Testimony of

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Hearing on
"Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures"

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Chairwoman Maloney, Ranking Member Huizenga, and other Members of the Subcommittee:

Thank you for the opportunity to testify at today's hearing. My name is James Andrus, and I am an Investment Manager for the Sustainable Investments program for the California Public Employees' Retirement System ("CalPERS"). I am pleased to appear before you today on behalf of CalPERS. I applaud and support the Subcommittee's focus on building a sustainable and competitive economy. CalPERS appreciates that Environmental, Social, and Governance ("ESG") disclosures play an important role in that work.

My testimony discusses how CalPERS benefits from a system that ensures effective, accountable and transparent corporate governance, while at the same time promoting capital formation with the objective of achieving the best returns and value for shareowners over the long-term. Ultimately, CalPERS's primary responsibility is to our beneficiaries, and so our long-term investment returns are central to all our thinking about these issues. I will provide an overview of CalPERS, discuss our governing principles, and review various legislative proposals under consideration.

<u>CalPERS</u>

CalPERS is the largest public pension fund in the United States ("U.S."), with approximately $370 billion in global assets as of market close on June 30, 2019. CalPERS has equity holdings in over 10,000 public companies globally. CalPERS is a fiduciary that provides over $22 billion annually in retirement benefits to more than 1.9 million public employees, retirees, their families, and beneficiaries. Delivering investment returns is our investment office's number one job. Achieving good investment returns helps us avoid increasing the contributions required from California's communities. Increasing contributions takes away budget resources otherwise available for those communities to provide public services. For this reason, we are focused on ESG topics that can affect our returns.

To promote long-term returns, CalPERS has developed and implemented a set of Governance and Sustainability Principles ("Principles"), which are included in the appendix to this testimony. Updated annually, these Principles are a statement of our views on best practices to guide the internal and external managers of CalPERS when making investment decisions and provide the framework by which we advocate with policy-makers, execute our shareowner proxy voting responsibilities and engage portfolio companies to achieve long-term returns.

CalPERS ESG Strategic Plan and Principles

In August of 2016, the CalPERS Board of Administration adopted an ESG 5-Year Strategic Plan ("Strategic Plan") for the purpose of minimizing risk, maximizing returns, and ensuring accountability from all those involved. Within this broad framework, my testimony will highlight CalPERS' views on data and corporate reporting, among other topics central to the ESG disclosure dialogue. Together, our Principles and our Strategic Plan support a robust reporting regime for publicly traded companies that would address issues that impact shareowner value over the long-term. Together, they have guided us to work with partners and advocate for policies that address climate change, board diversity, improvements in human capital management, and governance issues such as majority voting. I applaud this Subcommittee for focusing on certain matters that we consider critical to a sustainable economy.

Before we discuss the specific proposals, I think it is important to note that the proposals we are discussing today are limited to publicly traded companies. For the past few years, the majority of capital raised in the U.S. has not been generated through public offerings. To the contrary, the majority of capital raised in the U.S. is now through so-called "private" offerings, which do not have the disclosure obligations or investor rights and other protections that are the hallmarks of the public capital markets. In part because of the dramatic shift in where capital is being raised, we at CalPERS are changing where we invest as well. As fiduciaries focused on maximizing our returns for our beneficiaries, we are increasingly focused on private market opportunities. Despite the generally greater risks and costs of these private investments, we must focus on maximizing our long-term returns, and we cannot simply ignore the market where more than half of new investments are made.

This raises an important point for today's discussion: most of the ESG-related policy dialogue focuses only on the public markets. Moving forward, we encourage you to also consider how important ESG issues like those we are discussing today can be carried into the non-public market space as well.

Legislative Proposals: Strong Disclosure for Stronger Capital Markets

The U.S. is home to the world's most dynamic and robust capital markets. As a significant institutional investor with a long-term investment horizon, CalPERS fundamentally depends on the integrity and efficiency of our financial markets to provide the sustainable, risk-adjusted returns that allow us to meet our commitments over the course of multiple decades. We believe that enhanced data and transparency requirements will promote more efficient and sustainable financial markets over the long-term.

Corporate reporting plays a key role in sustaining capital markets. As a long-term shareowner, CalPERS understands first-hand that effective disclosures are essential to enhancing the efficiency of global capital markets, to focusing companies' management on risks and opportunities, supporting informed decision-making about shareowner proposals, and, ultimately, to delivering our pensioners their promised retirement and health benefits.

Our Principles outline opportunities to strengthen effective disclosures and guide our advocacy efforts. We strongly believe that all investors, whether large institutions or private individuals, should have access to financial reporting disclosures that allow providers of capital to make informed decisions whether to buy, sell, or hold certain securities. Likewise, such disclosures provide investors with the information they need to decide how to vote their shares. Without high-quality, consistent, and comparable disclosures, CalPERS and other investors are disadvantaged as we make capital allocation decisions and assess the performance of corporate boards and management teams.

Critically, CalPERS and other pension funds will be inhibited from adequately exercising their fiduciary duty without such disclosures. Such disclosures are necessary to close the information gap that occurs when management of a company is aware or should be aware of certain risks, yet such information is not available to shareowners. In line with this view, we strongly support the Securities and Exchange Commission's ("SEC") work to comprehensively review the disclosure requirements of Regulation S-X and Regulation S-K and have actively responded to the relevant requests for comment in support of greater transparency.[1] Indeed, there are many substantive areas about which long term investors could use more information. For example, as a member of the Human Capital Management Coalition, we joined others to file a petition with the SEC focused on human capital disclosures. [2]

We are excited and pleased by the opportunity to weigh in on the proposals before the Subcommittee today. It is our belief that this package of bills will require issuers to view ESG metrics through the lens of long-term business strategy, will encourage corporations to be mindful of ESG and other risks that could impact their operations, and will provide for greater transparency regarding cash flow, corporate expenditures, and public policy engagement. I will now discuss, in broad terms, CalPERS' views on the bills before us today.

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[1] *See* Letter from CalPERS to Brian J. Fields, Secretary, U.S. Securities and Exchange Commission (Nov. 30, 2015) (available at https://www.sec.gov/comments/s7-20-15/s72015-38.pdf); Letter from CalPERS to Brian J. Fields, Secretary, U.S. Securities and Exchange Commission (July 21, 2016) (available at https://www.sec.gov/comments/s7-06-16/s70616-267.pdf).

[2] *See* Letter from Human Capital Management Coalition to William Hinman, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission (July 6, 2017) (available at https://www.sec.gov/rules/petitions/2017/petn4-711.pdf)

Shareholder Protection Act of 2019

Our Principles call for robust board oversight and disclosure of corporate charitable and political activity to ensure alignment with business strategy and to protect assets on behalf of shareowners. As fiduciaries, we need to know how our capital is being used, including if and when political expenditures are made. We have consistently been in favor of enhanced disclosure of such spending and therefore support the “Shareholder Protection Act of 2019.” In fact, during the most recent proxy season, we supported various shareowner proposals that would require companies to report their political spending and to adopt board oversight procedures.

Notably, in the majority opinion of the Court in *Citizens United*, former Justice Anthony Kennedy wrote that:

> With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation’s political speech advances the corporation’s interest in making profits, and citizens can see whether elected officials are “‘in the pocket’ of so-called moneyed interests.” [] The First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages.[3]

Setting aside other aspects of the Court’s decision and with the important caveat that I am not commenting on CalPERS’ overall position on the decision, former Justice Kennedy’s words make clear that the Supreme Court envisioned future action by Congress to enhance corporate political transparency. We agree and urge Congress or the SEC to implement these important disclosures.

Climate Risk Disclosure Act of 2019

Embedded in our Principles is the expectation that corporate boards disclose fair, accurate, and material information relevant to investment decisions, thereby enabling shareowners to evaluate risks, past and present performance, and to draw inferences regarding future performance. For investors navigating the complexity of climate change, it is essential to have detailed scenario-based corporate disclosures regarding the potential impact of both the transition and physical

[3] *Citizens United v. FEC*, 558 U.S. 310 (2010).

risks to corporations' performance across time horizons (short, medium and long-term). Comprehensive disclosure of risk factors related to climate change should clearly reveal how companies identify and manage such risks to generate sustainable economic returns. Investors need companies to provide a detailed explanation of how each significant climate-related risk affects the company, as well as disclosure of exactly how the company plans to address and manage the risk. For investors, as the providers of the capital, knowing what measures the board of directors is taking to manage and mitigate risks creates trust and confidence regarding their investments. We therefore support the "Climate Risk Disclosure Act of 2019" because it will support investors in understanding the sustainability of their investments and in the development of the type of sustainable economy through which pension funds such as CalPERS can generate the returns we need over the long-term.

ESG Disclosure Simplification Act of 2019

Our Principles call on us to encourage corporate boards to present balanced and understandable assessments of companies' positions and prospects in their annual corporate reports. Accurate and accessible reports are critical for shareowners to assess a company's performance, business model, strategy and long-term prospects.

Consistent with CalPERS' Strategic Plan, the "ESG Disclosure Simplification Act of 2019" ("ESG Disclosure Act") would require companies to make new and more robust ESG disclosures. This legislation would establish an inclusive process for advancing important proposals aligned with our Strategic Plan objectives related to integrated reporting. Moreover, the legislation's suggested process is thoughtful: its proposal to establish a committee to advise the SEC in the development of appropriate disclosures would provide the SEC additional access to knowledgeable and innovative thinkers.

These additional disclosures are important to better understand companies' potential long-term performance and risks. The process identified in the ESG Disclosure Act should produce high quality ESG disclosures. As we stated in our comments on Regulation S-K, we believe that enhanced corporate reporting related to governance, risk, and compliance helps to put historical performance, as well as risks, opportunities, and prospects for the company into context.

CalPERS has advocated for many of these reforms outside of Congress as well. In 2018, CalPERS signed the Petition for Rulemaking on ESG Disclosure[4] ("the Petition"), which was authored by securities law professors Cynthia A. Williams and Jill E. Fisch. The Petition called on the SEC to develop a comprehensive framework requiring issuers to disclose identified ESG aspects of company operations.

[4] Petition from Fox, Saul A. and Williams, Cynthia A. to Brian J. Fields, Secretary, U.S. Securities and Exchange Commission (Oct. 1, 2018) (available at https://www.sec.gov/rules/petitions/2018/petn4-730.pdf).

Detailed disclosures around not only the probability of certain occurrences but also the result and implications on performance will help investors understand a company's strategic objectives and its progress in meeting them. Accordingly, we support the ESG Disclosure Act.

Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019

Our Principles are clear with regard to human rights:

> Corporations should adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates.

In line with our Principles, we advocate for policies, procedures, training and internal reporting structures to ensure commitment to universal human rights. We support the "Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019" because of its focus on the protection of human rights.

Country by Country Tax Payment Disclosure

Our Principles focus significantly on emerging systemic risks, stating that CalPERS will advocate for a disclosure regime that better enables earlier identification of risks that threaten global markets. Likewise, our Principles state that CalPERS will work to foster action that mitigates those risks.

The Organization for Economic Cooperation and Development ("OECD") has stated that changes are needed to effectively prevent double taxation and tax avoidance. The first step in addressing these significant issues is tax transparency.

As an investor in many of the largest public companies in the world, we are acutely aware of the complexities of international taxes, and the increasingly important role that taxes play in corporate profitability. Unfortunately, current tax disclosures in the United States do not provide investors with sufficient tax-related information to adequately assess companies' valuations and risks. This lack of transparency creates an information gap whereby management may be well aware of risks being taken while shareowners are left in the dark. The legislation before the Subcommittee would require the disclosure of overly aggressive international tax planning arrangements, thereby reducing systemic risk and ensuring stronger long-term outcomes.

Conclusion

CalPERS is a fiduciary whose primary goal is making good investments in order to fulfill our responsibility to our members. We have a long history of focusing on ESG topics because of the risks they pose to our returns. CalPERS' believes companies' long-term value creation requires effective identification and management of the ESG risks and opportunities relevant to their business.

Policy-makers have an important role to play in creating a policy context that incentivizes the companies we invest in to employ sustainable business practices while generating returns that meet public pension funds' needs. Policies that encourage sustainable business practices and require disclosures that help investors identify companies that are able to both deliver the returns we need and have measurable positive social and environmental impacts are useful in encouraging capital to flow toward a more sustainable economy.

The legislative proposals before the Subcommittee today could both minimize risk and promote greater capital formation, and CalPERS voices its support for them. We look forward to working with the Subcommittee and Committee to advance these, and hopefully more, proposals in the future. Thank you, Chairwoman Maloney and Ranking Member Huizenga for inviting me to participate in this hearing, and I look forward to your questions.