



Investment Committee

Agenda Item 6i

December 16, 2019

Item Name: Public Report – Climate-Related Financial Risk (SB 964)

Program: Total Fund

Item Type: Information Consent

Executive Summary

The attached report fulfills the legislative requirements of Senate Bill (SB)964 for CalPERS' Board of Administration (Board) to publicly report on the climate-related financial risk of its public market portfolio, including alignment with the Paris Agreement on climate change and California climate policy.

Strategic Plan

This item is required by statute. The underlying work on climate change which is described in the legislative report forms part of CalPERS' Total Fund Governance and Sustainability Five-Year Strategic Plan, which in turn is referenced in the CalPERS 2017-22 Strategic Plan.

Investment Beliefs

This item reflects CalPERS' Investment Beliefs, which reference climate change, in particular:

Investment Belief 4: Long-term value creation requires effective management of three forms of capital: financial, physical, and human.

Investment Belief 9: Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.

Background

Senator Benjamin Allen (D-26) introduced SB 964 in January 2018, which was approved by both houses of the Legislature and signed by Governor Brown on September 23, 2018.

According to the Senator Allen's office, as the legislation was being considered by the Legislature, SB 964 was intended to recognize that CalPERS and the California State Teachers' Retirement System (CalSTRS) each have governance directives that take climate risk into account. As such, the bill was intended to affirm "climate-related risks are material financial risks, recognize the funds' commitment to address this risk, and requires the funds to report on

their analysis of the risk and their engagement activities associated with publicly traded companies that are the most carbon intense, such as utilities, oil, and gas producers.”

The author’s office further stated, “A transition to a low-carbon economy, along with the anticipated impacts of climate change, will have significant, material financial consequences for long-term investors such as public pension funds.”

The requirements of SB 964 are set out in Government Code section 7510.5. These provide that the CalPERS Board, consistent with its fiduciary responsibilities, complete the following:

- By January 1, 2020, and every three years thereafter, the board shall 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.
- The board shall include in the reports pursuant to (the) subdivision(above) the methods and results of the board's 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. This component of the reports shall include both of the following:

(1) A summary of climate-related financial risk-related engagement activities undertaken.

(2) 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.

The requirements of the legislation remain in effect until January 31, 2035.

Analysis

CalPERS has a longstanding commitment to address the risks and opportunities of climate change, as part of its fiduciary duty to ensure repeatability of returns which pay pensions and benefits to its members.

Climate change is referenced in CalPERS’ Investment Beliefs, adopted by the Board in 2013 and forms a priority in the CalPERS’ Total Fund Governance and Sustainability Five-Year Strategic Plan, approved by the Board in 2016. CalPERS’ strategy has three channels: advocacy, engagement and integration. Each of these pillars is supported by partnerships with fellow investors and organizations that bring expertise. In CalPERS’ climate change agenda each of these channels has significant areas of work with measurable targets relating to the goals of the Paris Agreement.

To meet the specific reporting requirements of SB 964 CalPERS has reviewed its public market portfolio exposure to climate-related financial risk including the alignment of the fund with the Paris Climate Agreement and California climate policy goals. The calculations on carbon intensity across the portfolio needed to be treated with caution, as there is lack of comprehensive and reliable data. Two sources of analysis were commissioned in order to provide different lines of sight into the portfolio, however, the scale of estimation must not be disregarded. Alongside CalPERS’ priority on climate change is a commitment to address the need for improved data and corporate reporting, which in due course will improve the quality and reliability of the assessment.

Despite the challenging nature of the available emissions data in corporate reporting, there is a consensus in the scientific community that the world economy is currently set on a path to significantly exceed the global warming targets of the Paris Agreement. This makes clear the urgency of policy makers, investors, the business community and civil society to work effectively to bring down emissions.

Budget and Fiscal Impacts

Preparation of the public report required by SB 964 has been completed within existing budgeted resources and in line with estimates provided.

Benefits and Risks

Failure to comply with the statutory requirement of the Act could result in legal and reputational risk to CalPERS.

The sustainability of risk adjusted returns for the benefit of members and beneficiaries requires that the impact of climate change on the portfolio be assessed in line with CalPERS' Investment Beliefs and strategic plan on sustainable investment.

Attachments

Attachment 1 – Public Report – Climate-Related Financial Risk (SB 964)

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