BILL NUMBER: SB 964 (Allen) as amended March 14, 2018

SUMMARY

To the extent the CalSTRS and CalPERS boards identify “climate-related financial risk,” as defined, as a material risk to the fund, SB 964 requires that risk to be analyzed. By January 1, 2020, and every three years thereafter, the bill requires the boards to publicly report on the analysis of the material climate-related financial risks of their public market portfolios. The bill also provides a sunset date of January 31, 2035.

BOARD POSITION

Neutral. The board's policy is to adopt a neutral position on legislation that does not significantly or adversely impact the benefits or services provided through the funds administered by CalSTRS or the administration of the retirement plans. This bill’s requirements overlap with current board policy for evaluating investment risks related to environmental factors, including climate change.

REASON FOR THE BILL

As stated in the findings and declarations of the bill, the financial sector is not insulated from the adverse effects of climate change, which presents an array of material financial risks that reasonable investors must take into account when making investment decisions. Failure to acknowledge and address these risks could result in exposure to subsequent liabilities and financial risk.

ANALYSIS

Existing Law:

Under the provisions of Section 17 of Article XVI of the California Constitution, as amended by Proposition 162 of 1992, the CalSTRS board has plenary authority and fiduciary responsibility over the investment of retirement plan assets and is required to discharge its duties solely in the interests of the members and beneficiaries for the exclusive purpose of providing benefits. The board must invest the assets of the plan with the care, skill and diligence of a prudent person engaged in a similar enterprise so as to maximize the investments and minimize the risk of loss. When considering investments, the preservation of principal and maximization of income is the primary and underlying criteria for the selection and retention of securities.

This Bill:

Specifically, this bill:

- Defines “climate-related financial risk” as risk that may include material financial risk posed to the fund by the effects of the changing climate, such as intense storms, rising sea levels, higher global temperatures, economic damages from carbon emissions, and other financial and transition risks due to public policies to address

climate change, shifting consumer attitudes, and changing economics of traditional carbon-intense industries.
- To the extent the board identifies climate-related financial risk as a material risk to the Teachers' Retirement Fund, requires that risk to be analyzed.
- Requires the board, by January 1, 2020, and every three years thereafter, to publicly report on its analysis of the climate-related financial risk of its public market portfolio, including the alignment of the fund with the Paris climate agreement and California climate policy goals and the exposure of the fund to long-term risks.
- Requires the board to include in its report the methods and results of its engagement related to climate-related financial risk with publicly traded companies that are the most carbon intense, such as utilities, oil and gas producers within the fund, and both of the following:
    - A summary of climate-related financial risk-related engagement activities undertaken.
    - A description of additional action taken, or planned to be taken, by the board to address climate-related financial risk, including a list of proxy votes and shareholder proposals initiated by the board.
- Specifies that this bill does not require the board to take any action unless the board determines the action to be consistent with its fiduciary responsibilities under Section 17 of Article XVI of the California Constitution.
- Sets January 31, 2035, as the sunset date for the requirements of this bill.

As further described below, CalSTRS is active in assessing external risks of investments, including those posed by climate change, and works with its external managers to recognize and manage environmental risks and, where appropriate, directly engages with portfolio companies. Staff also considers and votes all environment-related proposals in a manner that aligns with CalSTRS' objectives of improving disclosure and mitigating risk. The specific reporting requirements of this bill overlap with current board policy related to evaluating investment risks related to environmental factors, including climate change. However, the requirements to analyze climate-related financial risk only go into effect if the board first identifies climate-related financial risk as a material risk to the fund, maintaining the board's investment authority.by the board.

LEGISLATIVE HISTORY

<u>SB 185 (De León, Chapter 605, Statutes of 2015)</u> requires the CalSTRS and CalPERS boards to engage with thermal coal companies, as defined, and to divest the public employee retirement funds of any investments in thermal coal companies and prohibited additional or new investments or the renewal of existing investments in thermal coal companies.

<u>SB 1550 (Florez, 2008)</u> would have required the State Controller, in consultation with the investment community and the Air Resources Board, to develop a climate change disclosure standard for voluntary use by listed corporations doing business in California. This bill was held on the Senate Floor.

AB 32 (Núñez, Chapter 488, Statues of 2006) enacted the "Global Warming Solutions Act of 2006," which required the Air Resources Board to adopt regulations to reduce California's greenhouse gas emissions to 1990 levels by the year 2020.

PROGRAM BACKGROUND

ESG Policy

CalSTRS has its own well-established and longstanding process for thoroughly vetting the environmental, social and governance (ESG) risks of potential investments set forth in the board's Investment Policy for Mitigating ESG Risks. As a key component of that process, the board has developed a list of 21 Risk Factors, which help staff to identify and evaluate investment risks relating to the existence of certain conditions with the potential to hurt long-term profits, including climate change.

Climate Risk Disclosure Initiative

In addition to the ESG policy, CalSTRS was one of 14 leading investors that participated in the Climate Risk Disclosure Initiative (CRDI), which kicked off in 2005. The CRDI aimed to standardize company climate risk disclosures to facilitate investor analysis and comparisons of company climate risk exposure. In 2006, the CRDI Steering Committee released a global framework for climate risk disclosure "in order to analyze a company's business risks and opportunities resulting from climate change, as well as the company's efforts to address those risks and opportunities."

Green Initiative Task Force and Annual Report

CalSTRS also established an environmentally focused Green Initiative Task Force, which produces an annual report to highlight environmental-themed investments, corporate governance and other environmental risk management efforts. As part of assessing environmental risks, CalSTRS considers not only how a particular investment affects the environment but also how the environment affects a particular investment. CalSTRS examines the extent to which portfolio assets are at risk of being exposed to extreme weather zones or changing climatic conditions. Similarly, CalSTRS examines the potential for demand disruption, as may be the case with increased regulation leading to the potential sequestration of fossil fuels.

CalSTRS works with its external managers to recognize and manage environmental risks and, where appropriate, directly engages with portfolio companies. CalSTRS also collaborates with other investors to broaden engagement reach whenever possible. CalSTRS routinely submits environment-related shareholder proposals to companies held in its public equity portfolio to raise their level of environmental risk awareness. Staff also considers and votes all environment-related proposals in a manner that aligns with CalSTRS' objectives of improving disclosure and mitigating risk.

FISCAL IMPACT

Program Cost – None identified.

Administrative Costs/Savings – Potentially more than $150,000 per year for staff to implement the provisions of the bill and to employ an outside consultant to assess the alignment of the fund with the Paris climate agreement and California climate policy goals. In addition, every three years there would be an additional cost of $50,000 to compile information and prepare the required report.

SUPPORT

Environment California (Sponsor)
Fossil Free California (Sponsor)
350 Bay Area
350 Conejo
350 East Bay
350 Marin
350 Riverside
350 San Francisco
350 Silicon Valley
350 Sonoma
350 South Bay Los Angeles
Asian Pacific Environmental Network
California League of Conservation Voters
California Teachers Association
Center for International Environmental Law
Cool Planet Working Group of First Presbyterian Church of Palo Alto
Friends Committee on Legislation of California
Friends of the Earth – U.S.
Glendale Environmental Coalition
Green River Sustainable Investing & Financial Services
Long Beach 350
Peninsula Interfaith Climate Action
San Diego 350
SEIU California
Sierra Club California
SoCal350 Climate Action

OPPOSITION

None known.

ARGUMENTS

Pro: Enhances visibility of CalSTRS engagement in considering the adverse impacts of climate change on the investment portfolio.

Con: Requires CalSTRS to incur additional administrative costs to assess climate-related financial risk.

LEGISLATIVE STAFF CONTACT

Sal Sanchez
Legislative Analyst,
CalSTRS Governmental Relations,
(916) 414-1984

ssanchez@calstrs.com

John Maradik-Symkowick
Manager,
CalSTRS Governmental Relations,
(916) 414-1977
jmaradik-symkowick@calstrs.com

Joycelyn Martinez-Wade
Director,
CalSTRS Governmental Relations,
(916) 414-1980
jmwade@calstrs.com