FLOOR ALERT

Item # 27

Senate Bill 252 (Gonzalez) – Public retirement systems: fossil fuels: divestment - OPPOSE [As Amended May 18, 2023]

May 22, 2023

To: Members of the Senate

The undersigned organizations respectfully OPPOSE Senate Bill 252 (Gonzalez), related to CalPERS and CalSTRS divestment from fossil fuel companies, as defined. Many public agencies utilize CalPERS to provide retirement benefits to their employees. As of December 31, 2022, the Public Employees Retirement Fund (PERF) had approximately $442 billion in total assets, a decline from approximately $479 billion in total assets as of March 2022. The fund is used to pay out retirement benefits to CalPERS members. The CalPERS and CalSTRS boards must make fiscally prudent decisions to protect the financial security of their members.

SB 252 prohibits the CalPERS and CalSTRS boards from making additional or new investments or renewing existing investments in a fossil fuel company, defined as one of the 200 largest publicly traded fossil fuel companies, as established by carbon content in the companies' proven oil, gas, and coal reserves. The bill requires divestment from such investments by July 1, 2031, unless that requirement is suspended upon a good faith determination by the board that an act of God, war, or other unforeseeable event creates conditions that materially impact normal market mechanisms for pricing assets. The authority to make such suspensions ends on January 1, 2035.

In order to improve the funded status of our employees' pension funds, it is critical that CalPERS and CalSTRS have healthy investment returns. Recent market turmoil demonstrates the challenges to achieving those returns – CalPERS' funded status declined more than 9%, from approximately 81.2% down to 72%, during the fiscal year ended June 30, 2022. Divestment makes achieving the returns needed to maintain plan health more challenging. According to a CalPERS Publication entitled *CalPERS and Divestment*, "Divestment limits investment opportunities, decreasing diversification, limiting returns, and increasing risk in our investment portfolio." With employer contribution rates stretching employer budgets thin, it would not be prudent to take action that would further increase employer contributions and put continued strain on local budgets. Due to the anticipated financial costs associated with divestment, our agencies oppose efforts that divert CalPERS from its duty to its members, including divestment of CalPERS assets to achieve political objectives if the divestment would have a negative impact on the overall health of the fund. CSBA similarly opposes such efforts as they relate to CalSTRS.

Divestment harms investment performance and increases transaction costs. In their analysis of SB 252, CalPERS staff concluded that: "As of December 31, 2022, the estimate of publicly traded securities held by CalPERS that meet the criteria of a "fossil fuel company" as defined in SB 252 is $9.4 billion. Should the CalPERS Board direct the investment team to divest these securities, the estimate of transaction costs (including commissions and market impact and excluding opportunity costs) to divest and reinvest the proceeds in other securities is between $75-$125 million." In their analysis of SB 252, CalSTRS staff concluded that CalSTRS' exposure "was determined by including companies that have fossil fuel reserves for energy application and sales being more than 1% of revenue. CalSTRS invests in 159 companies with a combined market value of approximately $5.4 billion that meet this definition." The CalSTRS analysis determined: “Fossil fuel divestment, combined with existing CalSTRS divestments, would create deviation from the benchmark. Potential costs resulting from this deviation place the CalSTRS Funding Plan at risk. Any resulting costs would increase the unfunded liability and also may result in an increase in the state’s contribution to the Defined Benefit Program.” CalSTRS also estimated $30.5 million in transaction costs, as well as additional costs and staff resources. Per the CalPERS staff analysis: “Every dollar in investment returns that is forgone, or expended on transaction costs and fees, must be offset by employer and employee contributions. If CalPERS were to divest from fossil fuel companies and the companies performed well, employers and employees would bear the investment loss and transaction costs to maintain divestment through increased contribution rates.”

As described in the CalPERS staff analysis of SB 252, “Divestment has little impact on a company’s operations or bottom line and does nothing to reduce real economy GHG emissions. But it does mean that investors like CalPERS, who are committed to reducing GHG emissions, lose their influence over these companies. If CalPERS divests, it loses its voice and CalPERS potentially loses money.” The CalSTRS staff analysis is similarly dire: “By requiring the largest public pension funds in the United States to divest from fossil fuel companies, this bill would severely hinder the future success of institutional investor collaborations to affect meaningful change in the fossil fuel industry.” CalPERS and CalSTRS have used their shareholder positions to effect change. (See e.g.: Activist firm ousts two ExxonMobil directors in shareholder vote - UPI.com) The loss of CalPERS’ and CalSTRS’ influence on corporate governance may have far-reaching negative impacts on broader sustainability efforts.

Forcing divestment of California retirees’ funding ultimately transfers the ownership of the investments to other investors at a great cost to the CalPERS and CalSTRS funds, and removes the ability for the funds, as shareowners, to influence the companies to act responsibly.

Signed,

California Special District Association
California School Boards Association
League of California Cities
Rural County Representatives of California