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Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

February 6, 2023

Subject: Principles for Climate-Related Financial Risk Management for Large Financial Institutions; Docket No. OP-1793

Dear Secretary Misback,

On behalf of the California Public Employees' Retirement System (CalPERS), we applaud that the Board of Governors of the Federal Reserve System (Board) has chosen to develop a framework for the safe and sound management of exposures to climate-related financial risks for Board-supervised financial institutions with over $100 billion in assets. At CalPERS, we have prioritized consideration and management of climate-related financial risks and have focused on enhancing governance and improving disclosures focused on financial data. I write to express our general support for the Proposed Principles.

CalPERS is the largest public defined benefit pension fund in the United States, managing approximately $450 billion in global assets. We work constantly to improve our ability, and that of the broader investor community, to identify both investment risks and opportunities in support of our mandate to provide retirement, disability and health benefits for our 2 million members. We seek long-term, sustainable, risk-adjusted returns through efficient capital allocation and stewardship aligned with our fiduciary duty. We are guided by our Investment Beliefs, which recognize that "long term value creation requires effective management of three forms of capital: financial, physical and human."[1] Accordingly, we seek fair, accurate, timely, and assured financial reporting about how companies manage financial, physical, and human capital to generate sustainable returns, and how they identify, monitor, and mitigate risks to those three forms of capital.[2]

[1] CalPERS Investment Beliefs, https://www.calpers.ca.gov/page/about/organization/calpers-story/our-mission-vision#investment-beliefs.

[2] CalPERS Sustainability Principles, https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf.

While CalPERS commends the Board's choice to develop such a framework for assessing and mitigating climate-related financial risks, and are supportive of the Proposed Principles, we have some remaining concerns for your consideration, which are detailed below.

I. GENERAL CONCERNS

We believe that the Proposed Principles would benefit from a clearer statement of what is known surrounding the renewable energy transition. Fossil fuels are finite by nature; formed millions of years ago. The resources are being depleted and will not be replenished. Thus, the faster they are burned, the more quickly we need to transition to renewable energy sources. Policymakers and regulators must plan for this inevitable transition. Focusing on the climate crisis and adjusting to meet such requirements ultimately supports planning for the inevitable renewable energy transition. However, by focusing solely on climate change, the Proposed Principles do not plainly state the whole problem at hand. Large financial institutions will play a vital role in the transition to renewable sources. As such, it is critical to promote proper governance, strategy and operations by such institutions.

The Proposed Principles appear to stand in the middle of a political debate without forcefully pointing large financial institutions along the path they must follow, if not because of climate change, but because we will eventually run out of fossil fuels. The transition will take decades, so having an effective framework in place now is critical to produce a Just Transition.[3]

We raise a further concern that when the Board chooses to focus on a particular issue within the Proposed Principles, such as the impact on low to moderate income (LMI) and other disadvantaged households and communities, it is not clear whether the intent is to actually help these communities. It appears that the Board's interest in LMI would be for the benefit of LMI, but the Proposed Principles highlight risks surrounding LMI and then require large financial institutions to focus on financial risks in such a way that would likely have the opposite impact on LMI. The Board should take care to properly focus on large financial institutions reducing carbon emissions and investing in renewable energy while working toward a Just Transition.

Finally, it is important to note in the Proposed Principles, as we have noted in many spaces, that the climate change news is not all bad. There are financial risks, but there are also financial opportunities. The Proposed Principles do not include adequate references regarding the opportunities.

II. RESPONSES TO SPECIFIC QUESTIONS

Question 1: In what ways, if any, could the draft principles be revised to better address challenges a financial institution may face in managing climate-related financial risks?

The Proposed Principles fail to clearly state that there are finite supplies of coal, oil and gas, and that the transition to renewable energy is inevitable. The energy transition is made to be

[3] Just Transition is a term initially used in the Paris Agreement. "Taking into account the imperatives of a just transition of the workforce and the creation of decent work and quality jobs in accordance with nationally defined development priorities,..." The term has been expanded since then to include making certain that there is proper regard given to human needs during the transition.

dependent upon approaches to addressing climate change, without anchoring the inevitable fact that fossil fuels will eventually run out, and we must begin to transition to renewable energy sources in order to meet long-term US energy needs no matter what. The focus on climate change is critical, and in our opinion, supports the best-timed transition. We believe top-level policymakers and regulators need to be more forthcoming in acknowledging that we will run out of fossil fuels and must begin to develop effective energy solutions leading to a Just Transition.

The Proposed Principles would benefit from simple, straight-forward requirements that build on the substantial body of information that is available on climate-related financial risks. Currently, the Proposed Principles waffle between two strong and polarized political views with a desire to include both sides of a complex argument. However, the Board needs to deliver a consistent and strong message coupled with competent guidance.

Below are some examples of the inconsistent messages in the Proposed Principles:

On page 75267, the introductory information reads, "The Board is therefore seeking comment on draft principles that would promote **a consistent understanding** of how climate-related financial risks can be effectively identified, measured, monitored, and controlled among the largest institutions..." However, on the next page, the Proposed Principles read, "the Board anticipates that differences in financial institutions' complexity of operations and business models will result in **different approaches** to addressing climate-related financial risks." The counterintuitive concepts of developing a "consistent understanding" and adopting "different approaches" needs to be fleshed out with more specifics. The Board must develop a consistent view in order to provide competent guidance. That view should support the largest financial institutions focusing on reducing carbon emissions, investing in renewable energy and promoting a Just Transition.

On page 75268, the Proposed Principles are said to be both "consistent with the existing risk management frameworks described in the Board's existing rules and guidance," but in the next paragraph the Proposed Principles add that they are "intended to supplement existing risk management standards and guidance on the role of boards and management." The Board should be clear whether it is focused on what the largest financial institutions should be doing based on existing rules and guidance, and then it should focus on supplementing the guidance, if necessary. When read in total, the Proposed Rules highlight what large financial institutions should be doing regarding climate change. Most will argue that they already do those things, and there is little evidence, without honest disclosures, that they are not in compliance with such existing rules. The Board needs to make clearer statements on what changes the largest financial institutions must make to address the financial risks and opportunities of the energy transition.

Finally, we believe the Board has identified a critical issue in emphasizing low to moderate income (LMI) and other disadvantaged households and communities, but the Board should be clearer regarding what is intended with such emphasis. CalPERS supports a Just Transition, instead, the Proposed Principles focus on financial risks and then explicitly highlight the disproportionate adverse impacts on LMI. On page 75269, "The Board encourages financial institutions to take a risk-based approach in assessing the climate-related financial risks associated with individual customer relationships and to take into consideration the financial institution's ability to manage the risk." As written, though well-intended, the Proposed Principles may do more harm than good to LMI and other disadvantaged households and communities because the largest financial institutions might move away from working with the riskier LMI communities. In sum, they might work counter to a Just Transition. The Board needs to do more to protect vulnerable communities and be more explicit regarding such intent.

> *Question 2: Are there areas where the draft principles should be more or less specific given the current data availability and understanding of climate-related financial risks? What other aspects of climate-related financial risk management, if any, should the Board consider?*

The Board should consider upgrading the principles to better reflect the current market on climate-related financial risks. There is room for the Board to be more prescriptive if it chose to do so or more ambitious in its principled approach given the massive amounts of data readily available to the applicable financial institutions. For example, at no point do the Proposed Principles acknowledge that fossil fuels are finite. Whether the focus is on climate change or not, there will be an inevitable energy transition because we have been quickly burning fossil fuels that have taken millions of years to produce, and there is not sufficient time to make more at a faster rate than they are being depleted. Approaching the energy transition as something that will happen regardless, given the limit of fossil fuel supply, would improve the Proposed Principles substantially.

Further, instead of focusing on data gaps on micro-information, there should be clearer guidance that the focus of the Proposed Principles is on reducing carbon emissions and developing renewable sources of energy. In fact, the largest financial institutions already evaluate whether the carbon emissions they produce or finance is increasing or decreasing on an annual basis. They also highlight their investments in renewables. The Proposed Principles should be more specific about having the largest financial institutions track year over year carbon emissions and the dollars invested (including loans) in renewables.

> *Question 3: What challenges, if any, could financial institutions face in incorporating these draft principles into their risk management frameworks?*

It appears that the Proposed Principles are written as if there is an internal battle within the Board about what is believed fundamentally, so all political sides are represented to a degree in its commentary. Based on the existing draft, the largest financial institutions could face challenges because the Proposed Principles do not clearly state the purposes, so some could choose to do nothing different while communicating compliance. There is too much commentary around the actual operative provisions and not enough focus on what the Board would like the largest financial institutions to do differently, if anything. Policy decisions that will impact the largest financial institutions have to be addressed. Some continue to approach fossil fuels as if they will always be available, when the reality is that more aggressive fossil fuel use will reduce how much time they will be available. Climate change is real, and we must move to address it from the perspectives of both risks and opportunities.

III. CONCLUSION

We appreciate the opportunity to provide comments and express our support for the Proposed Principles. In line with our principles, we support the Proposed Principles, but we think that the Board could do more to clearly acknowledge that climate change presents both risks and opportunities, and that fossil fuels are finite, so the transition to renewables is inevitable. The Proposed Principles would also benefit from reducing the commentary and focusing on the operative provisions in order to better focus large financial institutions on necessary actions. Those actions should focus on people as the most important resource, such that the Proposed Principles do not create additional harms to LMI communities or other people and support a Just Transition.

Please contact James Andrus, Interim Managing Investment Director, Sustainable Investing, at James.Andrus@calpers.ca.gov if you have any questions or would like to discuss our response.

Sincerely,

Marcie Frost
Chief Executive Officer