CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

California State Teachers'
Retirement System
Sustainable Investment & Stewardship Strategies
100 Waterfront Place, MS 4
West Sacramento, CA 95605

June 4, 2021

Via email: rule-comments@sec.gov

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Public Input on Climate Change Disclosures

Dear Chair Gensler:

We write on behalf of the California State Teachers' Retirement System (CalSTRS). Established in 1913, CalSTRS is the largest educator-only pension fund in the world with a global investment portfolio valued at approximately $291 billion as of March 31, 2021.[1] As administrators of both a defined benefit plan and a defined contribution plan, our mission is to secure the financial future and sustain the trust of more than 975,000 Californian educators.

We appreciate the opportunity to provide our comments in response to the March 15, 2021 request for input on the current disclosure rules and guidance of the U.S. Securities and Exchange Commission (the Commission) as they apply to climate change. We commend the Commission's effort to provide investors with a more complete set of information related to investment risks and opportunities. CalSTRS supports rulemaking to mandate a minimum set of climate data from all registrants in combination with the Commission's recognition of an independent sustainability accounting standards board to facilitate industry-specific reporting.

CalSTRS uses climate information in investment decisions

In January 2020, following extensive research[2], the Teachers' Retirement Board adopted a low-carbon investment belief:

> *Investment risks associated with climate change and the related economic transition—physical, policy and technology driven—materially impact the value of CalSTRS' investment portfolio.*

[1] California State Teachers' Retirement System current investment portfolio as of March 31, 2021.
[2] California State Teachers' Retirement System Green Initiative Task Force Interim Report for Period Ending December 31, 2020

We believe public policies, technologies, and physical impacts associated with climate change are driving a transition to a low-carbon economy. As a prudent and diversified global investor, we need to understand the transition's effects on companies, industries, and countries and consider actions to mitigate risk and identify investment opportunities. Carbon pricing frameworks play a critical role in integrating the costs of carbon emissions into the global economy and evaluating an individual asset's ability to pass through costs (such as carbon taxes) to customers. However, we are not waiting for national or international carbon pricing mechanisms before we take account of and manage climate risks to our portfolio. CalSTRS staff is applying our investment belief to evaluate new investments in public and private assets, prioritize our stewardship activities, and measure climate risk to existing investments across our total portfolio.

Climate risks and opportunities influence our capital allocation decisions

CalSTRS deploys capital into investments that meet the risk-return goals of our total fund and accelerate the low-carbon transition. In 2017, CalSTRS began investing in low-carbon index-like strategies. As of May 2021, our low-carbon index-like investments exceed $3.5 billion. In addition, CalSTRS recently funded a $1 billion low-carbon transition readiness equity strategy. The investment thesis for this risk-controlled active strategy is that capital markets are currently mispricing long-term, low-carbon transition risks and opportunities. This strategy overweights (buys more) or underweights (buys less) stock positions relative to the performance benchmark to maximize the portfolio's exposure to companies better prepared to transition. We have made these investments despite inconsistent company data through significant resources and expense for third party estimates.

CalSTRS partners with external managers where inefficient markets have made information or estimates harder to access. Asset managers charge higher fees for climate and sustainability data in part because they too must make use of third party data aggregators and estimates. If we had a complete set of publicly available climate data across our investable universe, we could more efficiently and cost-effectively allocate capital to lower climate risk assets in line with our investment objectives.

Recognizing the low-carbon transition has financial implications for private asset classes, CalSTRS is expanding sustainable investments in private equity, infrastructure, and real estate. Over the coming years, we anticipate investing $2.5 billion to $3 billion in sustainability-focused investments in private markets. Investment staff will initially focus on affordable housing opportunities, as well as low-carbon solutions relating to energy, technology-enabled resource efficiency, water and waste management, land and agriculture management, and food security as the sustainability and climate-related topics we find most likely to fit our investment return targets. We would benefit from more consistent and comparable, asset-level and entity-level sustainability data to support our analysis.

Climate risks and opportunities influence our proxy voting and engagement decisions

CalSTRS is a long-term, active owner and steward of capital. We engage hundreds of companies each year to promote sustainable business practices and decision-useful disclosures. When we consider how we will vote sustainability-related proxy items, we look to the company's current disclosures. This involves hunting across the company's investor relations, sustainability, and public affairs reports and web pages. We often must consult third party data aggregators to which companies have provided actual data, but where information is only available to subscribers. We base our vote decisions on the level and quality of information companies disclose. When voting shareholder proposals calling for greenhouse gas emissions reporting or greenhouse gas emissions reduction plans, we look for corporate disclosures with scope 1, 2, and 3. For those proposals asking for greenhouse gas reduction plans, we also look for reports prepared using Task Force on Climate-Related Financial Disclosures (TCFD) guidance and Sustainability Accounting Standards Board (SASB) standards. It is rare that we see all these elements. As a result, we vote in favor of many resolutions calling for better corporate disclosure.

When companies do not provide the information we need to make investment or voting decisions, we engage. We ask our portfolio companies to provide high quality, TCFD-aligned reports including plans to reduce greenhouse gas emissions. After years of private and constructive dialogue, we have secured significant emissions reduction commitments from some of our portfolio's highest emitters.[3] Assuming the companies follow through with rigorous plans, these commitments will effectively reduce the transition risk for our holdings in U.S.-headquartered Duke Energy, Southern Company, Dominion Energy, as well as Japan-based Daikin Industries, ENEOS, Nippon Steel, and Toray Industries. This effort has yielded promising results but has been resource intensive for our staff.

When private engagement fails to generate outcomes that reduce our perceived risk, we use public engagement tactics. After repeated attempts at constructive engagement with Phillips 66, we filed a shareholder resolution for the company's annual meeting. We requested more information about the company's climate-related lobbying activities. Roughly 62% of the oil and gas refiner's shareholders supported our proposal for greater disclosure.[4]

In severe cases of elevated investment risk where traditional engagement has not produced results, we will pursue what we call 'activist stewardship'. ExxonMobil is one such recent case. Ten years ago, the company was the largest company in the world by market capitalization, and subsequently a top holding in our fund. Its market capitalization has since halved. Over the last five years, the company missed its cash flow projections while failing to provide a credible strategy for the low carbon transition. We attempted to engage the company but were not satisfied with the information they were prepared to provide. We

[3] California State Teachers' Retirement System Green Initiative Task Force Interim Report for Period Ending December 31, 2020
[4] https://www.sec.gov/ix?doc=/Archives/edgar/data/0001534701/000153470121000116/psx-20210512.htm

escalated our engagement to vote against board members. We concluded a significant change was needed at the board and supported a slate of independent directors we believed were better qualified to guide the company's sustainable value creation in a decarbonizing world.[5] Our efforts were rewarded by Exxon's shareholders supporting three out of four of the directors we supported.[6] Still, partly because there was no universal proxy card to simplify voting choices, our staff spent considerable time and effort to make other long-term owners aware of the option to vote for new board members.[7]

We assess climate risk in our portfolio

Assessing climate risk across our portfolio is a crucial step in understanding investment risks to our fund. Poor data availability has constrained our ability to produce highly accurate assessments and analyses for our total fund. CalSTRS has published annual updates on our sustainability-related investment activities for the past 15 years. California Senate Bill 964 (2018) mandated that CalSTRS publish a report every three years describing the climate-related financial risks of our public market portfolio. This law did not exclude small capitalization companies, nor did it allow our fund to defer meeting our obligation while companies had the benefit of an extended implementation period to supply the data we required. In 2019, we added analysis on climate-related financial risks and aligned our annual report with guidance from the TCFD. We chose to focus first on our public equities and real estate investments. For those asset classes, we have the most available data and the strongest industry research and estimates. Still, 62% of companies in our public equity portfolio did not report emissions data for 2019. Knowing, measuring, and understanding climate risks for our portfolio is an investment imperative, fiduciary duty, and a legal requirement for CalSTRS. Absent complete, comparable, and reliable climate data for our total portfolio, we must expend extraordinary resources to fulfil our duties.

More consistently reported and comparable information would support our investment analysis and decision-making

CalSTRS recommends the Commission use rulemaking to mandate universal metrics and recognize independent standards to guide industry-specific disclosures and require both from companies of all sizes in all industries.

We support rulemaking to require all companies to disclose scope 1, 2, and 3 emissions annually using the globally accepted Greenhouse Gas Protocol. To meet our goals for total portfolio emissions measurement, we would need this comparable information for U.S. and non-U.S. issuers across all market capitalizations, as well as issuers of debt and privately or closely held companies. This information would give us a sense of each asset's current climate risk exposure and contribution to our total portfolio climate risk budget.

[5] https://www.calstrs.com/statement/statement-alternate-board-members-exxonmobil
[6] https://www.sec.gov/ix?doc=/Archives/edgar/data/34088/000003408821000031/xom-20210526.htm
[7] https://www.sec.gov/Archives/edgar/data/34088/000095015921000161/calstrspx14a6g.htm

To understand each company's industry-specific risks and mitigants, we ask the Commission to mandate companies provide annual investor communications aligned with TCFD guidance to describe their governance, strategy, risk assessment, metrics, and targets related to climate as well as all material topics described by the applicable SASB industry standards. Core elements of the TCFD framework help us assess an entity's plans for financial success while transitioning to a decarbonized economy—or determine whether further engagement (including voting action) is warranted from us. Implementing the TCFD's metrics and targets guidance requires companies to identify those metrics which are most relevant to their businesses, and to be useful to investors, these must be reported in a standardized, comparable way. Accordingly, we ask the Commission to recognize SASB standards as the industry-specific framework to guide comparable, industry-specific sustainability communications to investors. TCFD and SASB were both designed to be flexible enough to evolve with market practice.

The Commission can foster reliability and comparability in sustainability disclosures

Although CalSTRS has sought to influence enhanced corporate disclosure of material sustainability information for the better part of two decades, we recognize sustainability reporting standards are rapidly evolving with market practice and pricing.[8] To avoid boiler plate language, excessive revisions, or obsolescence, we encourage the Commission to focus climate disclosure rulemaking on the enduringly valuable greenhouse gas emissions metrics (scope 1, 2, and 3) and recognize external sustainability standard setters to guide the material issue-specific and industry-specific information investors need. As the Commission developed the market infrastructure for comparable and reliable financial accounts by recognizing external financial accounting standards, we urge the Commission to leverage existing sustainability disclosure building blocks, namely TCFD and SASB.[9] Importantly, the Commission must recognize standard setters which focus on the investor audience, have appropriate governance and transparency, follow due process with accountability mechanisms, demonstrate trust of both investors and issuers, and have the infrastructure and resources to maintain and update standards in the future.

CalSTRS has long advocated for companies to disclose material environmental, social, and governance (ESG) information alongside traditional financial information so investors can comprehensively assess risk and properly value investments. We value the Commission's role

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[8] We support efforts of sustainability disclosure organizations to collaborate to align their guidance where appropriate. CDP, the Climate Disclosure Standards Board (CDSB), GRI, the International Integrated Reporting Council (IIRC), and SASB have worked to help companies more efficiently and clearly communicate their sustainability performance to multiple audiences—investors, customers, employees, and others—and describe ESG impacts to their businesses as well as the impacts of their businesses on society and the environment. Our recommendation to the Commission centers on those organizations which focus on the investor audience and the ESG issues likely to have a material effect on financial performance.

[9] California State Teachers' Retirement System letter to the International Financial Reporting Standards Foundation regarding a Global Sustainability Standards Board, December 2020

as a central repository of this information making it free to access by all investors. To be useful for financial analysis, we would need the information reported at least annually on the same reporting cycles companies use to report financial information to investors. Sustainability performance and long-term financial performance are inextricably linked, and reporting that demonstrates this integration reflects integrated thinking and management of the full suite of issues material to long-term enterprise value creation.

The Commission can play a critical role in fostering the reliability and accuracy of sustainability information, including climate data, by emphasizing that companies must use appropriate internal controls to gather, assess, interpret, calculate, and prepare material sustainability disclosures to investors. It is our view that sustainability issues are material to operations, and critical to enterprise risk management. As such, they should be subject to equal rigor and oversight.

Investors need a complete set of material sustainability disclosures

We deeply appreciate the Commission's invitation to comment on investor interest in climate disclosures in relation to other sustainability topics. As CalSTRS has expressed to the Commission in previous letters, we support mandated disclosure of material sustainability topics in comparable formats prepared with the rigor and oversight suitable for investor communications.[10] Similar to our climate disclosure needs, we support mandated universal human capital metrics in combination with industry-specific disclosures.[11] Although human capital and climate are topics we find universally material to companies in our portfolio, we ask the Commission to pursue mandatory disclosure requirements of the broadest set of material sustainability issues, including industry-specific topics, to give investors the complete set of information they need to assess enterprise value, risk and opportunities, and make informed investment decisions. We urge the Commission to require these disclosures from all registrants at the earliest possible time and without delay. For years we have asked the companies we own to volunteer the information we need for investment decisions; the time is right now for all seekers of external capital to provide sufficient information to capital allocators.

We thank the Commission for its work to strengthen transparency and accountability in our markets for the benefit of long-term investors like California's teachers. We appreciate the Commission's consideration of CalSTRS' views on climate and broader sustainability

[10] California State Teachers' Retirement System letter to the U.S. Securities and Exchange Commission regarding Modernization of Regulation S-K, October 2019; California State Teachers' Retirement System letter to the U.S. Securities and Exchange Commission regarding Human Capital Management Rulemaking Petition, July 2017; California State Teachers' Retirement System letter to the U.S. Securities and Exchange Commission regarding Business and Financial Disclosure Required by Regulation S-K, July 2016

[11] California State Teachers' Retirement System letter to the U.S. Securities and Exchange Commission regarding Modernization of Regulation S-K, August 2020

disclosure, and we welcome the opportunity to discuss our views or any questions you may have.

Sincerely,

Kirsty Jenkinson
Investment Director

Aeisha Mastagni
Portfolio Manager

CC: The Honorable Allison Herren Lee, The Honorable Elad L. Roisman, The Honorable Caroline A. Crenshaw, The Honorable Hester M. Peirce