



June 25, 2019

Henry T. Jones, President, CalPERS Board of Administration; and board members
California Public Employees' Retirement System

Sharon Hendricks, Board Chair, CalSTRS Teachers' Retirement Board; and board members
California State Teachers' Retirement System

RE: LETTER OF SUPPORT, FOSSIL FREE CALIFORNIA AND ENVIRONMENT CALIFORNIA, SB 964

Dear Members of the Board,

On behalf of the Center for International Environmental Law (CIEL), a nonprofit legal advocacy group, we offer our support for the recommendations provided by Fossil Free California and Environment California to encourage climate risk disclosure that satisfies the spirit and intent of SB 964.

Since 1989, CIEL has used the power of law to protect the environment, promote human rights, and ensure a just and sustainable society. As advocates for more ambitious climate action by state and non-state actors, we believe that investor fiduciaries bear a responsibility to both current and future beneficiaries to respond to material climate-related financial risk.

In 2016, CIEL published a report analyzing how and why monitoring for climate-related financial risk is consistent with the prudent exercise of fiduciary duty by the trustees of public sector pension funds. Since then, CIEL has convened roundtable discussions among investment professionals to address the potential liabilities a fiduciary may face for failing to monitor fund assets for exposure to material climate-related financial risk. Additionally, CIEL actively supports the recommendations of the Task Force for Climate-related Financial Disclosure (TCFD) and advocates for implementing standards for disclosure for corporations that are seeking guidance about how to enhance climate risk disclosure without running afoul of securities regulations. TCFD recommendations also provide investors guidance for how and what kind of climate disclosure investors should demand from corporations.

Here CIEL's role in supporting FFCA and Environment California is to encourage the most robust financial disclosure possible under SB 964. Members of both Boards are in a position to act as leaders among global financial actors by setting a high bar for best practices for disclosure. Detailed and specific disclosure that describes the funds' exposure to climate-related risk (1) will satisfy the letter and the intent of SB 964; (2) serve the interests of the beneficiaries

concerned about whether their retirement funds are vulnerable to material climate-related financial risk and (3) serve as a model process and format for what is needed from other investor fiduciaries who must, or will likely be required to, disclose climate-related risk according to their own respective statute.¹

Disclosure that captures both the spirit and intent of SB 964 provides evidence of due diligence and demonstrates that Trustees have engaged in a prudent exercise of fiduciary duty. The Trustees as fiduciary investors owe a duty of care and a duty of loyalty to the current and future beneficiaries of the fund.² Disclosure is an opportunity for fiduciaries to demonstrate how investment decision making is aligned with the sole and best interests of the beneficiaries.³

When beneficiaries review these disclosures, the reasons why climate or transition vulnerable assets have been retained or released by the fund, should be clearly and plainly evident. Disclosures that include references to any scenario analysis testing, or any other supporting data and analysis demonstrates the rigor of the investment decision making process and provides evidence that the sole interests of the beneficiaries guided the actions of the Trustees.

1. Disclosures must reflect both the letter and the intent of SB 964.

We support the conclusions of FFCA and Environment California that SB 964 mandated disclosures must capture the material climate risk exposure of the portfolio and describe how continued retention of those assets serves the best interests of current and future beneficiaries. Disclosing the funds' holdings and their exposure to climate risk with specificity ensures that the climate vulnerable assets have been identified.

The Disclosures must also reflect that the trustees have acted consistently with principles and guidelines established in plan documents. CalPERS⁴ Investment Beliefs and CalSTRS' Governance and Sustainability Principles⁵ include several clear references to climate change

¹ See, e.g., Maryland State Retirement and Pension System, Maryland Pension Risk Mitigation Act Risk Assessment (2019) https://sra.maryland.gov/sites/main/files/file-attachments/maryland_pension_risk_mitigation_act_risk_assessment_january_2019_0.pdf (In 2017, the Board of Trustees of the Maryland State Retirement and Pension System submitted an assessment of risk for the several systems under their supervision.).

² Trustees are also required to act with "care, skill, prudence, and diligence" in discharging these duties. Cal. Const. Art. XVI Sec. 17(c).

³ The California Constitution requires trustees of CalPERS and CalSTRS to act "solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries." Cal. Const. Art. XVI Sec. 17(b).

⁴ See CalPERS, CalPERS Beliefs: Our Views Guiding Us Into The Future 10 (2015), <https://www.calpers.ca.gov/docs/board-agendas/201702/pension/item7-01.pdf> ("Investment Belief 9 ... As a long-term investor, CalPERS must consider risk factors, for example climate change and natural resource availability, that emerge slowly over long time periods, but could have a material impact on company or portfolio returns"); CalPERS, Governance & Sustainability Principles (2018), <https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf>.

⁵ See CalSTRS, Investment Policy for Mitigating Environmental, Social, and Governance Risks (ESG) A-23 (2018), <https://www.calstrs.com/general-information/investment-policy-mitigating-environmental-social-and-governance-risks> ("Climate Change[.] The investment's long-term profitability from inadequate attention to the impacts of climate change, including attention to relevant climate policy considerations and emerging climate risk

specifically and sustainability generally. Disclosure should provide a record of review by Trustees to demonstrate the periodic monitoring consistent with the standards for the prudent exercise of the fiduciary duty to monitor fund assets. The disclosure should also be of sufficient detail to address, in certain instances, why, despite the recognition that there are climate risks related to an asset, keeping the asset in the portfolio serves the best interests of the beneficiary.

2. The quality of disclosure is an indicator of the prudent exercise of fiduciary duty.

The process for providing the disclosure mandated by SB 964 is as important as the final disclosure report released to the public. The process requires that the Board and staff engage in a review of fund holdings, measure and monitor climate-related risk exposure and address any negative impacts on asset performance and valuation. SB 964 makes clear that the Board has an obligation to consider both the short term and long term effects of material climate risks on their beneficiaries. A robust review process ensures that there is sufficient information available about the holdings of the fund and includes a level of detail that will satisfy the intent, letter, and spirit of SB 964.

The detail and specificity of the disclosure mandated under SB 964 ensures that the public is informed about how the long and short term climate-related considerations have been appropriately monitored and measured by fund Trustees as a factor impacting fund performance. Additionally, disclosure must reflect the investment decision making to explain how fund assets align with the goals of the Paris Agreement and California climate policy goals.

3. Disclosures should demonstrate the motivations for investment decision making.

Robust disclosure provides an opportunity for the fund to demonstrate the reasons why certain investment decisions have been made. The disclosure report can build an evidentiary record for how trustee actions were aligned with the exercise of fiduciary duty. The document can also serve as a valuable record for the trustees of the fund to memorialize investment reasoning and to eliminate doubt about whether or not the decision to retain fossil fuel assets was in the best interests of beneficiaries.

As a preemptive measure, disclosure under SB 964 should be robust enough to answer the following questions:

- A. How does retention of assets exposed to material climate-related financial risk serve the best interests of both current and future beneficiaries in a manner consistent with the prudent exercise of fiduciary duty?
- B. How does the retention of assets exposed to material climate-related financial risk align with fund investment policies?

mitigating technologies.”); Sustainability Risk Management, CalSTRS, <https://www.calstrs.com/sustainability-risk-management-0> (last visited June 20, 2019).

Here, the disclosure mandated by SB 964 provides a process and a platform to explain why the Trustees choose to retain or release climate vulnerable assets despite the foreseeability of declining rates of return and projected declines in asset valuation and how that decision furthers the interests of current and future beneficiaries.

For funds that retain fossil fuel assets and continue to engage corporations, disclosure must demonstrate how the retention of these assets is consistent with provision of the investment policy and serves the interests of beneficiaries. Currently, it is unclear to many beneficiaries how retaining assets that are significant contributors to climate change serve the interests of beneficiaries. Of particular concern are continued investment in assets that appear uniquely and significantly exposed to climate-related financial risk, including direct investment in sectors and industries with exposure to coal, oil, gas, and climate vulnerable real estate or infrastructure holdings in coastal areas or wildfire zones.

Lastly, disclosure should provide a record of how evolving climate policies were factored into investment selection over time to provide a critical historical record of how fiduciaries responded to known and foreseeable risks.⁶

For the reasons outlined above, the Center for International Environmental Law (CIEL) endorses the recommendations of Fossil Free California and Environment California, and encourages the boards of CalPERS and CalSTRS to engage in a thorough and robust disclosure process to communicate the depth and breadth of the funds' treatment of climate-related financial risk.

Respectfully,

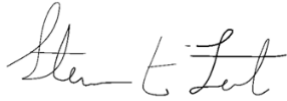


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⁶ While inadequate consideration of material financial risks may be a breach of fiduciary duty, a *failure to communicate* such consideration may also be interpreted as such a breach. The disclosure required by SB 964 is thus an opportunity for fund trustees to demonstrate to beneficiaries that they and other fiduciaries are taking climate-related financial risk seriously. A failure to do so would not only be inconsistent with the statutory requirements of SB 964, but a warning sign for concerned beneficiaries.



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