SB 964 – PROTECTING PENSION FUNDS FROM CLIMATE RISK

SENATOR BEN ALLEN

Fact Sheet

SUMMARY

Climate change poses an unprecedented risk to the global economy, as well as to our planet and way of life that depends on a stable and healthy environment. Climate change impacts and actions governments worldwide must take to address it will have profound consequences for long-term financial investments, which must be considered by institutional investors and asset owners. SB 964 affirms the commitment of the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) to addressing the material financial risks posed by climate change and asks the funds to report on that risk beginning in 2020.

BACKGROUND

Public pension fund fiduciaries are challenged to balance the interests of current beneficiaries and future retirees, while ensuring the stability of their funds and pursuing growth in a rapidly-changing investment market. Global climate change is unlike other risks long-term investors confront, as the effects of climate change are both inevitable and unpredictable, from both scientific and regulatory perspectives.

Researchers outline four different types of risk that climate change poses to the value of fund assets. Each of these needs to be considered by fund fiduciaries:

1. Physical impact risks to the environment and infrastructure—Sea level rise, severe storms, extreme weather events including droughts, floods, wildfires, and heat waves will impact physical assets and economic trends.
2. Litigation risk—A growing number of California municipalities, and the City of New York, are suing large energy companies for damages caused by climate change and compensation for future climate harms. As cases proceed through the courts, the risk to sued companies and their stockholders grows.
3. Stranded asset risk—As regulations tighten, fossil fuel companies are unlikely to be able to fully develop and profit from the carbon reserves they hold, resulting in loss of share value as billions of dollars in assets become "stranded."
4. Transition risk—The cost of transitioning to a low-carbon economy will negatively affect certain companies and investments while advantaging others.

These risks, all of which can result in material impacts to investments including direct financial losses, must be seriously evaluated in any long-term investment strategy as part of a manager's fiduciary duty. A recent report by Mercer Investments found that over the next 35 years, the coal industry could expect to see annual returns reduced by up to 82 percent. The oil and utility industries may also see returns diminish, potentially falling by 38 percent and 60 percent, respectively, over the same timeframe. Renewables, however, can expect average annual returns to increase by as much as 53 percent, according to the report.

In anticipation of the Paris Agreement in 2015, Citigroup noted that up to $100 trillion in fossil fuel assets were likely already economically stranded. Deutsche Bank acknowledged that fossil fuel assets were already subject to permanent impairment and value loss, and Barclays concluded that the fossil fuel industry is facing potential revenue losses of $34 trillion over the next 25 years. The collapse of the coal sector in the U.S. is just one more example.

New research shows that investors can effectively manage climate risks by examining their investments and factoring climate change into their risk models. Tools designed to make assist them in evaluating this risk are rapidly becoming available, lowering the cost of performing these analyses. Some firms and governments, including the European Union, France, Australia, the Province of Ontario, and Canada are already requiring such an analysis.

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BACKGROUND CONTINUED

In August 2015, France became the first country to require mandatory climate change-related reporting for institutional investors. In November 2016, the European Parliament approved a directive requiring pension funds to assess climate risk, along with financial and other risks, in their investment decisions, and to inform fund members and beneficiaries of their findings. The Financial Stability Board's Task Force on Climate-Related Financial Disclosures released its final report, establishing disclosure parameters for corporations worldwide in June 2017. In November 2017, Moody's announced that coastal municipalities must factor climate risk into their bond offerings or face credit downgrades. The Sustainability Accounting Standards Board has released sustainability accounting standards for 79 different industries, which outline interactions between various industries and their exposures to climate risk.

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. Because climate-related risk will likely have greater impacts on future beneficiaries than on current fund members and retirees, failure to consider long-term climate-related risks when investing today could be viewed in the future as an unreasonable bias favoring short-term gain over long-term stability and growth. This bias, and the failure to appreciate and account for these impacts, is likely to be seen in the future as a breach of fiduciary duty, subjecting fund fiduciaries to liability.

SOLUTION

CalPERS and CalSTRS each have governance directives that advise them to take climate risk, among other risks, into account when making investment decisions (CalPERS Investment Belief 9, and CalSTRS "Environmental" Risk Factor). SB 964 affirms that climate-related risks are material financial risks, recognizes 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.

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Sustainable Marin
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