CENTER for INTERNATIONAL
ENVIRONMENTAL LAW

Testimony of Lisa Anne Hamilton Director of the Climate and Energy Program for the Center for International Environmental Law

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My name is Lisa Anne Hamilton and I am the Director of the Climate and Energy Program for the Center for International Environmental Law. We are a nonprofit legal advocacy organization based in Washington, DC that has conducted extensive legal analysis concerning material climate-related financial risk and the prudent exercise of fiduciary duty under common law Trust Law principles. I offer my testimony today in support of S.2126/ A.1536 the Fossil Fuel Divestment Act that would require the State Comptroller to divest the New York State Common Retirement Fund from specified fossil fuel assets to protect the financial interests of beneficiaries and their families.

One of the controversies concerning divestment is whether or not divestment is consistent with the prudent exercise of fiduciary duty and therefore consistent with the legal obligations the fund's trustees have to ensure that hardworking New York pensioners and their families receive the benefits that they have been promised.

I offer my testimony today to demonstrate that divestment is consistent with the prudent exercise of fiduciary duty by providing (1) a brief overview of common law trust principles of the prudent exercise of fiduciary duty and (2) a few highlights of the research and data about the diminished risk return profile for fossil fuel assets that has motivated other institutional investors to divest or pledge to divest from fossil fuel assets. While the research and data presented here today are not comprehensive, it offers a snapshot of the key drivers that have informed the decision making of over 1,000 institutional investors to divest from fossil fuels. In nearly every way, these institutional investors are peers to the State Comptroller.

These 1,000 like-minded fiduciaries owe their respective beneficiaries the same duties of loyalty, care and prudence of the New York State Comptroller but have concluded that the most prudent way to act in the sole interests of the beneficiaries of the fund is to divest or pledge to divest the fund of its fossil fuel assets.

1. Common Law Principles of Fiduciary Duty and Divestment

The relevant provisions of New York State Retirement and Social Security Law (RSSL section 177(9)(b) concerning the purpose and standards for investment management provides that :

> "Such investments shall be for the exclusive benefit of the participants and beneficiaries and the trustee or trustees of a fund shall make such investments with the care, skill, prudence and diligence under circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[1]

As detailed in New York State's investment policies, this language is based on common law trust principles that include the duty of loyalty, whereby a fiduciary acts in the sole interests of the beneficiary without regard for the interests of that fiduciary or any other third party and the duty of care consistent with statutory and common law standards for the execution of these duties.[2] Recent judicial opinions have given more explicit interpretation of how a fiduciary must execute investment management responsibilities for the fund consistent with the prudence and care of a reasonably prudent person. In *Tibble v. Edison International*, the Supreme Court articulate standards for the conduct required of a Trustee fiduciary to satisfy the standards for the prudent exercise of fiduciary duty under the Employee Retirement Income Security Act of 1974 (ERISA). (Note that while ERISA is not binding on the New York State Common Fund, the statute and its corresponding Department of Labor bulletins offer guidance on matters of fiduciary duty.) In *Tibble*, the Court held that a fiduciary's duty of care does not stop at the initial point of investment selection and instead requires an ongoing duty to monitor the assets selected

[1] See Retirement and Social Security Law (RSSL section 177(9)(b) and the Regulations of the New York State Department Financial Services (DFS); 11 NYCRR part 136-2. See generally, The New York State Common Retirement Fund, General Investment Policies, August 1, 2017 available at https://www.osc.state.ny.us/pension/generalpolicies.pdf.

[2] See Restatement (Third) of Trusts § 78, Duty of Loyalty cmt f.

and where appropriate, remove any nonperforming or imprudent assets.[3] The *Tibble* decision is particularly pertinent here where divestment of fossil fuel assets is increasingly embraced as a prudent investor response to climate-related financial risk. As discussed throughout, there are an increasing number of market signals to indicate that the risk return profile for fossil fuel assets is less favorable today than thirty years ago.[4] Investor fiduciaries have a duty to monitor and conduct an ongoing review of fund assets and remove those assets if, as in the case with fossil fuel assets for example, the risk return profile that was deemed appropriate for the fund at the time of selection is no longer appropriate.

The Diminished Risk Profile of Fossil Fuel Assets and Responses by Prudent Investment Peers

Although the fossil fuel divestment movement began with concerns about the moral and ethical concerns regarding continued investment in the largest contributors to climate change, I want to focus on the material financial risks associated with fossil fuel assets as drivers for divestment. Although time does not permit a full listing of reports and research issued by financial and regulatory institutions addressing the vulnerability of fossil fuel assets in the transition to a low carbon economy, I do want to highlight the recent comments by the Federal Reserve Board of San Francisco (FRBSF) in its Economic Letter released in March 2019.[5] As a part of the Federal Reserve Board's goals for macroeconomic and financial stability, the recent Economic letter addressed several of the risks and effects climate change is projected to have on the U.S. Economy. First, the FRBSF expressed concerns about the limits of economic and monetary policy to address climate risks as investors reprice fossil fuel assets for a low carbon future.

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[3] The exclusive benefit provisions set out in the Retirement and Social Security Law (RSSL section 177[9] and the Regulations of the New York State Department of Financial Services (DFS) is based on common law principles of trust law and is similar to the language describing fiduciary duty standards in Section 404(a)(1) of the Employee Retirement Income Security Act of 1974 (ERISA). See Restatement (Third) of Trusts § ; See Tibble v. Edison Int'l, 135 S. Ct. 1823, 1828 (2015); Also see

[4] See Tom Sanzillo and Kathy Hipple, " Fossil Fuel Assets: Looking Backwards May Prove Costly to Investors in Today's Market"IEEFA, February 2019 available at http://ieefa.org/wp-content/uploads/2019/02/Divestment-Brief-February-2019.pdf.

[5] See Glenn Rudebusch, Federal Reserve Board of San Francisco (FRBSF) Economic Letter, "Climate Change and the Federal Reserve Board," March 2019 available at https://www.frbsf.org/economic-research/publications/economic-letter/2019/march/climate-change-and-federal-reserve/ ; It is also worth noting that the letter acknowledges that there is a current market failure where carbon fuel prices do not properly account for climate change and that one solution to the current absence of proper price signals about the costs of carbon, a carbon tax may correct the flaw in market pricing.

Second, the FRBSF referenced the findings of the Fourth National Climate Assessment (USGCRP 2018) released in November 2018 that projects that "without substantial and sustained global mitigation and regional adaptation efforts, climate change is expected to causes growing losses to American Infrastructure and property and impede the rate of economic growth over this century."[6] The FRSBF concludes that the losses to GDP referenced in the USGCRP, are the result of a fundamental market failure where carbon fuel prices do not properly account for climate change costs.[7]

Where some investors have resisted divestment based on the belief that material climate-related financial risk has been priced into fossil fuel assets, the Federal Reserve Board's comments debunks the myth that climate risk is already priced into carbon fuel prices and in turn fossil fuel assets.[8] The FRBSF's comments highlight a current market failure concerning carbon fuel prices, and should be viewed as another, among many red flag warnings to investor fiduciaries about the risk return profile of fossil fuel assets and the risk to the rate of return and overall performance of the Fund. Furthermore, what is clear from the growing amount of evidence and responses to climate change is that the material financial risks associated with climate change are no longer remote or speculative.

In response to these and other financial and economic warnings, hundreds of institutional investors are divesting their funds from fossil fuels as an example of how prudent investors exercise their fiduciary duty. As of September 2018, over 1,000 institutional investors with $6.24 trillion assets under management have pledged to divest their funds of fossil fuel asset as unsuitable for the respective funds.[9] According to a report issued by Arabella Advisors, the evidentiary basis for the recommendations offered by the G20's Financial Stability Task For on Climate Related Financial Disclosures[10], the global

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[6] USGCRP. 2018. *Impacts, Risks, and Adaptation in the United States: Fourth National Climate Assessment, Volume II.* U.S. Global Change Research Program, Washington, DC.available at https://nca2018.globalchange.gov.
[7] Id.

[9] See Arabella Advisors, "The Global Fossil Fuel Divestment and Clean Energy Investment Movement, 2018," available at https://www.arabellaadvisors.com/wp-content/uploads/2018/09/Global-Divestment-Report-2018.pdf.
[10] See Final Report: Recommendations of the Task Force on Climate Related Financial Disclosures (June 2017) available at https://www.fsb-tcfd.org/publications/final-recommendations-report/ .

regulatory responses to the UN Paris Climate Agreement, the increasing number of climate litigation cases with publicly traded fossil fuel companies as defendants, and concerns about the threat of stranded fossil fuel asset risk to investor value[11] offer just a few examples of the material climate-related financial risks that have compelled institutional investors to divest funds of fossil fuel assets.[12] As recently as March 2019, the Norwegian Government Pension Fund Global announced it would phase out oil exploration from its investment universe in order to reduce its exposure to falling oil prices.[13] Collectively, these institutional investors that share the same fiduciary responsibility to act in the sole interests of the beneficiaries of their funds, are peers of the Trustees of the New York Common Fund and under law represent the growing number of reasonable investors of similar capacity that are exercising their fiduciary duty by divesting funds of fossil fuel assets.

By directing the Comptroller to divest the fund of fossil fuel assets, this bill adopts the prevailing approaches adopted by similarly situated investment fiduciaries in a manner consistent with common law trust principles of the prudent exercise of fiduciary duty. By responding to the known uncertainties concerning the risk return profile of fossil fuel assets, hundreds of institutional investors have divested their funds from fossil fuel assets as a prudent response to protect their respective funds from what the Federal Reserve Board of San Francisco has described as a known market failure. Furthermore, time is of the essence. By divesting now, the Fund's assets are more likely than not to be shielded from the uncertainty of whether or not sudden and erratic market adjustments will create devastating losses for the fund as the transition to a low carbon economy continues to unfold. For these reasons we support this bill and divestment as an approach to ensure that the NYS Common Retirement Fund can continue to deliver on its promise to provide benefits to secure the future of the Fund's beneficiaries and their families.

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[11] See Carbon Tracker Initiative, "Unburnable Carbon: Wasted Capital and Stranded Assets," available at https://www.carbontracker.org/reports/unburnable-carbon-wasted-capital-and-stranded-assets/.

[12] Id. At 2; Also see

[13] See Rob Davies,The Guardian,"Norway's $1 trillion wealth fund to divest from oil and gas exploration," March 8, 2019 available at https://www.theguardian.com/world/2019/mar/08/norways-1tn-wealth-fund-to-divest-from-oil-and-gas-exploration.