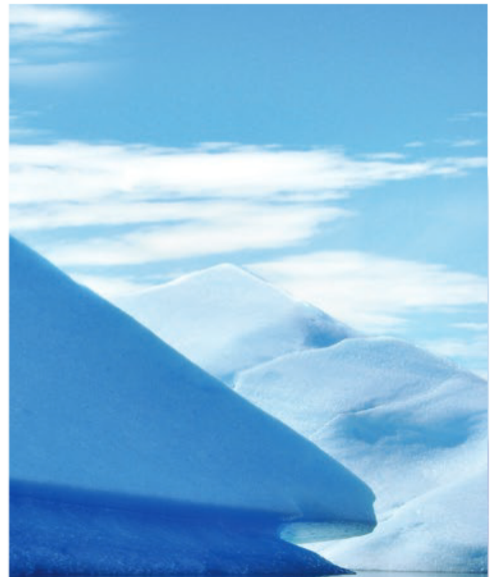
Investor Brief on Climate Risk



Climate change is a critical economic, political and moral issue for society as a whole, and presents a formidable challenge for long-term institutional investors. Foundations, pension funds, religious institutions and others are concerned not only with the security of their funds and the prospects for expected investment returns in light of climate risk, but also with its impact on the world around them. How can they align their investment practices to deliver on their mission, whether it be the payment of retirement benefits decades into the future or the philanthropic goals of a foundation? The measures that long-term investors can take to address climate risk are wide-ranging and vary by fund size, composition and objectives. The investment decisions made by institutional investors today, and in the near future, will play a crucial role in determining how society fares in the face of climate change.[1]

Due to its scale, complexity and universality, climate change will inevitably alter the way business is done. In 2010, national governments from around the world (including Canada) determined that future warming should be kept below 2 degrees Celsius to avoid the most catastrophic impacts of climate change.[2] To achieve this goal, greenhouse gas (GHG) emissions must be dramatically reduced leading up to the year 2050. According to some estimates, between 60 to 80% of proven fossil fuel reserves (coal, oil and gas) would have to remain in the ground in order to stay below the established global warming limit.[3]

Institutional investors are exposed to risks from climate change in many different ways and stakeholders, including beneficiaries and members of the public, are pressing them to address those risks. The physical, economic, regulatory and reputational risks of climate change extend beyond high profile carbon-intensive industries; the need to limit GHG emissions and develop resilience in the face of climate impacts is shared across the economy. Numerous approaches can be used to address climate risk in an investment portfolio, from increasing exposure to low-carbon assets, to engaging with corporations on the reduction of their GHG emissions, to divestment from specific companies or sectors. These approaches are not exclusive; together they can reinforce the ultimate aim of keeping global warming below dangerous future levels.

Signals from the global economy on climate risk and the shift to a low carbon economy:

- Bank of England Governor Mark Carney has called for a study on the financial risks of stranded assets – fossil fuel reserves deemed unburnable to keep global temperature rise below 2 degrees[4]
- The world's second largest pension fund, Norway's Government Pension Fund Global, has begun excluding companies based on their contribution to climate change, including 32 coal companies[5]
- According to Bloomberg, investment allocations to renewable energy has increased – clean energy investments beat expectations in 2014, up 16% from the previous year (total of US$310 billion)[6]
- MSCI has launched a family of low carbon indices last September at the behest of Sweden's AP Fund 4, France's FRR and Amundi Asset Management to support the transition to a low carbon economy[7]
- 365 institutional investors representing more than US $24 trillion in assets have signed the Global Investor Statement on Climate Change, calling for a global carbon price and climate agreement[8]

FEBRUARY 2015

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Suggested steps to better understand and address climate risks in institutional investment portfolios

No matter the size of the fund, management of assets, or whether investments are in pooled or aggregated funds, institutional investors can examine and mitigate exposure to climate risks as well as leverage opportunities in the transition to a low carbon economy. The steps below are some of the ways investment decision-makers can assess and begin to address climate risk.

1 DISCUSS: Develop your fund's understanding of climate risks and opportunities

- Conduct board or committee-level discussions on climate risks and opportunities
- Seek expert help on understanding climate risks and opportunities
- Examine how your investment beliefs relate to climate change:
  - How do fund decision-makers believe climate risks may affect the fund's portfolio's long-term value?
  - What do decision-makers believe about the opportunities to effectively mitigate climate risks?
- Develop investment policies that address climate change

2 ANALYZE: Assess how your fund is currently exposed to climate risks and opportunities

- Measure the fund's carbon footprint:
  - What is the current GHG impact of the investments in your portfolio?
  - How is it changing?
  - How can it be reduced?
- Publicly commit to initiatives such as the Montreal Carbon Pledge, Portfolio Decarbonization Coalition or Asset Owner Disclosure Project (see below), which commit the fund to measuring and reducing the carbon footprint of its investments or assessing its portfolio's alignment with a low-carbon economy

3 PRIORITIZE: Incorporate climate risk considerations in asset manager selection and monitoring

- Confirm that climate change considerations are integrated into the investment management process for prospective and current asset managers or service providers
- Align compensation structures to provide incentives for long-term investment performance
- Require managers to include a discussion of climate risks and opportunities in regular monitoring reports:
  - What is the potential impact of carbon pricing on high carbon or high climate-impact sector assets?
  - Does this investment increase or decrease our carbon footprint?
- Establish an investment mandate on climate risk to have asset managers or service providers to identify opportunities – across asset classes – to invest in renewable energy and other prospects that support the transition to a low carbon economy.

4 IMPLEMENT: Encourage companies to improve climate risk management and reduce GHG emissions

- Engage with companies on management and disclosure of climate performance indicators:
  - Has the company set targets to cut its GHG emissions?
  - How does the company factor in a future price on carbon when making expenditure decisions for long-term projects?
- Support shareholder engagement and proposals that encourage companies to improve energy efficiency, plan capital expenditures with the climate in mind, reduce GHG emissions, and limit political lobbying against effective climate regulations

5 ADVOCATE: Raise climate change policy with government and policymakers

- Call on policymakers and regulators to take measures to provide clear and long-term regulatory stability and incentives to encourage investments in renewable energy and increase the supply of low-carbon investment products:
  - What are policymakers doing to support the implementation of effective carbon pricing and the phasing out of fossil fuels subsidies?
- Join investor initiatives calling for global climate policy and action

Some initiatives for institutional investors to consider:

- Sign the Global Investor Statement on Climate Change http://globalinvestorcoalition.org
- Endorse the Montreal Carbon Pledge http://montrealpledge.org
- Join (or ask your asset manager to join) the Portfolio Decarbonization Coalition http://unepfi.org/pdc
- Participate in the Asset Owners Disclosure Project http://aodproject.net
- Join SHARE's engagement program www.share.ca/services/shareholder-engagement

For more information and other resources, see SHARE's website: www.share.ca/climate-risk

SHARE's Approach to Climate Change

SHARE helps institutional investment decision-makers implement investment practices that promote sustainability, good governance and respect for human rights and the environment. Climate risk is integrated across the range of SHARE's active ownership services, including proxy voting analysis, shareholder engagement, policy development and investor education. SHARE is helping its clients to develop responsible investment policies, vote their shares, identify and understand the impacts of their investments, engage collectively with companies to improve practices, and advocate for sustainable capital markets at the policy level.

SHARE's approach to addressing climate risk is based on the understanding that to tackle climate change, we need to shift our whole economy to a low-carbon economy. We can contribute to that shift by implementing SHARE's four "R" approach: Reduce, Remedy, Reallocate, and Regulate.

- **Reduce:** Reducing the demand for carbon-intensive energy is a critical part of shifting to a low carbon economy. Reductions in energy use and greenhouse gas emissions by individual companies also save money and indicate efficient management of resources.
- **Remedy:** While in the longer term addressing climate risk will require shifting energy sources, in the shorter term many environmental and social risks in the energy industry still require immediate remedies. For example, energy companies create risks from waste generation, excessive water use, the release of particulate matter or methane emissions, and the transport of oil and gas to markets. Some shareholders also prioritize engagement with energy companies in support of First Nations' rights.
- **Reallocate:** Shifting capital into low-carbon sources (e.g.: renewable energy companies and infrastructure, energy efficient buildings, green bonds) is a key ingredient for limiting global temperature increases. As industries shift to cleaner energy sources, investments in training and employment for workers in resource-dependent communities must be made as well.
- **Regulate:** To support appropriate capital allocation decisions that address climate change and shift to a low-carbon economy, companies and investors depend upon market regulations and policy frameworks. Better policy and regulations are essential to keeping global warming at levels necessary to avoid the most disastrous impacts of climate change.

Shareholder engagement facilitates dialogues between investors and companies on key environmental, social and governance (ESG) issues that have the potential to reduce risks and improve corporate performance. Climate risks exist across the entire portfolio, so SHARE's engagement program not only addresses fossil fuel industries; it also focusses on a range of energy-consuming industries and major GHG emitters. Companies have the opportunity to reduce GHG emissions, to reallocate capital expenditures from high- to lower-emitting projects, to remedy operations where environmental and social risks are present and to disclose their participation in political lobbying regarding climate regulation.

SHARE's current engagement plan incorporates three major themes for addressing climate risk at Canadian companies:

1. **Measuring and disclosing real climate risks:** Working to increase corporate disclosure regarding emissions and management of climate risks so that investors can better measure and understand the short-term impacts of their operations as well as their longer-term resilience to climate risks.
2. **Reducing greenhouse gas emissions in high-emissions sectors:** Facilitating dialogue with targeted companies on reducing the emissions intensity of their operations as well as development and implementation of targets for overall reductions in GHG emissions.
3. **Addressing the financing of climate risk:** Engaging with Canada's banks to establish measurable targets for their financing of the renewables sector and to report on how their loans and other financial services contribute to greenhouse gas emissions.

For more information on SHARE's engagement program, proxy voting support or other services, contact:

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1 http://www.unepfi.org/fileadmin/publications/cc/IPCC_AR5__Implications_for_Investors__Briefing__WEB_EN.pdf
2 http://unfccc.int/meetings/cancun_nov_2010/meeting/6266.php
3 http://www.iea.org/publications/freepublications/publication/English.pdf; http://www.carbontracker.org/report/wasted-capital-and-stranded-assets
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