As the systemic risks facing the global economy due to climate change become increasingly clear, leaders in the investment community have begun to emphasize the links between consideration of environmental, social, and governance (ESG) factors and investment decisions that minimize financial risk for individuals, governments, and markets.

CLEE’s Climate Risk Initiative, working with the Principles for Responsible Investment (PRI)—an international network of investors focused on supporting ESG integration—today released a roadmap for California leaders to advance this effort.

California has long led the nation in innovative climate, public investment, and corporate governance policy, and just last week Governor Newsom announced the California Climate Investment Framework, which begins to integrate climate risk strategy across state investment entities. And California will continue to occupy a leadership position as federal direction remains unclear.

Earlier this month, the Commodity Futures Trading Commission (the federal agency that regulates US derivatives markets) issued a report that marks the first large-scale recognition by a federal financial regulator of the risks to financial markets posed by climate change. Dave Jones, former California Insurance Commissioner and current director of CLEE’s Climate Risk Initiative, is a member of the subcommittee that crafted the report.

At the same time, the Department of Labor (with significant opposition) is proposing to limit the extent to which managers of federally regulated pension plans can consider ESG factors in their investment decision-making—evidently confusing ESG integration (which seeks to maximize investment performance based on the known long-term risks) with impact investing (which seeks to leverage capital to achieve goals in the real economy). While ESG integration may achieve many of the same goals as impact investing, its purpose is to protect investors, pension holders, and the broader economy.

While federal action is uncertain, California can take several steps to reduce risk for residents and the statewide economy. The California Roadmap, which Dave Jones and I co-authored (in coordination with PRI) based on expert interviews with leaders from throughout the state’s economy, offers over 40 recommendations for state legislators, financial regulators, public pension funds, and private investors to better integrate ESG issues in investment decision-making throughout the state. Key recommendations include:

- Requiring all publicly traded California companies to conduct climate risk disclosure in accordance with the Financial Stability Board’s Task Force on Climate-related Financial Disclosures.
Directing all financial and investment advisors to ask retail investors about their preference in ESG-aligned investment opportunities, and to offer them those opportunities if desired.

Conducting climate risk stress testing for all financial institutions and insurers licensed in the state.

Adding ESG-related disclosure requirements for projects funded by state financing authorities.

Many of these recommendations build on leadership already taking place at the state and local level in California. CalPERS and CalSTRS, which together manage hundreds of billions of dollars of pension fund dollars on behalf of state employees, have led their peers in disclosure of climate-related financial risks and divestment from risky carbon-intensive assets, while recent legislation requires California public corporations to maintain a minimum number of women on their boards of directors. Other recommendations build on Governor Newsom’s executive order directing greater alignment between state investment and infrastructure decisions and climate policy. In each case, they focus on minimizing the financial risks posed by climate change and other emerging ESG issues, and maximizing the potential financial opportunities of a transforming economy.

You can download the roadmap here.