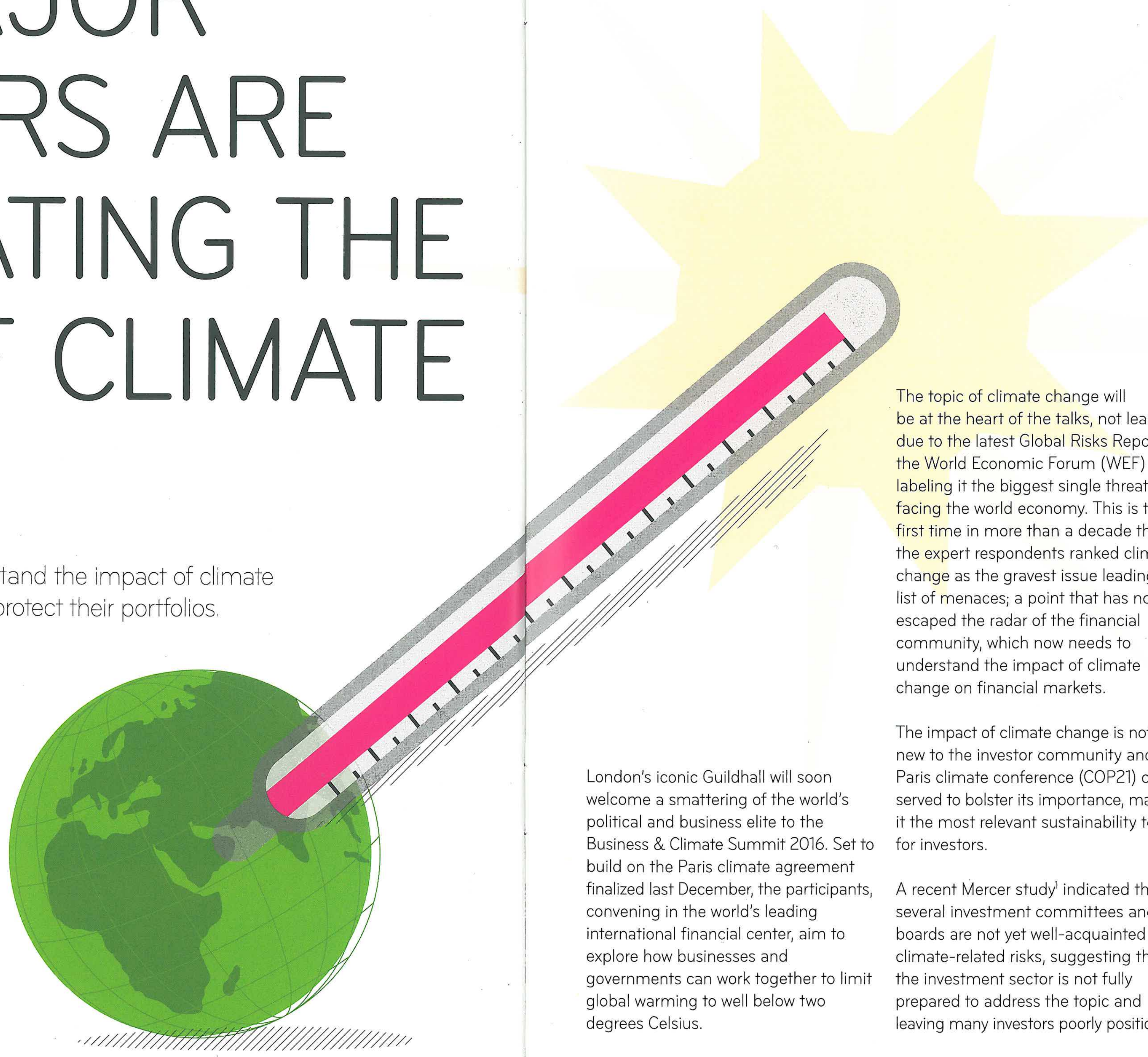
Renat Heuberger
CEO, South Pole Group

» HOW MAJOR INVESTORS ARE ANTICIPATING THE RISKS OF CLIMATE CHANGE

The financial community needs to understand the impact of climate change and how they can take action to protect their portfolios.

"THIS IS THE FIRST TIME IN MORE THAN A DECADE THAT THE EXPERT RESPONDENTS RANKED CLIMATE CHANGE AS THE GRAVEST ISSUE"



London's iconic Guildhall will soon welcome a smattering of the world's political and business elite to the Business & Climate Summit 2016. Set to build on the Paris climate agreement finalized last December, the participants, convening in the world's leading international financial center, aim to explore how businesses and governments can work together to limit global warming to well below two degrees Celsius.

The topic of climate change will be at the heart of the talks, not least due to the latest Global Risks Report by the World Economic Forum (WEF) labeling it the biggest single threat facing the world economy. This is the first time in more than a decade that the expert respondents ranked climate change as the gravest issue leading the list of menaces; a point that has not escaped the radar of the financial community, which now needs to understand the impact of climate change on financial markets.

The impact of climate change is nothing new to the investor community and the Paris climate conference (COP21) only served to bolster its importance, making it the most relevant sustainability topic for investors.

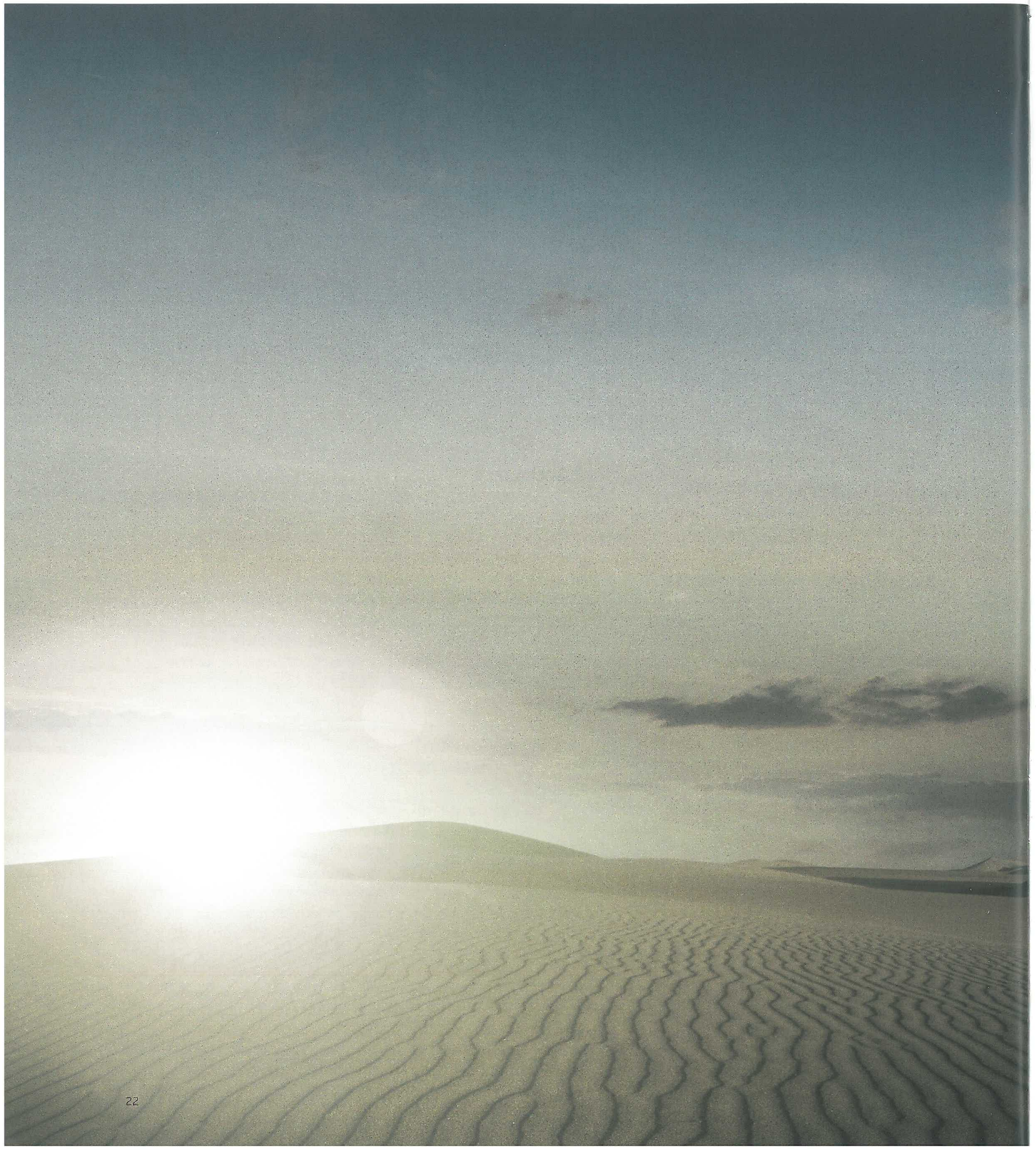
A recent Mercer study[1] indicated that several investment committees and boards are not yet well-acquainted with climate-related risks, suggesting that the investment sector is not fully prepared to address the topic and leaving many investors poorly positioned.

This, in turn, leads to a series of questions investors need to start asking themselves: Are my portfolios exposed to fossil fuels adequately valued? How quickly can I adapt? The risks faced by investors will also be linked to the timing and scope of new policies. If new changes are well-anticipated, investors can prepare for their impact. Getting caught off guard is certain to be accompanied by potential losses.

A typical 'progression' has started to develop on this topic among mainstream investors; many have engaged in activities to better understand their impact on the climate and to create transparency within their investment processes. For instance, Öhman, the Swedish asset management firm entrusted with managing assets worth SEK 39 billion (about USD 4.5 billion), conducted a comprehensive portfolio carbon footprint with South Pole Group to better understand its portfolio's exposure to carbon risk. A signatory of the Montréal Carbon Pledge, Öhman has been able to engage with internal and external stakeholders on the topic of climate change to a much greater degree, leading to a mutual understanding of problems and contribution to the development of solutions.

1. Mercer, "Investing in a Time of Climate Change", June 2015

"THE BUSINESS CASE FOR CLIMATE-SMART INVESTMENT IS GROWING"



While the Montréal Carbon Pledge encourages investors to commit to understanding and publicly disclosing the carbon footprint of their investment portfolios on an annual basis, the next step is taking action in the form of decarbonizing a portfolio. This is what the Portfolio Decarbonization Coalition is all about; this multi-stakeholder initiative aims to drive GHG emissions reductions on the ground, and is currently overseeing the decarbonization of 600 billion US dollars in assets under management.

The increasing number of signatories to such pledges supports the growing business case for climate-smart investment. The cost of inaction has recently been given a price tag of 4.2 trillion US dollars – a sum roughly on par with Japan's entire GDP. Depending on what type of climate scenario unfolds, the average annual returns from, for instance, the coal industry could shrink by anywhere between 18% and 74% over the next 35 years. This poses the risk of assets tied to fossil fuel deposits becoming obsolete, or stranded, when they cannot be extracted and sold.

The action to minimize the possibility of stranded assets has taken the form of divestment and engagement: following the vocal divestment movement, KLP, Norway's largest manager of pension funds, among others, has decided to sell off all its investments in companies that derive 30% or more of their revenues from coal-based operations. Nonetheless, outright divestment is only one way to deflate the growing carbon bubble; it's a single jigsaw piece in a larger puzzle.

Another equally important approach is to entice companies to move into the direction of a low-carbon economy by changing the way they do business. The UK-based Hermes Investment Management, one of the leading engagement firms, uses smart data from South Pole Group to bring up climate strategy topics with its investees. Toronto-based research firm Corporate Knights goes one step further: together with strategic partners, the company recently launched the Decarbonizer platform, enabling anyone to easily determine the impact a divestment from fossil fuels three years ago would have had on fund or index performance. Using this metric, the platform found that the Gates Foundation would have been better off by 1.9 billion US dollars if it had divested from fossil fuels. This has been further compounded by new research findings conducted by Waterloo University.

Reducing carbon emissions has become a global objective, and, as we can see, market participants have embarked on a 21st century quest for fully tailored solutions to decarbonize portfolios and address long-term climate risks. One of the main challenges in this process is nonetheless the availability of granular analysis of companies' carbon footprints and their impact upon climate through the entire supply chain. This is the gap that low-carbon indices have started to fill, STOXX being a great example: by combining data from South Pole Group and CDP, STOXX has built the comprehensive STOXX® Low Carbon index family, catering to different investor needs. These indices direct and encourage investments into companies with lower emissions within their sector – and track the companies' reporting through CDP.

Taking on a 'wait and see' approach will invite real danger into portfolios as risks grow and become tougher to mitigate. Embracing smart solutions and sustainable investment approaches will help get investors ready for a more carbon-constrained world and its financial implications. As the gathering at London's Guildhall also reminds us, the global economy is truly starting to pivot around the necessity to limit global warming to well below two degrees Celsius. «