



Investment Committee

Agenda Item 8c

June 15, 2020

Item Name: CalPERS' Investment Strategy on Climate Change: First Report in Response to the Taskforce on Climate-Related Financial Disclosure (TCFD)

Program: Investment Committee

Item Type: Information

Executive Summary

This item presents CalPERS' first report in response to the recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD).

This report sets out the goal of CalPERS' investment strategy on climate change to ensure the portfolio is resilient to risk and positioned for the investment opportunities that the energy transition brings, in line with the target rate of return.

Strategic Plan

This item supports the goal of Fund Sustainability. Providing transparency through this report helps to strengthen the long-term sustainability of the pension fund.

Investment Beliefs

This item supports a number of CalPERS' Investments Beliefs:

Investment Belief 2: A long term horizon is an advantage and a responsibility.

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

Investment Belief 7: CalPERS will take risk only where we have a strong belief we will be rewarded for it.

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

Background

The Financial Stability Board (FSB) established the Task Force on Climate-Related Financial Disclosures (TCFD) in December 2015 to develop a set of voluntary, consistent disclosure recommendations for use by companies in informing investors, lenders and insurance

underwriters about their climate-related financial risks. These include physical and transition risks toward a low-carbon climate-resilient future. The TCFD also recommends that asset owners provide disclosures in four key categories:

- **Governance:** detailing the organization's governance around climate change-related risks and opportunities.
- **Strategy:** how the organization's business strategy accounts for current and potential climate-related risks and opportunities.
- **Risk Management:** explaining how the organization identifies, assesses and manages climate-related risks.
- **Metrics and Targets:** disclosing the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Analysis

As a long-term investor, CalPERS recognizes the scale and multi-faceted nature of climate change, which pose both risks and opportunities to the portfolio. This is reflected in the Board's adoption of a Total Fund Policy that includes Investment Beliefs which highlight climate change in long-term value creation and risk mitigation. Climate change is also addressed in CalPERS' Governance and Sustainability Principles which guide engagement, proxy voting, advocacy and partnerships. Furthermore, the Board in 2016 approved a strategic plan for Sustainable Investment in which climate change is highlighted as one of six priorities.

In order to prepare the TCFD report CalPERS commissioned data analysis and modeling from a range of specialist sources to provide different lines of sight into the portfolio risk and opportunity related to climate change. CalPERS' portfolio is globally diversified and thereby broadly tracks the global warming potential of the wider economy.

CalPERS has four channels in our climate change strategy: engagement, to ensure that the companies we invest in bring down the emissions which contribute to global warming; advocacy, to support the policy and regulation that will foster the energy transition; and integration, where we bring consideration of climate change risk and opportunity into our investment decision-making. It also explains how we work in partnership with others.

One example of this partnership is Climate Action 100+, in which CalPERS is the convener and co-founder. Climate Action 100+ is the world's largest investor engagement initiative, with over \$40 trillion AUM. Quantifying the success of the Climate Action 100+ companies has already shown significant results. According to the CDP analysis, Climate Action100 companies would collectively avoid 55Gt of CO₂-e scope 1 and 2 emissions if they all reach net zero emissions by 2050. This is equivalent to 13% of the remaining carbon budget (420 Gt if emissions) to have a 66% chance of limiting warming to 1.5°C. Scope 3 emissions estimates for this cohort are several orders of magnitude greater than this, but precision in calculation is challenging due to limited reporting and the potential for double counting. CDP provides an aggregate analysis for illustrative purposes.

To meet the goal of limiting global warming to 1.5 degrees Celsius, CalPERS complements corporate engagement through advocating for policy measures with governments and regulators to foster the transition to a low-carbon economy. One key goal is to broaden and deepen carbon pricing across energy markets whilst removing fossil fuel subsidies. We also

support mandatory climate risk reporting to ensure the financial markets have information which is timely, relevant and reliable in order to allow pricing of risk and opportunity. CalPERS work with regulators and policy makers in our advocacy work is highlighting this as a priority.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

The TCFD framework identifies the business sectors where they see the greatest risk, and in this report, we set out our detailed assessment of risk for each of these in our portfolio based on assessments across our asset classes.

We have also commissioned new analysis and modeling to provide a first estimate of the global warming potential in our portfolio, and a scenario to assess the impact of our engagement strategy through Climate Action 100+.

Attachments

Attachment 1 – CalPERS’ Investment Strategy on Climate Change: First Report in Response to the Taskforce on Climate-Related Financial Disclosure (TCFD)

Attachment 2 – Wilshire’s Opinion Letter

Attachment 3 – Presentation on CalPERS’ Investment Strategy on Climate Change

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