The Importance of Corporate Engagement on Climate Change

Being global investors comes with great responsibilities. We have a fiduciary duty to be principled and effective investors to meet our financial commitments to our members and employer partners. We also recognize, and studies have proven, that effective corporate governance of companies we invest in have an impact to our bottom line. We firmly believe that engagement is the first call of action, and results show that it is the most effective form of communicating concerns with the companies we own.

CalPERS and CalSTRS Care About Climate Change

We recognize climate change as a material risk to society, the economy, and the impacts on our investment decisions. We have been at the forefront of tackling climate change issues through policy advocacy, engagement with portfolio companies and investing in climate change solutions.

CalSTRS and CalPERS both have well-established, thorough vetting processes for potential investments, which seek to test not only for financial potential, but for social, human and environmental impacts, as well.

CalSTRS developed an investment policy for mitigating environmental, social and governance risks under its CalSTRS 21 Risk Factors, adopted in 2008.

- Included in the 21 factors are points specific to environmental concerns such as air quality, water quality, climate change, and land protection.
- This policy guides the Teachers' Retirement Board's investment decisions.
- CalSTRS internal 'Green Team,' made up of representatives across all investment groups, further identifies ways to avoid or mitigate risks to the investment portfolio posed by environmental, social and governance factors.

CalPERS adopted Investment Beliefs addressing Climate Change issues:

- CalPERS believes long-term value creation requires effective management of three forms of capital: financial, physical and human.
- Investors must consider risk factors, for example climate change and natural resource availability that could have a material impact on portfolio returns.

Climate Change Poses Risks within our Investment Portfolios

In addition to the opportunities created by climate change, such as clean energy investments, CalSTRS and CalPERS believe that the risk of climate change needs to be mitigated within the overall investment portfolio. These risks can include:

- **Regulatory Risk:** It is likely that some type of carbon emissions legislation will be introduced at the federal level. Should enactment of legislation occur, companies, particularly those with large carbon footprints and those with high direct emissions, will need to be prepared to work within this carbon-constrained environment or face penalties.

- **Physical Risk:** As a result of greenhouse gas emissions, scientists predict the world will experience changes in atmospheric temperatures, depleted water tables, rising sea levels, shifting agricultural regions and other extreme weather events. Therefore, portfolio assets exposed to extreme weather zones or changing climatic conditions are at risk of being devalued or rendered obsolete.

- **Reputational Risk:** More and more people are beginning to believe that climate change is indeed happening and that there is a need for quick, decisive action to combat the predicted effects. Companies that are perceived to be inattentive to climate change run the risk of adverse publicity which could take the form of negative ad campaigns or product boycotts.

- Our approach is consistent with the fiduciary purpose of our investments, which is to achieve the maximum return at a prudent level of risk.

Our Voices for Policy Change

- CalPERS and CalSTRS are members of the Investor Network on Climate Risk – a leading network of 100 U.S. institutional investors, representing more than $10 trillion, addressing a policy agenda that calls on governments and regulators to introduce carbon pricing and disclosure, so that risks can be addressed effectively. This is part of a global effort among investors worth $24 trillion that have signed and supported the United Nations Statement on Climate Change.

- Both pension funds are signatories of the United Nations-supported Principles for Responsible Investing (PRI) and helped craft its six tenets that serve as a guide for investors to better understand the implications of sustainability and how to incorporate these issues into their investment decision making and ownership practices.

- CalPERS is a founding signatory of the Montreal Carbon Pledge, which commits asset owners and investment managers to measuring and publicly disclosing the carbon footprint of their investment portfolios on an annual basis.

- CalPERS CEO is co-chair of CERES -- a non-profit organization that mobilizes investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices and solutions in corporate America. CalSTRS CEO also serves on the Ceres board.

- CalSTRS and CalPERS joined forces with CERES in urging the SEC to issue guidance requiring disclosure of climate change risks in corporate filings. The work led to a major milestone in 2010 when the SEC approved the first economy-wide guidance for climate change disclosure.

- CalPERS and CalSTRS both support federal proposals that encourage capital deployment at scale to finance the transition to a low carbon economy and encourage investment in climate change adaptation; provide stable, reliable and economically meaningful carbon pricing that helps redirect investment commensurate with the scale of the climate change challenge; and phase out subsidies for fossil fuels.

Our Proxy Votes for Company Change

- We are also part of the CERES-led Carbon Asset Risk Initiative that draws together 70 global investors managing more than $3 trillion of collective assets. The initiative asks 45 large oil and gas, coal and electric power companies to assess the financial risks that climate change poses to corporate business plans – companies on the list include ExxonMobil, Royal Dutch Shell, BHP Billiton, Rio Tinto and Vale.

- CalPERS is targeting 33 companies in the energy sector this proxy season calling for shareowners to have the right to nominate directors to corporate boards. Changing corporate directors is one of the best ways to change corporate practices. In 2014, CalPERS voted in favor of 66 shareowner proposals related to environmental sustainability topics.

Our Investments for Change

- In 2010, CalPERS allocated $500 million to an internally managed public stock environmental index fund that invests in approximately 380 securities around the world that derive a material portion of their revenues from environmentally friendly sectors such as low-carbon energy production, energy efficiency management, and carbon trading.

- CalPERS also committed approximately $1.2 billion to its private equity portfolio for investment in the alternative energy and technology sectors.

- CalPERS has reduced energy consumption in its real estate portfolio by nearly 23% in the last five years. The pension fund continues to work with managers to track and reduce energy usage and carbon footprint in its holdings.

Successes With Corporate Engagement

- Since 2010, CalPERS has engaged 203 major U.S. companies regarding the adoption of majority vote for director elections. More than 198 of the companies have adopted or agreed to adopt majority voting.

- CalSTRS strongly believes the issues presented in *Carbon Tracker's Unburnable carbon 2013: Wasted capital and stranded assets* report call for action. Of the top 200 global fossil fuel companies listed on the Carbon Tracker website, CalSTRS has engaged 44 U.S. companies held in our portfolio requesting disclosure.

- In 2013, CalSTRS targeted 100 companies in the Russell 1000 index portfolio which lacked sufficient disclosure of energy and water use management. More than 30 companies responded with evidence of their desire to either release efficiency efforts or consider alternative approaches. On the heels of this progress, we've expanded our engagement to encourage fossil fuel valuation.

- Recent proxy access proposals at many companies engaged by CalSTRS and CalPERS have won a majority of support, including Nabors Industries, Chesapeake Energy, Verizon Communications, CenturyLink, Inc., Abercrombie & Fitch, Darden Restaurants, International Game Technology, Boston Properties, Big Lots, and SLM Corporation.

Recent Success on Climate Change

- British Petroleum (BP) and Shell have agreed to back shareowner proposals on climate risk reporting following CalPERS work with a coalition of investors engaging fossil fuel companies on climate change. BP has $8 billion dedicated to its alternative energy business and 20 percent of its R&D dedicated to low carbon transition. Shell has a $21 billion biofuel joint venture with Brazil's Cosan.

Our Divestment Philosophies and Policies

Our pension funds prefer constructive engagement to divesting as a means of affecting the conduct of companies in which we invest. Our fiduciary obligations generally prohibit us from sacrificing investment performance for the purpose of achieving goals that do not directly relate to our operations or providing promised retirement benefits.

As sustainable organizations CalSTRS and CalPERS recognize and appreciate the question of divestment from fossil fuel companies. Any actions around divestment must be carefully weighed against our fiduciary duty to perform profitably with consideration of the best tools and approaches available where appropriate.

When considering divestment, we firmly believe that active and direct engagement as a first line approach is the best way to resolve issues. Specifically, CalPERS and CalSTRS believe that engagement, or having a voice at the table, is an effective tool to mitigate risk such as climate change. Aligned interests working in concert can influence capital market change.

Divestment is the most serious step an investor can take.

- Divestment severs our ties with a company and therefore, severs our influence as well.
- Divestment from fossil fuels raises complicated implications for globally diverse investment portfolios such as ours.

Learn more by reading CalPERS Divestment Policy and CalSTRS Divestment Policy.

Read more about CalPERS sustainability work in our report Towards Sustainable Investment & Operations

Read more about CalSTRS Green Initiative Task Force.

Read more about CalSTRS 21 Risk Factors.