BILL NUMBER: **S. 588 (Feinstein-CA) as introduced March 4, 2021**
H.R. 1549 (Casten-IL) as introduced March 3, 2021

SUMMARY

S. 588 and H.R. 1549 establish a permanent Climate Risk Advisory Committee on the Financial Stability Oversight Council (FSOC), require specified regulatory agencies to include climate risk in their supervisory guidance, require FSOC to incorporate climate risk into specified decisions, require the Federal Insurance Office to report on modernizing and improving climate risk insurance regulation, and encourage financial regulators to join international networks on climate financial risk.

BOARD POSITION

Support. The board's policy is to support legislation that is consistent with the investment policy adopted by the board as presented in the CalSTRS Investment Policy and Management Plan.

REASON FOR THE BILL

According to the authors, the transition to a low-carbon economy as well as damages and risks caused by the effects of climate change could have significant effects on real estate values, whole sectors of the economy and insurance affordability. These impacts threaten the stability of the financial system, and financial regulators should assess and address these climate risks.

ANALYSIS

Existing Law:

The FSOC has collective responsibility for identifying risks and responding to emerging threats to financial stability. The Secretary of the Treasury chairs FSOC. FSOC members include the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau and other regulatory agencies. These agencies have broad powers to influence U.S. capital markets, and indirectly global markets, and, therefore, have direct or indirect impact on CalSTRS' global portfolio.

FSOC has authority to impose or restrict business activities with jurisdiction over large bank and nonbank financial companies with U.S. operations. FSOC member agency policies have broad effect on domestic investment activities and economic activities, and indirectly on whole industries or sectors globally. The FSOC can limit certain activities that are deemed risky to the financial system by imposing stress tests, levying capital requirements or disallowing dividend payments. FSOC also has authority to directly alter business activities at banks, asset managers, insurance companies and other select non-bank institutions such as securities exchanges. FSOC can do this by designating businesses as systemically important financial institutions.

This Bill:

Specifically, S. 588 and H.R. 1549 would:

- Establish a permanent Climate Risk Advisory Committee on FSOC made up of experts in climate science, climate economics and climate financial risk, which would publish an annual report making recommendations on improving federal and state financial regulatory systems' ability to identify and mitigate climate financial risk.

- Require each federal banking agency and the National Credit Union Administration to update their supervisory guidance to include climate risk and to develop a strategy to identify and mitigate climate financial risk.
- Require FSOC to specify how it will incorporate climate risk into its decisions about whether to designate certain nonbank financial institutions as requiring additional oversight by the Federal Reserve due to the risk that their collapse would pose to the financial system.
- Require the Federal Insurance Office to report on how to modernize and improve climate risk insurance regulation.
- Encourage U.S. financial regulators to join the Network for Greening the Financial System, formally join the Basel Committee's Task Force on Climate-Related Risk and work with international regulators on climate financial risk to the extent possible.

CalSTRS has identified climate change as a key factor in its Investment Policy for Mitigating Environmental, Social and Governance Risks. CalSTRS expects external fund managers and internal investment staff to evaluate climate change risk for potential and current investments. As fiduciaries, CalSTRS is charged with understanding the potential economic impacts to plan assets in financial terms. Climate risk can manifest as technological, business model, physical or regulatory risk to a firm. S. 588 and H.R. 1549 help define regulatory risk in more specific terms, which will aid total fund risk assessment.

CalSTRS has also advocated for greater climate disclosure for years; however, slow market uptake has made it difficult to assess climate risks across the U.S. market. Staff believe a regulated mandate to evaluate current available data, combined with the regulatory power to require fuller disclosure from all businesses operating in the U.S., would quickly improve CalSTRS' ability to measure portfolio risk from climate change. While this bill does not specifically require corporate disclosure, staff believe future disclosure requirements will be necessary to satisfy the data collection needed to support the Climate Risk Advisory Committee report.

LEGISLATIVE HISTORY

H.R. 2570/S. 1217 (Casten/Warren, 2021) would require publicly traded companies to annually disclose physical and financial risks they would face under different climate change scenarios, explain strategies and corporate governance processes in place to manage those risks, and analyze the social cost associated with the company's greenhouse gas emissions.

H.R. 1187 (Vargas, 2021) would require an issuer of securities to annually disclose to shareholders certain environmental, social and governance metrics and their connection to the long-term business strategy of the issuer, and would require the Securities and Exchange Commission to establish a Sustainable Finance Advisory Committee, which would identify challenges and opportunities in sustainable investing and recommend policies to facilitate the flow of capital towards sustainable investments.

SB 449 (Stern, 2021) would require various financial institutions and corporations to prepare annual climate-related financial risk disclosure reports, and would require the Climate-Related Risk Disclosure Advisory Group established pursuant to Executive Order No. N-19-19 to annually report climate-related financial risk, analyze climate-related financial risks facing the state, and propose policies and actions to mitigate climate-related financial risks. This bill was held in the Senate Appropriations Committee as a two-year bill.

H.R. 5194/S. 2903 (Casten/Schatz, 2019) would have required the Federal Reserve to establish a Climate Risk Scenario Technical Development Group to help create climate change risk scenarios and determine the financial and economic risks resulting from those scenarios, and would have required the FSOC to establish a subcommittee to identify risks and respond to threats to the stability of the United States financial system as a result of climate change. These bills were respectively held in the House Financial Services and House Energy and Commerce committees as well as the Senate Banking, Housing, and Urban Affairs Committee.

SB 964 (Allen, Chapter 731, Statutes of 2018) required the CalSTRS and CalPERS board to analyze climate-related financial risk to the fund, and publicly report their analysis of the material climate-related financial risks of their public market portfolios every three years.

SB 1550 (Florez, 2008) would have required the State Controller, in consultation with the investment community and the Air Resources Board, to develop a climate change disclosure standard for voluntary use by listed corporations doing business in California. This bill was held on the Senate Floor.

PROGRAM BACKGROUND

California Climate Investment Framework

On September 20, 2019, Governor Gavin Newsom issued Executive Order N-19-19, which directed the Department of Finance to develop a Climate Investment Framework in collaboration with CalSTRS, CalPERS and the University of California Retirement Program. The framework was published on September 24, 2020, and recommended the Governor create a climate risk disclosure working group, the state sign onto the Coalition for Climate Resilient Investment, and the state’s pension funds invest additional funds in low-carbon strategies.

California Climate-related Risk Disclosure Advisory Group and State Steering Committee

CalSTRS is a participant in the California Climate-related Risk Disclosure Advisory Group and State Steering Committee, which are led by the Governor’s Office of Planning and Research. The advisory group and committee are charged with developing recommendations for climate risk reporting in California.

Climate Risk Disclosure Initiative

CalSTRS was one of 14 leading investors that participated in the Climate Risk Disclosure Initiative (CRDI), which kicked off in 2005. The CRDI aimed to standardize company climate risk disclosures to facilitate investor analysis and comparisons of company climate risk exposure. In 2006, the CRDI Steering Committee released the Global Framework for Climate Risk Disclosure, which consists of four main disclosure elements: total historical, current and projected greenhouse gas emissions; strategic analysis of climate risk and emissions management; assessment of physical risks of climate change; and of risk related to the regulation of greenhouse gas emissions.

Task Force on Climate-related Financial Disclosures (TCFD)

The Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) in 2015, and the TCFD issued a report containing climate-related financial disclosure recommendations in 2017. The recommendations fall into four thematic areas: governance, strategy, risk management and metrics. As of 2020, more than 1,500 organizations have expressed support for the TCFD framework, and almost 60% of the 100 largest global public companies either support the TCFD, report in line with the TCFD recommendations or both. CalSTRS actively engages companies and regulators, including through collective engagement via the Climate Action 100+ group, to adopt the recommendations of the TCFD in order to help investors price climate risk and reward climate innovation.

Green Initiative Task Force and Annual Report
CalSTRS established an environmentally focused Green Initiative Task Force in 2007, which produces an annual report to highlight environmental-themed investments, corporate governance and other environmental risk management efforts. As part of assessing environmental risks, CalSTRS considers not only how a particular investment affects the environment but also how the environment affects a particular investment. CalSTRS works with its external managers to recognize and manage environmental risks and, where appropriate, directly engages with portfolio companies. CalSTRS also collaborates with other investors to broaden engagement reach whenever possible. CalSTRS routinely submits environment-related shareholder proposals to companies held in its public equity portfolio to raise their level of environmental risk awareness. Staff also considers and votes all environment-related proposals in a manner that aligns with CalSTRS' objectives of improving disclosure and mitigating risk.

FISCAL IMPACT

Program Cost – None identified.

Administrative Costs/Savings – Potential marginal savings due to more readily available climate risk data, which could replace the need to pay private research firms for climate risk estimates.

SUPPORT

CalSTRS
Ceres
Edison International
National Association for Latino Community Asset Builders
National Conference on Public Employee Retirement Systems
National Whistleblowers Center
New York State Common Retirement Fund
PG&E Corporation
Sempra Energy
Sierra Club
Union of Concerned Scientists
UN Principles for Responsible Investment

OPPOSITION

None known.

ARGUMENTS

Pro: Creates greater public understanding and access to information on climate-related financial risk.

Requires federal regulatory agencies to view climate risk as a systemic financial risk, consistent with CalSTRS' position.

Ensures inter-agency cooperation in measuring climate risk to the financial system.

Provides CalSTRS and other investors additional clarity on climate-related regulatory risk, which is a key input to assessing climate risk to the portfolio.

Con: May be perceived as relegating climate risk as tangential to, rather than intrinsic to, systemic financial risk.

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