action
Public Citizen, INC
Rapidshift Network
REI
Sacramento Area Congregations Together
Salesforce Inc.
Sandiego350
San Fernando Valley Climate Reality
San Francisco Bay Physicians for Social Responsibility
Santa Cruz Climate Action Network
Save EPA
Seventh Generation
Sierra Club California
Sierra Nevada Brewing Company
Socal 350 Climate Action
Solano County Democratic Central Committee
Solidarityinfoservice
Stand.earth
Sustainable Rossmoor
System Change Not Climate Change
The Climate Center
The Phoenix Group
The Vessel Project of Louisiana
Third ACT
Transformative Wealth Management LLC
Trinity Respecting Earth and Environment (TREE)
Union of Concerned Scientists
Urban Ecology Project
VF Corporation

Working for Racial Equity

OPPOSITION

Advanced Medical Technology Association
African American Farmers of California
Agricultural Energy Consumers Association
American Beverage Association
American Composites Manufacturers Association
American Pistachio Growers
Auto Care Association
Building Owners and Managers Association
California Advanced Biofuels Alliance
California Apartment Association
California Apple Commission
California Asphalt Pavement Association
California Bankers Association
California Blueberry Association
California Blueberry Commission
California Builders Alliance
California Building Industry Association
California Business Properties Association
California Construction & Industrial Materials Association
California Cotton Ginners & Growers Association
California Credit Union League
California Date Commission
California Fresh Fruit Association
California Fuels and Convenience Alliance
California Independent Petroleum Association (CIPA)
California Life Sciences
California Manufacturers & Technology Association
California Poultry Federation
California Retailers Association
California Walnut Commission
Can Manufacturers Institute
Chamber of Commerce: Antelope Valley; California; California Hispanic; Carlsbad; Chino Valley; Citrus Heights; Costa Mesa; Danville Area; Greater High Desert; LA Canada Flintridge; Long Beach Area; Los Angeles Area; North San Diego; Oceanside; Palos Verdes Peninsula; Rancho Cordova Area; Santa Barbara South Coast; The Greater High Desert; Torrance Area; and Walnut Creek
CAWA
Far West Equipment Dealers Association
Naiop California
Nisei Farmers League
Olive Growers Council of California
Orange County Business Council
Pci West-chapter of The Precast/prestressed Concrete Institute
Sacramento Regional Builders Exchange

Securities Industry and Financial Markets Association
Southern California Leadership Council
Specialty Equipment Market Association (SEMA)
West Precast Prestressed Concrete Institute
West Ventura County Business Alliance
Western Agricultural Processors Association
Western Growers Association
Western Plant Health Association
Western States Petroleum Association
Wine Institute

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.

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