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UNIVERSITY OF CALIFORNIA
Center for Law, Energy & the Environment

CONFERENCE BRIEF

FROM BRUSSELS TO THE BAY

Climate Risk and Sustainable Finance in the EU and California

August 2019

Introduction

The global financial system faces structural risks from the worsening impacts of climate change and the various policy responses to it. As jurisdictions like the European Union (EU) and California seek to address these risks, they face significant questions about what actions will be necessary and how financial regulators and industry members across the globe will need to coordinate decision-making and resource-sharing.

To address these concerns, UC Berkeley School of Law's Center for Law, Energy & the Environment (CLEE) hosted experts and leaders in sustainable finance from California and the EU in May 2019 for a conference to discuss climate-related financial risks and key regulatory developments in the US and Europe. These include the EU Sustainable Finance Action Plan and Green Taxonomy efforts that seek to drive sustainable investment through innovative regulatory incentives and US industry partnership in implementing new disclosure and accounting standards. This brief highlights the key insights delivered at the conference.

European Leadership

The European Commission's Action Plan on Financing Sustainable Growth is a pioneering effort to drive global capital markets toward achieving the goals of the 2015 Paris Accord. Europe is responsible for meeting approximately one-third of the global need for an additional $1 trillion annually in clean energy investments—a significant number in relation to public finance, but a modest one compared to the capacity of private capital markets. As a result, the Action Plan attempts to direct public expenditures toward sustainable investments while creating incentives for private markets to provide the bulk of the necessary capital. These incentives are based on:

> "We are transitioning from a carbon-based economy to a zero-carbon economy by 2050, and we need to take care of that transition. During the transition, we need to get polluters to change, and we need to find a way to create incentives for private investment to do that. If we only finance what is extremely clean, we will not have that effect. The goals need to be ambitious but achievable."
>
> – Mario Nava, *Director, European Commission Directorate-General for Financial Stability, Financial Services and Capital Markets Union*

- Disclosure of the market risks and opportunities posed by climate change;
- Benchmarks to track progress both toward and beyond the Paris goals; and
- A "green taxonomy" that classifies economic activities by their environmental impacts to identify sustainable investment opportunities.

Despite its economic power, Europe represents only 11 percent of global greenhouse gas emissions. It is not only essential for policymakers and regulators to leverage private capital to meet sustainability goals—they must also socialize these incentives throughout global capital markets. The European Union took a significant step in this direction in June 2019 by releasing a draft taxonomy (open for stakeholder comment through September 2019) focused on climate change mitigation and adaptation, sustainable water use, waste prevention, pollution prevention, and ecosystem protection.

California Leadership

With the vacuum of leadership at the federal level, California is advancing its climate leadership position by scaling up its ambition as part of the global investment community. California's state employees' and teachers' pension funds (CalPERS and CalSTRS) are the two largest pension funds in the nation, with a combined portfolio of over $500 billion in assets. This size has the ability to help shape sustainable investment policy, and the fund boards' advocacy has helped lead 96 percent of fund managers to adopt investment sustainability strategies. Key focal points for ongoing leadership include:

- Supporting carbon pricing mechanisms that do not exacerbate economic inequality;
- Maximizing the sustainability potential of direct investment in real estate and private equity; and
- Balancing climate goals with a focus on creating long-term value in the fiduciary role.

Further aligning California's financial policies with its climate policies will require state leaders to better understand the risks that companies face from climate change and to increasingly engage with partners across the globe. California has made a lot of progress, but much work remains.

> "California's physical capital is deeply strained because of climate change. Our financial capital is under stress too, but we can create policy to limit that strain. As we adapt and evolve our economy, we must ensure it is a just transition that broadens economic and human prosperity."
>
> – California State Controller Betty T. Yee

Promoting Long-Term Sustainability in Global Capital Markets

> "A number of mechanisms are available to help markets price climate risks and shift investments toward sustainability. But what do we do when markets do not make these shifts happen, or do not make them happen fast enough? That's what we are facing in the U.S., and that's when stronger policy and regulatory mechanisms may be necessary."
>
> – Dave Jones, *Director, Climate Risk Initiative, CLEE*

The ability of global markets to adapt to a changing climate and a carbon-constrained economy will rely on a complex web of institutions, including market intelligence providers to assess risk; independent accounting boards to standardize disclosure; investor networks to advocate for corporate sustainability; and asset managers and asset owners to move capital away from carbon-based investments. To successfully address the transition risks (and take advantage of the market opportunities) of climate change, industry and policy leaders will need to take a range of actions such as:

- Universal implementation of disclosure standards for climate-related risks in the areas of corporate governance, strategy, risk management, and progress measurement, developed by the Task Force on Climate-related Financial Disclosures (TCFD);
- Universal adoption of accounting and reporting standards for environmental, social, and governance (ESG) and climate risks by corporations, such as those developed by the Sustainability Accounting Standards Board (SASB);
- Increased dedication of investment analysts, asset owners, and asset managers to incorporating ESG considerations in their investment decisions; and
- Regulatory leadership and enforcement to ensure companies both meet these disclosure standards and do so on a level playing field.

If capital markets fail to respond to climate risk, policy makers will need to institute more direct policy measures. And the longer the delay in reducing greenhouse gas emissions, the more draconian the inevitable policy response. At the same time, policy makers and other stakeholders will have to work to minimize the pain of transition and ensure that burdens are shared equitably, while helping all communities share in the opportunities that will arise.

"What does a two-degree policy framework look like? Long-term GHG emission reduction targets, phasing out fossil fuel subsidies, phasing out thermal coal—these aren't just climate policies, they're financial policies. They create signals for how investors should invest."

– Morgan LaManna, *Senior Manager, Investor Engagement - Climate Action 100+, Ceres*

"Disclosure of climate risk is not about who has been good or bad; it's about how you will fare financially in a world shaped by climate change. Regulatory and market changes needed to reduce emissions, as well as physical risks like storms, flood, and displacement will all cost money, and we will need more services and financial products to prepare for that. How will corporations handle this?"

– Emilie Mazzacurati, *Founder and CEO, Four Twenty Seven*

"ESG standards are all about long-term value creation. Sound sustainability and ESG practices lower the cost of capital and improve operational performance. Standardizing and sharing information on these measures is essential."

– Robert Hirth, *Co-vice Chair, Sustainability Accounting Standards Board*

"Investors need to focus on what can be done now: left-tail actions with low risks today that can minimize climate exposure, and right-tail actions that are affordable today and have potential to greatly increase value under carbon constraints."

– John Goldstein, *Managing Director, Goldman Sachs Asset Management*

Photo credits: Bernard Spragg (left) and Eoghan OLionnain (right) on Flickr.

ABOUT CLEE AND THE CLIMATE RISK INITIATIVE

The Center for Law, Energy & the Environment (CLEE) channels the expertise and creativity of the Berkeley Law community into pragmatic policy solutions to environmental and energy challenges. The Climate Risk Initiative at CLEE focuses on the risks posed by climate change to the insurance and other financial sectors and how public policy can help these sectors better identify, evaluate, and address that risk.

ABOUT THIS POLICY BRIEF

This brief was authored by Ted Lamm and Dave Jones. Jones, director of the Climate Risk Initiative, convened the conference that informed this brief. As California Insurance Commissioner from 2011 to 2019, Jones pioneered first-in-the-nation climate risk disclosure requirements for insurers and scenario analysis of insurers' investment portfolios taking into account physical and transition risks of climate change. Dave Jones and CLEE thank the European Union, the ClimateWorks Foundation, and United Nations Principles for Responsible Investment for their support of this conference.

PRI Principles for Responsible Investment

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CENTER FOR LAW, ENERGY & THE ENVIRONMENT (CLEE)

UC Berkeley School of Law
390 Simon Hall
Berkeley, CA 94720
www.clee.berkeley.edu

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Contacts:
Dave Jones, Director of the Climate Risk Initiative at CLEE, at davejones@berkeley.edu
Ted Lamm, Research Fellow in the Climate Program at CLEE, at tlamm@law.berkeley.edu