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Agenda Memo

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FROM:

DAN KALB (510) 238-7001
Councilmember District 1 E-mail: dkalb@oaklandnet.com

TO: Rules and Legislation Committee

SUBJECT: Resolution in Support of SB 560 - Protecting Pensions From Climate Risk

DATE: March 30, 2017

Dear Members of the Rules and Legislation Committee,

We respectfully ask you to adopt the following resolution:

Resolution in support of senate bill 560 (Senator Allen) that will require members of California's public pension funds boards, as part of their fiduciary duties, to consider financial risks associated with climate change with respect to their investments, and, beginning in 2020, to report annually on the financial climate risks, including the carbon footprint of the investments.

Thank you!

Respectfully submitted,

Councilmember Kalb

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SB 560 – PROTECTING PENSIONS FROM CLIMATE RISK
SENATOR BEN ALLEN

Objective: Protect the assets of California's public pension funds, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), from the material financial risks posed by global climate change.

Solution: SB 560 requires the funds' boards to add consideration of "financial climate risk," to their fiduciary duty to fund members and beneficiaries, and report annually on the climate risk of their investment portfolios, beginning in 2020.

SUMMARY

Just as global climate change poses an unprecedented risk to our planet and life that depends on a stable and healthy environment, so too does climate change threaten long-term financial investments. As governments around the world strive to keep global temperatures from increasing more than 2 degrees Celsius (consistent with the 2015 Paris Agreement that took effect in November 2016), pension fund fiduciaries must consider the realities of climate change and ongoing efforts to combat it as they manage the funds in the interest of generations to come.

BACKGROUND

Public pension fund fiduciaries are challenged to balance the interests of both current beneficiaries and future retirees, while ensuring the stability of their funds and pursuing growth. Global climate change is unlike other risk categories long-term investors confront, as the changes climate change will cause are both inevitable and unpredictable, both from a scientific and regulatory perspective. Managing climate-related risk is a unique challenge for fiduciaries seeking to do right by their investors in a rapidly changing global market.

Researchers have outlined four different types of risk that climate change poses to the value of fund assets that need to be considered by fund fiduciaries:

- Physical impact risks to the environment and infrastructure -- e.g., sea level rise, severe storms, extreme weather events such as droughts, wildfires, and heat waves that may impact assets and global economic trends.
- Carbon asset risk -- As regulations tighten, fossil fuel companies may not be able to fully develop and use the carbon reserves they hold, resulting in billions of dollars in "stranded assets."
- Transition risk -- The cost of transitioning to a low-carbon economy will negatively affect certain companies and investments while advantaging others.
- Litigation risk -- Under changing laws and increasing climate change risks, a company may be sued as a result of its contribution to climate change, and consequently lose market value.

These risks, 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 the 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 the risks associated with climate change by examining their investments and factoring climate change into their risk models. Some governments and firms, including the European Union, are already requiring such an analysis. And, tools designed to make it easy to evaluate this risk are rapidly becoming available.

- In December 2015, the Financial Stability Board established a Task Force on Climate-Related Financial Disclosures to develop recommendations for voluntary disclosures relating to climate change.
- Last year, Moody's announced that it will incorporate Paris Agreement targets into its analyses.
- 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.
- In November 2016, the European Parliament passed a law 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.

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

California's largest pension funds, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) 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 560 affirms that climate-related risks are material financial risks and so must be considered in investment and asset allocation decisions for the state's public pension funds, assuring that future boards will not weaken or dilute the directives and that the funds' assets will be protected. The bill also requires public disclosure of findings related to climate risk.

SUPPORT

Environment California
Fossil Free California

CONTACT

Tina Andolina
Office of Senator Ben Allen
(916) 651-4026, (916) 651-4926 (Fax)
tina.andolina@sen.ca.gov

SENATE BILL **No. 560**

Introduced by Senator Allen

February 17, 2017

An act to add Section 7510.5 to the Government Code, relating to public retirement systems.

LEGISLATIVE COUNSEL'S DIGEST

SB 560, as introduced, Allen. Public retirement systems: investments: financial climate risk.

The California Constitution requires members of the retirement board of a public pension or retirement system to discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. Existing statutory law establishes various public employee retirement systems and provides for the administration of the State Teachers' Retirement System by the Teachers' Retirement Board and for the administration of the Public Employees' Retirement System, among other public employee retirement systems, by the Board of Administration of the Public Employees' Retirement System.

This bill, on and after January 1, 2019, would require those boards to consider the financial climate risk, as defined, of each investment, or potential investment, as part of their discharge of their fiduciary duties with respect to the investment. The bill, by January 1, 2020, and annually thereafter, would require the boards to report on the financial climate risks of their investments, including the carbon footprint of the investments, as specified. The bill would make related legislative findings and declarations.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares as follows:

(a) Climate change is a long-term problem that will affect our environment, health, and economy for decades to come.

(b) Effects of global climate change that scientists predicted in the past are already occurring – sea ice has been lost, sea levels are rising at accelerated rates, and longer, more intense heat waves and extreme weather events are occurring.

(c) As global temperatures to continue to rise, these effects will likely accelerate. Heat waves, droughts, and hurricanes are all projected to grow in both frequency and intensity as climate change progresses.

(d) The financial sector is not insulated from the adverse effects of climate change.

(e) California is a global leader in addressing climate change and has consistently striven to protect the physical, social, and economic resources of all Californians, as most recently exemplified by Senate Bills 32 and 350 of the 2015–16 Regular Session.

(f) Climate change presents an array of material financial risks, including transition risk, physical risk, and litigation risk, that reasonable investors must take into account when making investment decisions. Failure to acknowledge and address these risks will result in exposure to subsequent liabilities and financial risk.

(g) If global temperature rise is to be limited to no more than 2 degrees Celsius, or the aspirational target of 1.5 degrees proposed in the COP 21 agreement now in effect, governments must act to limit warming and hasten the transition to a low-carbon economy by halting the extraction and development of carbon reserves. This regulatory risk will affect major sectors of the global economy.

(h) In the retirement system context, these risks are especially salient. Retirement boards are duty-bound to administer retirement funds solely in the interest of system participants and their beneficiaries. In order to ensure sufficient funding of both current and future retirees' financial benefits, retirement boards must

1 consider both short-term and long-term effects and risks of
2 retirement fund investments.
3 (i) If climate change and carbon emissions continue on their
4 current trajectories, both acute and chronic weather-related activity
5 will greatly compromise the ability of businesses that do not
6 account for these changes to reliably generate returns. Pension
7 funds' influence in the markets can induce firms to accurately
8 report their carbon risk to the public.
9 (j) Given the potentially catastrophic consequences of climate
10 change, the documented social and economic cost of carbon, and
11 the emerging body of literature on the material financial risks of
12 climate change, retirement boards simply cannot disregard financial
13 climate risks.
14 SEC. 2. Section 7510.5 is added to the Government Code, to
15 read:
16 7510.5. (a) For purposes of this section, the following
17 definitions apply:
18 (1) "Board" means the Board of Administration of the Public
19 Employees' Retirement System or the Teachers' Retirement Board.
20 (2) "Financial climate risk" means material financial risk posed
21 to an investment by the effects of the changing climate, including,
22 but not limited to, intense storms, rising sea levels, higher global
23 temperatures, economic damages from carbon emissions, and other
24 financial risks due to public policies to address climate change,
25 shifting consumer attitudes, changing economics of traditional
26 carbon-intense industries, and other transition risks.
27 (b) On and after January 1, 2019, the board shall consider the
28 financial climate risk of each investment, or potential investment,
29 as part of the board's discharge of its fiduciary duties with respect
30 to the investment.
31 (c) By January 1, 2020, and annually thereafter, the board shall
32 report on the financial climate risks of its investments, including
33 the carbon footprint of the investments computed using the
34 Greenhouse Gas Protocol of the World Resources Institute,
35 including Scope 3.

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