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SB 252 Reduces Financial Risk; Curtails Futile Engagements

The SB 252 fossil fuel divestment bill requires that CalPERS and CalSTRS, the nation's largest public pension funds, divest their most carbon-intensive fossil fuel holdings over the next 7-12 years, unless they determine that divesting would conflict with their fiduciary duty.

Both CalPERS and CalSTRS oppose the bill with arguments that rest on misinformation or faulty assumptions.

SB 252 specified fossil fuel divestment in a way that provides the maximum benefit with the minimum amount of disruption to the Funds' normal course of business. The bill acknowledges, and allies with, the mandate of the Funds to invest for the exclusive benefit of their members and beneficiaries, but requires - for the greater public good - excluding investments that are bad for public health and likely to prevent achievement of the state's and the Funds' climate goals.

Divestment: Neutral or Positive Returns

The divestment required by SB 252 is limited in scope, affecting only 101 companies with market value of $9.4 billion (CalPERS); and 159 companies with market value of $5.4 billion (CalSTRS), out of an estimated 40,000 holdings. Even though the proposed divestments total nearly $15 billion in market value, they represent less than 2% of total assets. But these few investments have an outsize carbon footprint - they represent most of the financed emissions in the portfolio. Removing these investments will significantly help CalPERS and CalSTRS achieve their net-zero goals.

The intent of SB 252 is to decarbonize the portfolios without diminishing returns.

Fossil-Free Funds Outperform Standard Funds

Despite the fossil fuel industry's recent soaring profits (accompanied by price gouging at the pump), fossil fuels are still not a good investment. After a decades-long decline, the fossil fuel Energy sector represents only 5.3% of the S&P 500. A growing number of studies show that excluding fossil fuel investments have a neutral or positive impact on returns. The fossil-fuel-free version of the MSCI All Country World Index has ***outperformed*** the standard version 2010-2023.[1]

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[1] See also Financial case for pensions to dump fossil fuels in California is strong despite resistance, 3/2/2023, IEEFA.

It’s important to note that when shares subject to divestment are liquidated, the proceeds are re-invested proportionally in the rest of the portfolio, which will continue to provide returns. This is why we compare the performance of the portfolio with and without the major fossil fuel companies. The portfolio doesn’t “lose” the divested amount. For example, the $152 billion University of California portfolio divested from fossil fuels in 2019, but the overall portfolio has grown ***60.5% since 2014***.

Make Fossil Fuels an Active Investment

The equities in CalPERS and CalSTRS portfolios are passively invested using a custom benchmark that tracks a standard index such as the MSCI ACWI. Removing the identified fossil fuel equities from the benchmark means that the “market as a whole” will no longer force CalPERS and CalSTRS to invest in these companies automatically.

The legislative analyst expressed a concern about “Increased investment management costs caused by requiring individualized stock and index selection, development of specialized benchmarks, and specialized monitoring instead of traditional, low-cost, passive index investing.” However, active management of the carbon-intensive investments on the exclusion list provides an opportunity to monitor their performance and report (as SB 252 requires) the impacts of any changes to this fossil fuel investment pool. Moreover, putting these investments on “active status” could actually increase the number and quality of shareholder engagements.

Stop Loaning Money to Polluters

Bonds serve as loans to corporations. The Funds actively manage their bond holdings. CalPERS and CalSTRS purchases of corporate bonds are directly financing fossil fuel expansion and development of reserves, although the International Energy Agency (IEA) has made it clear that NO investment in expanding reserves is a good investment. CalPERS and CalSTRS portfolios are already holding stranded assets, because we cannot extract and burn all known reserves without catastrophically overheating the planet. Their bond holdings represent self-inflicted threats both to financial stability and net-zero goals.

Increasing stranded assets by loaning fossil fuel companies money for expansion projects is fiduciarily irresponsible. CalPERS and CalSTRS have pledged to be net-zero by 2050, but many of their fossil fuel bonds have maturity dates of 2052 and later. As with their index investing in equities, the Funds have locked themselves into continuing to prop up fossil fuel companies.

Assets can become stranded very quickly. Earlier this year shares of coal giant Adani Enterprises fell sharply on allegations of fraud, causing CalPERS and CalSTRS to lose millions.

And CalPERS' $385 million and CalSTRS' $323 million in Russian fossil fuel stocks now have a market value of 0 because of US government sanctions.

Attempts to Engage with Fossil Fuel Companies Are Futile

CalPERS and CalSTRS assert that shareholder engagement is preferable to divestment, and that shareholder engagement and advocacy is the best way to bring about needed change. The Funds have signed Net-Zero pledges, joined coalitions with a host of other institutional investors, and claimed to have "inside knowledge" of Big Oil's good intentions.[2]

In reality, shareholder engagement so far has not been successful in transforming fossil fuel producers into clean energy providers. After years of shareholder engagement efforts, major oil and gas companies have steadfastly resisted changing its business model.

The main response of the fossil fuel industry to pressure to transform has been greenwashing. After record-breaking profits last year (ExxonMobil alone had profits of $6 million dollars an hour), the major oil companies walked back their commitments to invest more money in renewables.[3] ExxonMobil has abandoned its nonsensical "green algae" campaign, and CEOs of Exxon, Shell, and Chevron have announced their intentions to keep on drilling.

Despite years of boardroom lobbying and proxy votes, no fossil fuel producer, as analyzed by the shareholder engagement collective Climate Action 100+, is fully aligned with the goals of the Paris Agreement.[4] It is unrealistic to expect that the Funds can achieve a net-zero portfolio while retaining significant fossil fuel holdings. Fossil fuel companies are uniquely misaligned when it comes to the energy transition. The sector has vested interests in delaying the shift to a zero carbon economy, and is actively placing bets on sustained carbon extraction long into the future.

Engagement and advocacy primarily entail voting on climate resolutions and on Directors at the company's annual meeting, yet CalPERS and CalSTRS often vote with Big Oil AGAINST climate resolutions and FOR company directors—*up to 90% of the time*.

Divesting the largest fossil fuel companies could improve the Funds' engagement record by curtailing the long, demoralizing string of failed engagements with publicly traded fossil fuel companies.

To avoid the kind of catastrophic climate change that destroys Californians' jobs, communities, and lives, the IPCC calls for a reduction of burning of fossil fuels by 50% by 2030 and by 100% by 2050. When the time horizon to curtail fossil fuels is closing, the people of the world, and the people of California do not have years to waste on a futile engagement strategy.

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[2] Fossil Free California, Promises, Promises: Evaluating CalPERS; Climate Engagements

[3] Evans, Big Oil walks back climate pledges as earnings show 2022 was their most profitable year ever, CBC News, Feb. 8, 2023.

[4] Climate Action 100+. Who's involved: Companies.

The Benefits of Divestment

Both Funds assert that divestment has no effect on greenhouse gas emissions, despite its obvious effect on the portfolios' financed emissions. But there is in fact growing evidence that divestment *does* reduce emissions. Moreover, companies with lower (relative) carbon emissions have a superior financial performance.[5]

A 2022 paper[6] analyzed 6,646 managed US and European equity mutual funds from 2010 to 2017, comprising over $4.7 trillion assets under management. A comparison of divested and non-divested firms demonstrated that divested companies significantly reduced emissions.

If SB 252 succeeds, divestment's greatest benefit will be to the long-term performance of the portfolio, which benefits its current and future members and beneficiaries. Divesting now, while fossil fuel share prices are high, is a great opportunity to realize profits and put that money to work for a better future.

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[5] Busch and Lewandowski, Corporate Carbon and Financial Performance: a Meta-analysis (Summary), 2018.

[6] Rohleder et al, The effects of mutual fund decarbonization on stock prices and carbon emissions, 2022.