AXA Investment Managers

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# Climate Change and Investment

The environmental impact we are having on the planet is highlighted in 2018's Global Risks Report by the World Economic Forum. Three of the top five risks are environmental, and all have a higher-than-average likelihood of occurrence. It is time for governments and businesses to seize the initiative and pave the way for new opportunities.

The finance sector has the potential to champion a more holistic approach to investing that keeps both financial and environmental returns top of mind.

When the Paris Agreement on Climate Change was signed in 2015, 195 countries agreed to attempt to keep global temperatures "well below" 2°C above pre-industrial levels, and to "endeavor to limit" them to 1.5°C. Most signatories focused on the 2°C figure, which was a significant strengthening of previous ambitions.

Fast-forward to Oct. 2018, and The Special Report on Global Warning by the Intergovernmental Panel on Climate Change (IPCC) is approved by governments ahead of the Katowice Climate Change Conference in Poland in December. The report cites more than 6,000 scientific references and the dedicated contribution of thousands of expert and government reviewers worldwide.

Limiting global warming to 1.5°C will have huge benefits, the report concludes, as warming of 2°C will significantly increase the risks of climate change – floods, sea level rise, extreme heat, drought and poverty – for hundreds of millions of people.

**The scale and pace of change required to limit warming to 1.5°C is unprecedented**

Meeting the climate target will not be easy; the IPCC notes it will require "rapid, far-reaching and unprecedented changes in all aspects of society." The International Energy Agency (IEA) estimates that around $3.5 trillion per year – about twice the current level of investment – must be invested between 2016 and 2050 just to keep the temperature rise to 2°C.

By 2030, four billion people are expected to be living in areas suffering from severe water stress, and by 2050, half of the world's population will lack sufficient access to water. Investment of an estimated €114 billion ($130 billion) per year is needed to meet water and sanitation investment needs by 2030, 60 percent of it in sub-Saharan Africa[1].

Helen Clarkson, CEO of The Climate Group, says "the time to act is now."

"This IPCC report calls for action not just from nations, but from businesses, state and regional governments and cities, precisely because the scale and pace of change required to limit warming to 1.5°C is unprecedented," she says "The path to decarbonising the economy has already begun. What we need to see now is the mobilisation of businesses and sub-national governments to act faster, with more ambition and urgency, than ever before."

## Investors Need to Reassess Assets

Dr Charles Donovan, Director of the Centre for Climate Finance and Investment at Imperial College, says: "There is a massive gap in climate finance investment because we have come to the realisation, really late in the day, that the largest pools of capital are held within the private sector. Without the participation of the institutional investor community, there is no chance of meeting our climate targets."

Initiatives such as the Taskforce on Climate-related Financial Disclosures (TCFD)[2] have ensured that investors are increasingly aware of the risks of climate change. Nevertheless, the U.N.-backed Principles for Responsible Investment[3] (PRI) warns that "there is an ambition gap to the Paris Agreement goal, based on the current policy trajectory."

**The size of the task is so great that we cannot regulate our way out of greenhouse gas emissions**

This situation may prompt what the PRI calls an "Inevitable Policy Response (IPR)" to close gaps in the Paris Agreement. This would mean stricter climate policies that "would immediately change how investors value assets and create a period of uncertainty and high volatility until investors are able to gauge the full impact of such announced, and then implemented, policies," notes the IPR.

But the size of the task is so great that we cannot regulate our way out of greenhouse gas emissions," warns Donovan. "While that worked for the ozone problem and acid rain, the relationship between emissions and the way the global economy operates is just too deep and systemic. We have to remake the energy sector, so we have to invest at an aggressive pace, to channel trillions of dollars into the transformation of energy."

In a first for a central bank, the U.K.'s Bank of England, has warned banks and insurers that they each need to appoint a senior executive to take responsibility for managing climate risks[4]. It is unlikely to be the last such alert; the announcement came just days after 18 central banks, members of the Network for Greening the Financial System, warned that the consequences of climate change are "system-wide and potentially irreversible if not addressed"[5].

## Building a Suitable Response

The combination of tighter regulation and the huge amount of investment required has made it crucial that investors understand the challenges and opportunities climate change presents.

This is becoming easier as our knowledge increases. Almost 500 of the world's largest companies have adopted targets as part of the Science-Based Targets initiative, and investors are starting to use similar tools, says Matt Christensen, Global Head of Responsible Investment at AXA Investment Managers.

"Investors will start to ask about the temperature of their aggregate portfolio. It's a way to make climate easier to understand and digest—an asset version of the Science-Based Targets," adds Christensen. "We will get to the point where people start to have a vernacular with which to compare companies on climate performance."

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Investors have started to explore a growing number of ways they can maximise positive social and environmental benefits. Asset owners are increasingly asking their asset managers for tools to enable them to make the switch.

This is where tools such as TCFD come in, because they bring an element of standardisation to the process. Harmonisation and transparency are important. At present, disclosure is

still mostly voluntary and selective.

"We need a list of questions that we can ask all industry players, so their responses are easily comparable," says Christensen. "Currently, it's fatiguing for us and for the companies themselves."

## Being Part of the Solution

As well as seeking to improve companies' performance, investors can also invest in the solutions to climate change – renewable energy technologies such as wind and solar, energy efficiency and storage, as well as the wider infrastructure and services that support them.

Demand for clean technologies is driven by a mix of government regulations, consumer support and corporate demand. Some of the world's biggest companies, including Ikea, Anheuser-Busch InBev, GM and Mars, have signed the RE100 initiative, pledging to source all their electricity from renewable sources.

Targets such as these are driving astonishing growth in corporate purchases of renewable energy, with 7.2GW of clean energy power purchase agreements signed in the year to August, compared to 5.4GW in the whole of 2017. The 152 RE100 signatories alone have committed to buy more clean power annually by 2030 than California's entire electricity demand today[6].

Although climate-friendly investing might seem straightforward, there is still a need for greater clarity on what constitutes green investment. For example, asset owners are keen to invest in low-carbon infrastructure like hydropower, however, its impacts in terms of displacing communities and destroying habitats continues to be debated.

**There are currently around $228,1bn in assets under management within impact investments**

One way to address this issue is by impact investing – where there is an explicit aim of generating positive, measurable social and environmental impact along with a financial return. While still a minor part of the market, this sector is growing fast.

There are currently around $228,1bn in assets under management within impact investments, according to the Global Impact Investing Network's 2018 Annual Impact Investor Survey. This is up from $46bn in 2014, and has likely been boosted by the U.N.'s Sustainable Development Goals – a global effort to pursue an agenda for sustainable economic growth and address social needs including education, health, social protection and job opportunities, while also tackling climate change and other environmental issues, with the aim of meeting targets by 2030.

The SDGs represent such a huge agenda that no single company can tackle them on its own. Collaboration is key, and a number of initiatives have been launched to tackle climate change and other issues.

## Shifting the talk to risk and return

Climate Action 100+ focuses on engaging the world's largest greenhouse gas emitters, while the Investor Agenda enables investors to report on the actions they are taking on climate change. Some 392 investors with $32 trillion in assets collectively under management are using the Investor Agenda to highlight climate action they are already taking, and making new commitments.

"We are trying to provide a clear evidence base so that the talk is about risk and return, not commitment and ambition. We are building a good base, but we are way behind because we spent the first 20-30 years of this challenge not having these types of conversation," says Imperial's Donovan.

**It's no longer enough for companies to just use negative screening to exclude harmful companies.**

"There is still a lack of awareness in most organisations. Even in the forward-looking institutions that have invested the time in understanding the issue, there are still deep pockets of lack of knowledge. Many people are unaware of the technological disruptions that are already starting to happen."

"Investors are in a unique position to mitigate the threats of climate change," says Betty Yee, California State Controller and a board member of two of the biggest U.S. pension funds, CalPERS and CalSTRS. "With trillions of dollars under management globally, we can demand accountability from the largest corporate GHG emitters, and hold governments responsible for the impact of their decisions."

In order to make a difference, active, positive engagement will need to become hygiene. It's no longer enough for companies to just use negative screening to exclude harmful companies. As AXA IM's Christensen says: "That's a very blunt instrument. Going forward, success will be in shifting major industries, like oil and utilities, to pathways that are fit for a world that is carbon-constrained but able to sustain growth."

Ultimately if the world is going to achieve its climate change goals, businesses are going to have to fundamentally change what they do and how they do it. But, in order to do so, they will require financing. For investors this will mean fresh ways of thinking, different ways of acting and new areas of opportunity.

**FOOTNOTES:**

[1] European Investment Bank: Sustainability Awareness framework presentation, July 2018
[2] https://www.fsb-tcfd.org/
[3] https://www.unpri.org/climate-change/the-inevitable-policy-response-to-climate-change/3578.article
[4] https://www.bankofengland.co.uk/-/media/boe/files/news/2018/october/pra-consults-on-its-expectations-for-the-management-of-financial-risks-from-climate-change.pdf?la=en&hash=D2C1AD2854024009989560B4B54ED66E34CF1331
[5] https://www.banque-france.fr/sites/default/files/media/2018/10/11/818366-ngfs-first-progress-report-20181011.pdf
[6] https://about.bnef.com/blog/corporations-already-purchased-record-clean-energy-volumes-2018-not-anomaly

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