

**Written Testimony
Prepared for the U.S. Senate Banking
Subcommittee on Securities, Insurance and Investment**

October 31, 2007

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Chairman Reed, Ranking Member Allard and members of the Subcommittee, I am pleased to provide the perspective of an institutional investor on the issue of the necessary corporate disclosure of information related to climate change.

The California Public Employees' Retirement System, known as CalPERS, provides pension and health benefits to 1.5 million state, local public agency and school employees, retirees and their families.

A 13-member Board of Administration oversees the management of CalPERS assets, which total more than \$250 billion. Our Fund began in 1932, initially investing only in bonds. Over the years, we diversified our assets into four major classes: global equity (public stocks), fixed income, real estate, and – beginning in 1990 – in private equity.

The goal of diversification has always been the same – to balance our portfolio against risk and to add value based on our ability to take advantage of market opportunities.

The CalPERS Board recognizes that the way it deploys investment capital can not only shape the financial future of its investment portfolio, but also the future of our communities, our society, and our environment for decades to come. We also recognize that environmental responsibility and climate risk is a financial issue as well as a health security issue that affects everyone.

Environmental Disclosure and Why It's Important

It is important for the Senate and particularly the Subcommittee to address the issue of environmental disclosure by corporations. Increasing evidence indicates that climate change presents material risks to numerous sectors of the economy and to the financial market place. These risks may include operational, market, liabilities, policy, regulatory, and reputation risk. Accordingly, CalPERS has advocated for the right of shareowners to obtain information on environmental risks and opportunities to make informed investment decisions.

The fundamental principle underlying the Securities and Exchange Commission's disclosure requirements is that a public corporation must fully and fairly disclose all facts about its performance and operations that would be material to a shareowner's investment decision. This disclosure obligation springs from the core requirement of the 1933 and 1934 Acts that investors receive financial and other significant information concerning securities offered for public sale.

Under both Supreme Court and Commission precedent, the existence of significant investor demand for information helps to guide the determination of whether that information is material and hence required to be disclosed. “A fact is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹

As a long-term investor, CalPERS believes that environmental issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, and asset classes through time.)

CalPERS is also interested in the sustainability of companies that may be threatened by climate change as well as those that can find new opportunities in a carbon-constrained market. Sustainability is potentially undermined by climate change. This is the concern that drives our environmental investment program -- including initiatives seeking transparent reporting of greenhouse gas emissions, the design of corporate measures to reduce those emissions, and clean technology investments.

Addressing climate change is part of our overall corporate governance policy, which says that “to ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks and opportunities,

through adoption of policies or objectives, such as those associated with climate change."

We want portfolio companies that are well positioned to avoid the financial risks associated with climate change and that can capitalize on new opportunities emerging from the regulation of greenhouse gases, including alternative energy technologies.

But we cannot assess companies' financial viability unless we know their potential exposure to climate change-related risks and potential benefits.

Why Voluntary Environmental Disclosure is Insufficient

CalPERS recognizes that some companies have chosen to include climate risk in voluntary sustainability reports or more general corporate responsibility reports, often filed in response to shareholder activism. However, there are many companies that do not provide voluntary disclosure of their climate risk.

Further, the information that is voluntarily disclosed often lacks the material information required by a reasonable investor to properly assess companies' financial viability. The lack of SEC guidance on or a standardized format for climate risk disclosure has resulted in reports with very little consistency in the format or level of detail of information presented. A recent report found that "while

almost all companies reported on climate change in their sustainability reports, on closer examination companies reported far more on potential opportunities rather than financial risks for their companies from climate change.”²

Sustainability reports often include additional information on environmental trends and business strategies but they are primarily directed towards an audience of environmental interest groups and the general public, rather than investors. These reports more often acknowledge the science of climate change and discuss efforts to build awareness rather than presenting the specific effects of climate change on their performance and operations.

While sustainability reports provide a solid foundation on which the companies can base the disclosures required under the Commission’s existing reporting requirements, they do not provide the information investors require. Reporting must be consistent and must support comparisons among companies. The 10-K report is and will remain the gold standard for reporting information to investors, and investors need to know that material information relating to companies’ performance and operations will be in those required reports. Given the significance of climate risks for many corporations’ financial position and competitive prospects in a new, carbon-constrained environment, reporting on climate issues is no longer a mere virtue, but a legal obligation and a necessity for investors.

CalPERS Efforts to Improve Environmental Disclosure

CalPERS has worked with CERES, the Investor Network on Climate Risk (INCR) and a coalition of other public pension funds and institutional investors both in the United States and abroad to advocate for improved disclosure of companies' climate risk. Examples of CalPERS' efforts include:

- The Carbon Disclosure Project: CalPERS is a member and signatory – An annual questionnaire is sent to companies on behalf of institutional investors representing \$41 trillion of assets under management requesting information on the business implications of climate change and the companies' greenhouse gas emissions.
- The Global Reporting Initiative Sustainability Reporting Guidelines: Reporting mechanism by which companies can disclose their ESG performance. The CalPERS Core Principles of Accountable Corporate Governance also recommend that “Corporations strive to measure, disclose, and be accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development. It is recommended that corporations adopt the Global Reporting Initiative Sustainability Reporting Guidelines to disclose economic, environmental, and social impacts.”
- The Global Framework for Climate Risk Disclosure: CalPERS helped draft the Global Framework, which encourages standardized climate risk

disclosure to make it easy for companies to provide information and for investors to analyze and compare companies. The CalPERS Core Principles of Accountable Corporate Governance expressly provide that “[t]o ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks and opportunities, such as those associated with climate change. Companies should apply the Global Framework for Climate Risk Disclosure when providing such disclosure.”

The Global Framework for Climate Risk Disclosure consists of four elements of disclosure that investors require in order to analyze a company’s business risks and opportunities resulting from climate change, as well as the company’s efforts to address those risks and opportunities. The four elements of disclosure include:

- 1) Emissions Disclosure: As an important first step in addressing climate risk, companies should disclose their total greenhouse gas emissions. Investors can use this emissions data to help approximate the risk companies may face from future climate change regulations.
- 2) Strategic Analysis of Climate Risk and Emissions Management: Investors are looking for analysis that identifies companies’ future challenges and opportunities associated with climate change. Investors therefore seek management’s strategic analysis of climate risk, including a clear and straightforward statement about implications for competitiveness. Where

relevant, the following issues should be addressed: access to resources, the timeframe that applies to the risk, and the firm's plan for meeting any strategic challenges posed by climate risk.

- 3) **Assessment of Physical Risks of Climate Change:** Climate Change is beginning to cause an array of physical effects, many of which can have significant implications for companies and their investors. To help investors analyze these risks, investors encourage companies to analyze and disclose material, physical effects that climate change may have on the company's business and its operations, including their supply chain.
- 4) **Analysis of Regulatory Risks:** As governments begin to address climate change by adopting new regulations that limit greenhouse gas emissions, companies with direct or indirect emissions may face regulatory risks that could have significant implications. Investors seek to understand these risks and to assess the potential financial impacts of climate change regulations on the company.

All companies have climate risk and opportunity embedded in their operations that will vary across sectors. Regardless, all companies should be required to disclose the four elements highlighted in the Global Framework whether or not they are high emitters of greenhouse gas emissions. For example in the past year, CalPERS was approached by a major global soft drink company to discuss how climate change is affecting the company's water sourcing.

While we encourage all companies to disclose their climate risk, CalPERS has, as part of its corporate governance environmental strategic plan, actively targeted the highest emitting industries including electric utilities. In January 2007, CalPERS and the California State Teachers' Retirement System (CalSTRS) released a CDP-affiliated report on global utilities emissions.

We asked 265 global power companies about commercial risks and opportunities posed by climate change, the impacts of greenhouse gas regulation, physical risks associated with climate change, relevant technologies and innovations, and related management responsibilities. We also asked about energy costs, and emissions in terms of total annual generation, emissions from products and services, reduction programs and targets, and emissions trading arrangements.

Few of the 112 companies that responded to the survey were creating overall economic value once they accounted for the costly environmental impact of their carbon emissions. This is the kind of disclosure that investors need to evaluate not only the earnings of companies, but also costs stemming from greenhouse gas emissions.

Further, the electric utilities industry is heavily exposed to regulatory risks.

Absent a federal program to control greenhouse gas emissions, state and local regulation of greenhouse gas emissions has already become a significant force in the United States economy.

In 2007, the Governors of Arizona, California, New Mexico, Oregon, Utah, and Washington, as well as several Canadian provinces and Indian tribes, entered into the Western Climate Initiative to establish a regional greenhouse gas reduction goal and develop market-based strategies to achieve emissions reductions. This is just one of many initiatives being taken at the state and local level to control greenhouse gas emissions.

The lack of federal policy on climate change causes uncertainty that creates risks for both investors and businesses as they engage in long-term strategic planning, asset management, and capital budgeting. To address this uncertainty, CalPERS played a key role in a national effort to seek federal regulations to address climate change. The “Call to Action” campaign, which was organized by CERES and the INCR and included both investors and businesses, held a press conference in Washington, D.C., in mid-March and issued a letter urging the federal government to take three specific actions to address the uncertainty created by the lack of national policy on climate change. The three action items are:

- 1) Establish a mandatory national policy to contain and reduce national greenhouse gas emissions economy-wide, making the sizable, sensible, long-term cuts that scientists and climate models suggest are urgently needed to avoid the worst and most costly impacts from climate change.

This approach will also enable businesses and investors to make investments with a known long-term planning horizon. Wherever possible, this policy should utilize market-based mechanisms, such as cap-and-trade systems, to create an economy-wide carbon price.

- 2) Realign incentives and other national policies to achieve climate objectives, including a range of energy and transportation policy measures to encourage deployment of new and existing technologies at the necessary scale. Only governments can create the infrastructure needed to underpin the new clean energy system.
- 3) Guidance from the Securities and Exchange Commission and other financial regulatory bodies to businesses and investors on what material issues related to climate change companies should disclose in their regular financial reporting, so that investors can assess more accurately the effects of climate risk and opportunity in their portfolios.

With regard to action item 2, CalPERS believes it is a good idea for governments to subsidize infant technologies to achieve lift-off and commercial scale in short order. Currently though we see a problem, at least at the federal level, as subsidies are not provided for alternative fuels or clean technology in general. Rather, the federal government is subsidizing very specific technologies to the comparative detriment of others. For example, corn-based ethanol is subsidized while methane from municipal waste is not subsidized. The narrowness of the current subsidy structure could actually be inhibiting the development of those

clean technologies which could have better long-term viability. To remedy this problem, there should be a broad-based subsidy for alternative and clean energy technologies over conventional and dirty technologies.

Consistent with our request for guidance from the Securities and Exchange Commission in action item 3, CalPERS recently joined several other leading institutional investors to petition the Securities and Exchange Commission to ask it to require publicly-traded companies to assess and fully disclose their financial risks from climate change. Specifically, we are asking the Securities and Exchange Commission to require companies to disclose information:

- On the physical risks associated with climate change – including potential physical damage to facilities.
- About the financial risks stemming from the present or probable regulation of greenhouse gases, and their prospects for new business opportunities by responding to the changing physical and regulatory environment.
- About potential exposure and costs arising from legal proceedings that are related to climate change.

CalPERS Environmental Investment Initiatives

Investment Strategies

The CalPERS Board has been a leader in environmental investing. CalPERS recognizes the financial risks as well as the opportunities created by climate change.

- **Public Equity:** In November 2005, the CalPERS Board approved the hiring of five investment firms to manage \$500 million in stock portfolios that use environmental screens.
- **Private Equity:** In 2005, CalPERS initiated the Environmental Technology Program – a \$200 million program that targets investments in environmental technology solutions that are more efficient and less polluting than existing technologies. In 2007, CalPERS committed an additional \$400 million to the program.
- **Real Estate:** In our core real estate portfolio, the Board has set an energy reduction goal of 20 percent over the next five years. CalPERS also supports green building initiatives and continues to explore investments that fit within the Leadership in Energy & Environmental Design requirements.
- **Corporate Governance Environmental Strategic Plan:** The objective is to improve environmental data transparency and timely disclosure.
 - o **Environmental Company Engagement program:** CalPERS engages companies in the airline, auto, utilities, and oil and gas industries

that are underperforming relative to their industry peers and lack disclosure on the four elements highlighted in the Global Framework for Climate Risk Disclosure;

- o Carbon Disclosure Project: Support the Carbon Disclosure Project through our membership and as a signatory;
- o Investor Network on Climate Risk: Participate in the INCR; and
- o Support of Environmental Shareowner Resolutions for Improved Disclosure: As a shareowner in many different companies, CalPERS generally supports shareowner resolutions requesting improved environmental disclosure. These resolutions generally suggest that companies assess and report on how they are responding to the business risks and opportunities of climate change or adopt and report on quantitative goals for reducing total greenhouse gas emissions from the company's products and operations.

We appreciate this opportunity to represent institutional investors on what we believe is a very important issue. Improved environmental disclosure is required in order for investors to properly assess the material impact of companies' climate risk and opportunities on their portfolios.

¹ SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 12, 1999) (quoting TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976)).

² Global Reporting Initiative & KPMG Global Sustainability Services., Reporting the Business Implications of Climate Change in Sustainability Reports (2007)