Managing Climate-Resilient Portfolios - A Case Study for Investors

Topic of the month March 2015

The combined effects of severe weather fluctuations and risks to natural resources pose a severe economic threat- one that has not gone unnoticed by investors. This year marked a dramatic shift in investor action towards climate change, driven in part by pressure from public figures like Christine Lagarde, managing director of the IMF, and UN General Secretary Ban Ki Moon.[1, 2]

Days before the UN Climate Summit in New York was convened in September, nearly 350 global institutional investors representing over USD 24 trillion in assets signed the Investor Statement on Climate Change, intended to spur climate action and facilitate a global climate agreement.[3] A few days later, Swedish pension giant AP4 was in the lead in announcing the Portfolio Decarbonization Coalition, a multi-stakeholder initiative committed to decarbonizing USD 100 billion of institutional equity investments.[4] Similarly, the Montreal Carbon Pledge, a parallel initiative, was also announced in September. Signatories of the initiative, which include some of the world's biggest institutional investors, commit to measure and publicly disclose the carbon footprint of their investment portfolios until the COP climate conference in Paris next year.[5]

Understanding carbon risk exposure

Investment carbon footprinting enables quantification and management of greenhouse gas emissions and is the first step towards understanding an investor's impact on climate change. This is done by measuring and/ or estimating the quantities and assessing the sources of various greenhouse gas emissions that can be directly or indirectly attributable to the activities of the invested organization.

The exercise reveals the invested organization's carbon footprint and breaks it down to the investment level. This is a measure of the impacts of the organization on the environment in terms of the GHG volume produced in its everyday operations, expressed as tons of carbon dioxide (CO_2) equivalents emitted, usually on an annual basis. The exercise provides the basis for constructing, optimizing or de-risking an investment portfolio based on climate impact, as well as reporting and positioning of an investment product or house towards stakeholders.

Acting on climate impact assessments

One way investors can reduce their exposure to carbon-risks is to divest from emission-heavy sectors or companies with poor climate policies. Norway's largest manager of pension funds ($84bnAuM), KLP, has decided to sell off all its investments in companies that derive 50 per cent or more of their revenues from coal based operations. South Pole Carbon assisted in calculating these coal-based related revenues and provided further company-specific analysis. Upon divesting, KLP will instead invest half-a-billion kroner (around USD 75 million) in renewable energy ventures.

For many of our clients, divesting from companies that derive a significant portion of their profits from unsustainable business practices is a matter of ethics. For all investors, however, investment climate impact constitutes material

performance risk: An increasing amount of companies globally, including in China, are being forced to pay for their greenhouse gas emissions, which impacts company value and hits investments.It is, however, not all about risk but also about investment opportunities. When done well, an investment impact assessment helps investors pick those companies that will likely outperform their peers in times of climate change and increased environmental legislation.

The threat of divestment builds up pressure on carbon–intensive sectors and companies. The decision of the heirs of the Rockefeller oil fortune for example to divest from fossil fuels over climate change gained substantial public recognition.[6] At this stage however, many investors shun divestment, and for the time being prefer to hold their assets. They use the institutionalized power of their ownership to engage with companies in order to encourage positive change within the organization.

The combination of divestment coupled with parallel engagement efforts by fund managers like Skandinaviska Enskilda Banken (SEB, a Swedish Bank) have put climate change on the corporate agenda. South Pole Carbon is pleased that its services have helped the Swedish Bank identify targets for engagement.

We believe, whether investors choose to divest, engage, or hedge their investments in renewable energy, the important thing is that they act - the sooner the better.

yourSRI - Carbon Portfolio Screener

The innovative and easy to use Portfolio Carbon Screener by yourSRI and South Pole is an online based tool, which allows investors to easily understand their investments' climate impact. The tool helps to minimize climate change related risks and recognize investment opportunities. It also enables climate impact screenings of bond portfolios.

YourSRI.com allows investors to screen any equity and corporate bond portfolio online. On YourSRI.com, the investor simply uploads identifiers and sector weightings and then downloads an investment carbon footprinting report. The analysis includes overall portfolio emissions, sector and detailed company analysis. Moreover, most sustainable mutual funds can be found pre-screened for their carbon footprint on YourSRI.com. Finally, the tool also calculates an overall cost of externalities and allows for automatic emission reductions in developing countries.

YourSRI.com is endorsed by the Montreal Pledge to used by investors for reporting their greenhouse gas emissions. More information: yourSRI Fact Sheet

Footnote and References:

1) *http://www.ft.com/intl/cms/s/0/26e3e6d4-5095-11e4-8645-00144feab7de.html*
2) *http://www.un.org/apps/news/story.asp?NewsID=46995#.VInL2mTF840*
3) *http://investorsonclimatechange.org*
4) *http://www.unepfi.org/fileadmin/documents/PortfolioDecarbonizationCoalition.pdf*
5) *http://montrealpledge.org/*
6) *http://www.theguardian.com/environment/2014/sep/22/rockefeller-heirs-divest-fossil-fuels-climate-change*

Author:
Dr. Maximilian Horster
Partner,
South Pole Group

Maximilian Horster, Partner at the South Pole Group, has worked with many of the signatories of the Montreal Carbon Pledge, Portfolio Decarbonisation Coalition and Investor Statement on Climate Change to help measure and reduce their investment climate impact. - More information: www.thesouthpolegroup.com