

Inspired thinking



Reflections on the management of climate change risks and opportunities in the investment community

Introduction

On 12 and 13 October 2006, major European pension funds, consultants and asset managers met in Paris at the Institutional Investors Group on Climate Change (IIGCC) conference, entitled Managing Investments in a Changing Climate. The conference provided an opportunity for investors to consider the risks and opportunities presented by climate change, to review the contribution that has been made to date by institutional investors and to map out the future direction for investor action on climate change.

Background

IIGCC – which now has 31 European members representing around €2.5 trillion of assets – is a forum for pension funds and asset managers to collaborate to address the investment risks and opportunities associated with climate change. The group seeks to promote better understanding of the implications of climate change for financial performance and to encourage the integration of climate risks and opportunities into investment decision-making and dialogue with companies and policymakers.

At the time of the first IIGCC conference in 2003, investor interest in climate change was beginning to grow: a number of fund managers had established dedicated teams to engage with companies on climate change issues; several broker reports had been published focusing on the policy risk from climate change; fund managers were starting to integrate climate change into their valuations of electricity utilities; and a number of the major investment

consultants had started to expand their research processes to assess fund managers' approaches to integrating environmental, social and corporate governance issues within investment processes.

Since then, there has been significant progress, driven, in particular by the European Union's Emissions Trading Scheme (EU ETS). In the sectors covered by the EU ETS (e.g. electricity utilities, cement), the cost of carbon is now a standard part of the evaluation of companies by investors both on the buy side and the sell side. The past three years have also seen collaborative initiatives strengthen, tools for analysing the investment implications of global warming develop, and consensus grow that investors need to engage with public policy and act as advocates for reductions in greenhouse gas emissions. Addressing climate change is increasingly seen as an integral part of trustees' fiduciary duty and as an appropriate issue for trustee attention.

Collaboration on climate change

There is a growing sense that investor collaboration on engagement, research and public policy can make a real and substantive contribution to efforts to reduce greenhouse gas emissions. As just one example, BP stated that the invitation for Lord Browne (the BP CEO) to speak at the IIGCC's 2003 conference had helped to create the impetus for BP to review and develop its policies and strategies on climate change. This, in turn, led the company to increase its investments in alternative energy generation, including the investment in, and development of, hydrogen-based electricity generation facilities around the globe.

The conference

Despite the very significant progress over the past three years, the conference attendees also recognised that current investment decision making and share ownership activities do not fully account for the risks and opportunities presented by climate change. Perhaps most significantly, much climate change-related investment research focuses on the implications of regulation directed at reducing greenhouse gas emissions, with relatively little attention being paid to the other routes by which climate change can impact on companies (in particular, through the physical impacts of climate change).

In addition, most investment research focuses on the implications of climate change for equity and, to a lesser extent, corporate bond investments. Other asset classes have, as yet, to receive the same level of attention and, therefore, the implications of climate change for investment portfolios as a whole remain relatively unexplored. The assessment of investment risks and opportunities is made more difficult by the general inadequacy of corporate disclosure on greenhouse gas emissions, and the significant uncertainties in the future direction of climate change policy.

Four priority areas

The conference identified four priority areas for action: corporate engagement, public policy engagement, investment research, and the better integration of climate change into investment mandates. Some of the key actions identified were:

- The focus of investors' engagement with companies needs to move beyond simply requesting more or better disclosure to encouraging companies to set management responsibilities for climate change, to make commitments to greenhouse gas emission reductions, to integrate climate change considerations into their business strategies and to support public policy efforts to significantly reduce greenhouse gas emissions.
- Investors need to play a more active and public role in the climate change debate. This requires that

investors communicate their support for public policy measures directed at achieving significant reductions in greenhouse gas emissions and at allowing society to adapt to the physical impacts of climate change. With such a policy framework in place, investors will have greater confidence in investing in low carbon technologies, energy efficiency and other measures to reduce emissions.

- The investment community – asset managers, pension funds, investment consultants and other advisers – needs to work together to ensure that investment mandates and fund manager payment schemes are structured to reward not only short-term performance but also the degree of integration of climate change analysis into fund managers' investment decision-making and engagement processes.
- Investors need to work together to share information and to incentivise research on the risks and opportunities of climate change and climate policy.

Conclusions

The conference concluded by calling on other investors to join the Institutional Investors Group on Climate Change (IIGCC) and to sign the IIGCC Investor Statement on Climate Change, which was launched at the conference. The Statement represents perhaps the most significant call by UK and European investors for action on the threat posed by greenhouse gas emissions. Its signatories commit to strengthen their focus on climate change in their investment processes and to actively engage with companies and governments to develop appropriate policy solutions to climate change. [See the article entitled 'Investor Statement on Climate Change that explains more about the Statement.]

The full conference report, *Managing Investments in a Changing Climate*, is available at [<http://www.iigcc.org/docs/PDF/ManagingInvestmentsChangingClimateIIGCCconferencereport.pdf>]. The report was prepared by Rory Sullivan (Head of Investor Responsibility at Insight Investment) .

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The IIGCC Investor Statement on Climate Change can be found at:

<http://www.iigcc.org/docs/PDF/Public/FirstInvestorStatementonClimateChangeReport.pdf>