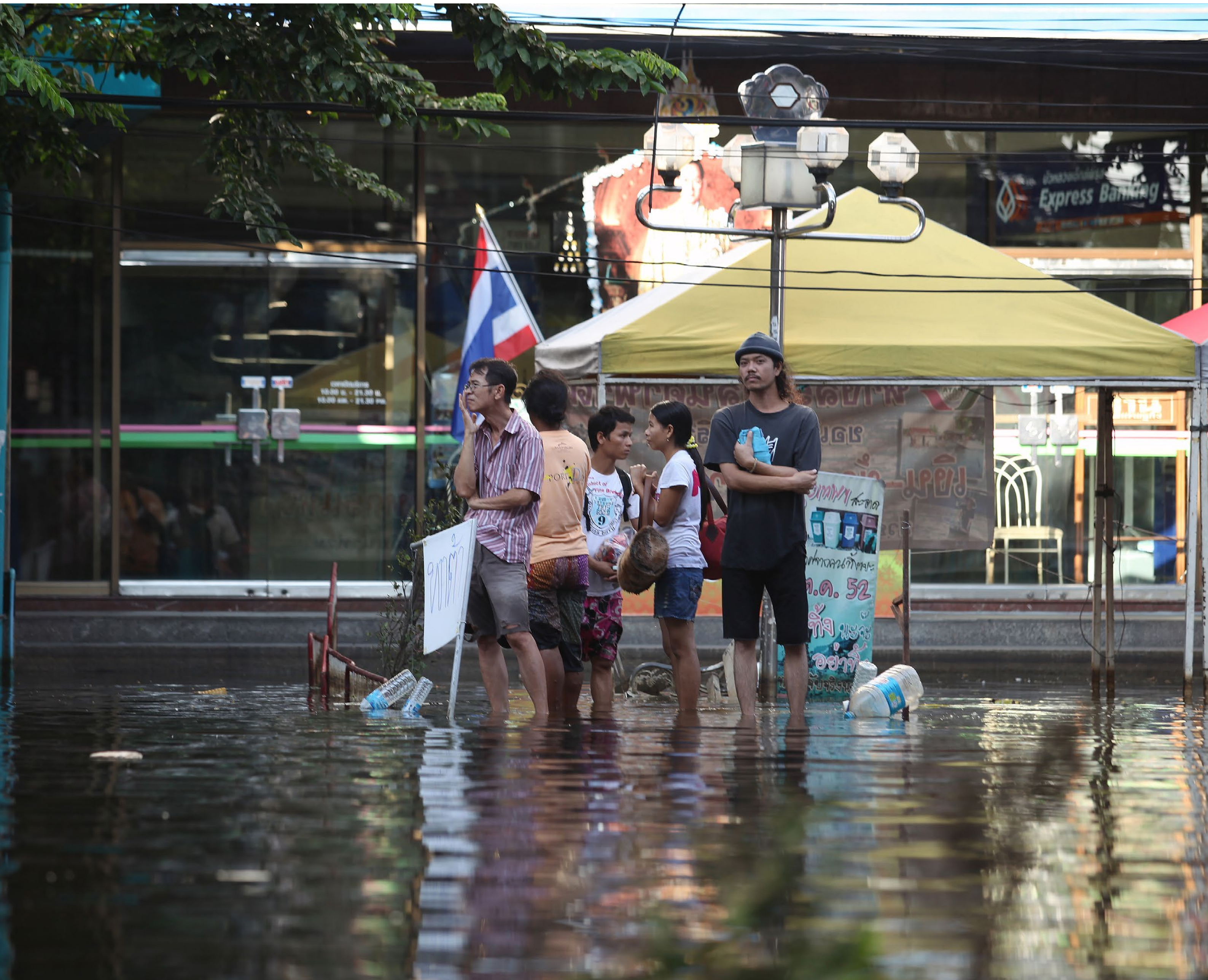
Sector Deep Dive

SustainAbility Transparency Network

Finance: Climate Risk

By **Sarah Volkman**

Part of **Common Threads: Designing Impactful Engagement**



Introduction

As the impacts of climate change continue to escalate globally, the real and potential financial and economic risks become more apparent. Extreme temperatures continue: 2017 was the hottest year on record, and wildfires, droughts and floods resulted in historic levels of billion-dollar disasters in the U.S..[1, 2]

Driven by a growing understanding of how the financial and economic consequences of climate change can be influenced by the financial sector, a broad range of stakeholders are advocating for increased action from banks, investment managers, and insurers.

With many trillions of dollars under management in the financial sector, there is an opportunity to make a significant impact. The financial sector has in turn begun to increase integration of climate risk into its decision-making and products and leverage its position to influence companies to address their societal impacts.

Stakeholder input has taken a variety of forms on this topic. At a global level, the 2015 Paris Agreement represents an intention from nearly 200 countries to address climate change and has driven significant momentum for the financial sector to address climate risk. Despite the U.S. withdrawal from the Paris Agreement, government action globally and industry-led initiatives like the Task Force on Climate-related Financial Disclosures (TCFD) indicate continued interest in addressing climate risk. At the same time, consumers, especially women and millennials, are driving demand for investment products that reflect their environmental and social values, which includes addressing climate risk.[3] Institutional investors including the public pension fund CalSTRS have committed to investing in low-carbon indices.[4]

Companies step up

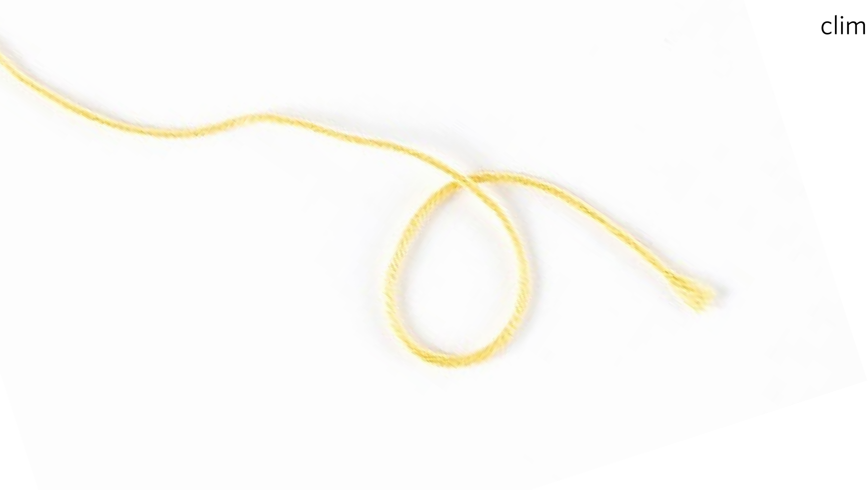
Companies in the financial sector have been increasingly responsive to stakeholder demand for addressing climate risk.

A number of companies are acting on this concern through formal partnerships, while others are individually helping to mitigate climate risk beyond their own companies through:

→ Industry-led Initiatives like the TCFD, established by the Financial Stability Board, provide guidance for how the private sector can understand climate risk and encourage enhanced disclosure of climate risk in financial reporting. As of December 2017, 150 financial firms have publicly committed to support TCFD.[5]

→ Climate Action 100+ is an institutional investor-led initiative focused on engaging companies to curb greenhouse gas emissions, improve governance on climate change and provide more transparent climate-related financial disclosures.

→ ClimateWise, a coalition of leading insurance industry organizations, leads an annual assessment of each member that helps inform regulators and the broader financial markets on how the insurance market is responding to climate risks.

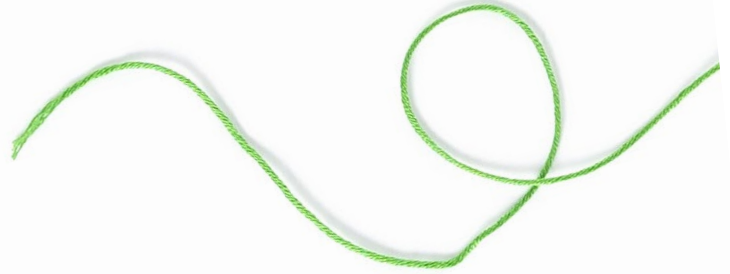


Financial companies are also responding to stakeholder climate risk concerns with new products that offer options for investors to choose to invest in companies that have a smaller carbon footprint. Green bonds markets are expected to increase by 30% in 2018, and sustainable and impact investing, which addresses climate risk broadly, has almost doubled from 2012 to 2016, largely driven by demand from customers in Europe.[6] In addition, companies including HSBC and MSCI are offering low-carbon funds and indices, and many companies are offering ESG targeted funds that exclude fossil fuel and energy companies.

Overall, expectations of the finance sector's responsibility for addressing climate risk are rising. Some of the largest institutional investors, including BlackRock, Vanguard and State Street now include climate risk in their investment stewardship engagement, and BlackRock also encourages companies to report against TCFD recommendations. In the past two years, for the first time, shareholder resolutions asking for increased levels of climate risk transparency with an understanding of 2-degree scenario analysis are passing with majority votes, especially for oil and gas companies.

Notably, institutional investors with $5 trillion worth of assets co-filed a shareholder proposal calling on Exxon Mobil to assess and disclose the company's climate risk, and it passed with 62% of the vote.[7]

Case Studies



State Street

Engaging with portfolio companies

State Street began engaging with its portfolio companies to proactively address climate risk in 2014. As of 2017, State Street has engaged with nearly 200 companies, of which 30% are in the energy and utilities sector.[8]

With holdings in more than 10,000 companies, State Street has the ability to influence company board decisions through dialogues as well as proxy voting and shareholder resolutions requesting that companies provide disclosures on climate-related risk.

In addition to engaging in dialogue with companies about climate risk and explicitly including climate risk in its Investment Stewardship Guidelines, State Street is using its vote to send a clear message. In 2017, State Street voted in favor of climate-related disclosures 61% of the time, significantly more often than peers of similar asset size, according to 50/50 Climate Project, a nonprofit group that tracks key climate votes.[9]

State Street's engagement strategy appears to be successful. It has noted "most of the insurance companies that we spoke to in 2017 reported that their board members have been increasingly active in learning about and discussing the implications of climate change on their business strategies."[10]

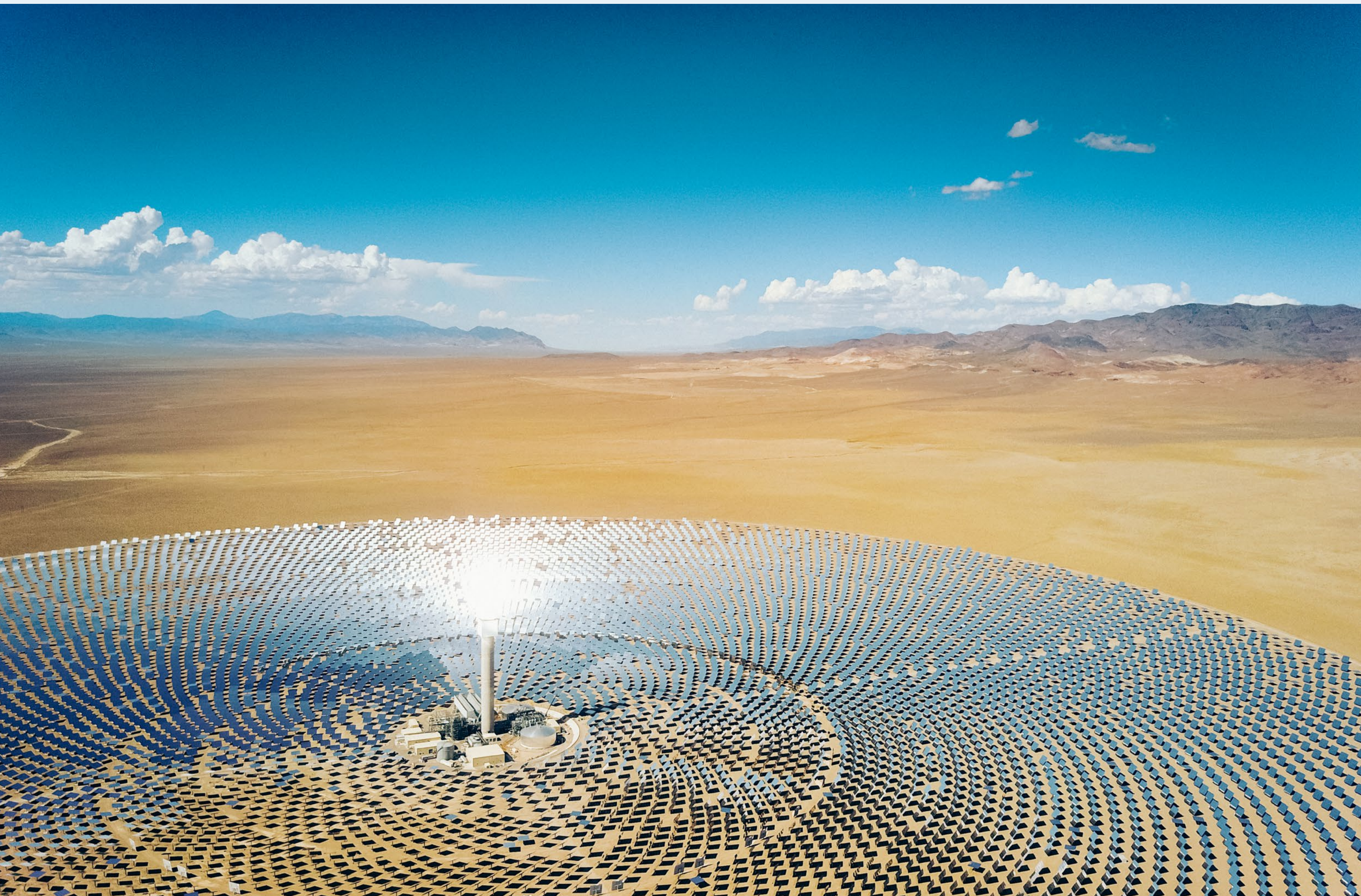
Most of the insurance companies that we spoke to in 2017 reported that their board members have been increasingly active in learning about and discussing the implications of climate change on their business strategies.

HSBC

Developing lower carbon products for institutional investors

In 2017, HSBC developed two new products that were designed to address climate risk in investment by decreasing the carbon footprint of the investment portfolio. The products include the Global Lower Carbon Equity Fund and the Global Lower Carbon Bond Fund.

HSBC developed these new products in response to increasing demand from customers, both institutional and individual investors, for investment options that address climate risk. HSBC research indicates that 68% of institutional investors plan to increase their investment in low-carbon funds within the next year.[11] With the creation of these lower carbon funds, HSBC is also responding to potential regulatory requirements that could pose potential financial risks to investors. In the case of a carbon tax, as one example, a portfolio weighted heavily in fossil fuel companies could affect the investment.



Task Force

Task Force on Climate-related Financial Disclosures

The Task Force on Climate-related Financial Disclosures (TCFD) is an industry-led initiative that is taking the lead in providing guidance to both the finance sector and the broader business community.

In June 2017, TCFD released recommendations for climate-related disclosures that are intended to be used by companies in providing information to investors, lenders, insurers and other stakeholders.

The momentum behind TCFD speaks to the mutual need for a sector-wide collaborative effort on climate risk that addresses the needs of NGOs, government regulators, and companies inside and outside the financial services sector. Many types of stakeholders are using TCFD as a galvanizing tool to advocate for disclosure on climate risk. CDP, for example, has aligned its 2018 questionnaire with TCFD's recommendations, alongside introducing a sectoral focus and adopting a forward-looking approach to climate-risk disclosure. Among financial companies who have integrated TCFD into their reporting practices already are the Royal Bank of Scotland in its Approach to TCFD and Morgan Stanley in its 2017 Sustainability Report.

Initial response has been strong, but further education and advocacy will be necessary. According to research from the Climate Disclosures Standards Board and CDP, only 34% of the 1,500+ respondent companies are considering physical risks associated with climate change beyond six years and just 28% are considering regulatory risks in that same period.[12]

Recommendations for companies

→ **Connect with your peers**
Climate change is a complex problem that can't be solved by one company alone. Look to initiatives and coalitions like TCFD and Climate 100+ for guidance.

→ **Partner with your colleagues**
Explore how you can have influence through your business model (e.g. developing climate products for customers, engaging with portfolio companies through Investment Stewardship).

→ **Start the conversation**
You don't have to have all the answers to set up an event, host a panel, or begin a dialogue with your stakeholders.

Looking ahead

As the physical and financial impacts of climate change continue to rise, we expect to see the corporate sector step up.

Climate change presents significant financial risk to individuals, companies and national and global economies. The finance sector is uniquely positioned to engage its stakeholders to address climate risk at a scale that could have an enormous impact. Interest in and demand from stakeholders will only continue to grow as the impacts of climate change become more apparent, and the role that the financial sector can play in addressing climate risk will continue to rise.

References

[1] http://www3.weforum.org/docs/WEF_GRR18_Report.pdf

[2] https://www.climate.gov/news-features/blogs/beyond-data/2017-us-billion-dollar-weather-and-climate-disasters-historic-year

[3] *"U.S. Trust Survey and BlackRock Survey."* https://www.forbes.com/sites/michelegiddens/2018/07/05/demographic-trends-are-driving-demand-for-impact-investment-and-the-industry-is-starting-to-adapt/#4f52d0d74264

[4] https://www.unpri.org/climate-change/low-carbon-investing-and-low-carbon-indices/3283.article

[5] https://www.fsb-tcfd.org/wp-content/uploads/2017/12/TCFD-Press-Release-One-Planet-Summit-12-Dec-2017_FINAL.pdf

[6] *"Interview with Michael Baldinger, Head of Sustainable and Impact Investing, UBS".* https://www.google.com/search?q=ubs+ interview+with+michael+baldinger&oq=ubs+interview+with+michael +baldinger&aqs=chrome..69i57.8337j0j4&sourceid=chrome&ie=UTF-8#

[7] https://www.nytimes.com/2017/05/31/business/energy-environment/exxon-shareholders-climate-change.html

[8] https://www.ssga.com/investment-topics/environmental-social-governance/2018/07/annual-stewardship-report-2017.pdf

[9] https://www.ft.com/content/48ad5476-a6aa-11e7-ab55-27219df83c97

[10] https://www.ssga.com/investment-topics/environmental-social-governance/2018/07/annual-stewardship-report-2017.pdf

[11] http://www.ftseglobalmarkets.com/news/two-lower-carbon-funds-launched-by-hsbc-global-asset-management.html

[12] https://www.cdsb.net/sites/default/files/tcfd_preparedness_report_final.pdf

SustainAbility