committee on workers' capital

investor brief

## contents



### Quick reference guide

**Climate change**: result of increased greenhouse gas emissions from human activity leading to more extreme weather events and impacts

**Climate change-related investments**: for pension funds, assets that reduce or eliminate emissions such as clean energy projects, energy and material efficiency and environmental resources investments

**Climate-related investor risk**: physical, regulatory, competitive, reputational, and litigation risks that pension funds could face as a result of climate change impacts and regulations

**Workers' capital**: assets accumulated in collectively funded schemes in order to provide workers with financial security in their retirement

# Climate Change Risks and Opportunities for Investors

## OVERVIEW

Addressing climate change risks and opportunities is an important responsibility for pension funds. Investments in assets that address climate change can help shift workers' capital from short-term to long-term investments that can responsibly meet liabilities while also creating decent jobs and supporting a sustainable future. With more than USD30tr in assets under management globally, pension funds have the resources and interest to provide backing for suitable green bonds, clean energy infrastructure funds and environmentally-focused equity indices that meet both prudential and responsible investment criteria. According to research from the International Trade Union Confederation (ITUC) and the Trade Union Advisory Committee to the OECD (TUAC), pension funds' could direct as much as USD 300bn toward addressing climate change by 2015 if larger pension plans were able to allocate up to 5% of their portfolio to a diversified pool of climate change-related assets.[1]

### Climate change and the need for investment

Climate change is the result of the increase in greenhouse gas concentrations in the atmosphere generated by human activities. Climate change is leading to an increase in the frequency and intensity of extreme weather events, as well as long-term transformation in weather patterns. If emissions are left uncontrolled or only marginally reduced, climate-related risks, including catastrophic events, will increase further, exposing millions of people and the economy at large.

To avoid this scenario, major transformations will have to be undertaken in the production and delivery of goods and services in the coming years. Governments alone will not be able to raise the level of financing needed to adequately address climate change. Financing from pension funds (and other institutional investors) can help provide the necessary additional capital to meet climate change challenges while also creating decent jobs and build workers' retirement savings over the long-term.

**What is a climate change-related investment?**

There is no real consensus on the definition of climate change-related investments; the distinction between broad definitions such as 'green investment' and climate change mitigation and adaptation specifically is not always clear. Climate mitigation refers to actions taken to eliminate or reduce greenhouse gas emissions, while adaptation refers to activity taken to moderate potential damage by climate change and help communities respond to climate-related events.

The majority of adaptation measures will not fit a private sector approach – i.e. a market-based return on investment – and will need to be financed by grants and public money, even if some specific adaptation projects could be undertaken through micro-credit and community-based insurance systems.

For this reason, pension funds and other institutional investors' investments in climate change will primarily focus on mitigation projects, such as:

- clean energy (power generation, transport),
- energy & material efficiency (building retrofits, power grid efficiency, recycling, waste heat recovery, etc.), and
- environmental resources (forestry, agriculture efficiency, waste management).

Climate change mitigation projects can be financed across different asset classes; there is no single or preferred asset. Bonds, equity and indices of listed securities are possible vehicles, as are private funds (such as clean energy infrastructure funds), direct investment (private company, real estate, lands) and credit (renewable energy credit or carbon credit).

**Investor risks & opportunities**

Climate risks are a material concern for long-term investors, and ensuring that these risks are properly assessed in pension funds is an important role for trustees. Assets can be exposed to physical risks from the direct impacts of climate change, regulatory risk in carbon-intensive industries, competitive risks as companies prove to be more or less proactive in addressing climate change, as well as reputational and litigation risks.[2]

Projections based on business-as-usual scenarios – where climate risks are not addressed – predict severe impacts for the financial sector. The UK Institute and Faculty of Actuaries released a report in early 2013 indicating that pension fund assets could be greatly undermined by resource constraints arising from climate change if action is not taken to manage these risks.[3] The economic decline that institutional investors may face as resources are impacted by climate change could reduce pension funds significantly.

Climate-related investments can provide fund portfolios with some protection against climate risks while offering long-term, sustainable investment options. The time horizon for climate change assets lines up well with the length of time pension funds need to accumulate capital to finance workers' retirements.[4] While trustees face pressure to show short-term returns, there is a growing consensus – including at the level of G20 heads of states[5] – on the need for workers' pension money to shift from short-term to long-term investments and to help promote responsible investment practices. Climate change-related investments can also provide a hedge against carbon-intensive assets that could be suddenly impacted by carbon pricing or regulatory policy.

Investments in climate change mitigation can also help create new jobs. A report from the International Labour Organization indicates that overall gains in employment are possible in the shift to a greener economy, in the range of 15-60 million additional jobs across the globe.[6] It is important that this shift is accompanied by a 'just transition' for workers, including "decent and green jobs", social protection, skills development, rule of law and democracy and economic diversification for regions that might suffer from the transition towards sustainability.[7] Appropriate climate investments have the potential to bring sustainable, long-term returns for institutional investors alongside good jobs and economic security for workers while supporting a stable environment.

*As the stewards of substantial workers' capital, pension fund boards make allocation decisions that have significant implications for progress towards a low-carbon economy.*

**Pension fund leadership**

Leadership from pension funds and trustees can help ensure that workers' capital is aligned to address climate risks and support a sustainable future. As the stewards of substantial workers' capital, pension fund boards make allocation decisions that have significant implications for progress towards a low-carbon economy. In addition, they can call on governments to address major barriers found on the demand side of the climate investment equation.

A number of large trade union pension funds have proven leadership on addressing climate change, including Danish ATP, Dutch ABP and PGGM, US CalPERS and CalSTRS, Swedish APs and several Australian funds.[8] Major investor networks have issued climate change statements,[9] action plans[10] and other proposals, including the Climate Bond initiative from the Network for Sustainable Financial Markets and the Carbon Disclosure Project.[11]

There is room for growth in climate change-related assets. According to OECD estimates, less than 1% of pension funds assets globally are allocated directly to infrastructure investment, let alone to clean energy projects.[12] Another recent OECD survey covering 52 large public and private sector pension funds totalling USD 7.7tr AUM shows that infrastructure (green or otherwise) accounts for just 0.5% of portfolio.[13] There are, however, significant barriers that need to be addressed to support pension funds in this shift.

Limited access to climate change investment products is one such obstacle. Depending on definition issues, the valuations of the green bond market range in USD16-200bn, "a drop in the ocean" of the +USD95tr world bond markets.[14] Annual green bond issuances (i.e. the net inflows) are in the range of USD1-2bn (compared with some USD6tr worth issuances of normal bonds).

In the short term, government guarantees on financial assets, such as green bonds and on clean energy investment funds, can help pension funds move in this new direction. The most common form of government guarantee is the public guarantee on the credit default risk of a green bond. Government support for climate change-related investments can take other forms: subsidized low-interest direct loans, export credit insurance and facilities, foreign exchange risk insurance and subsidized support services to investment deals.[15] Climate policy and financing supports need to be properly structured to facilitate pension funds' contribution to climate change-related investments.

*Pension funds and their trustees can take proactive steps; they have an important role in seeing that climate risks and opportunities are integrated into investment decision-making to ensure that future liabilities can be met.*

## WHAT PENSION FUND TRUSTEES CAN DO

Current political and regulatory uncertainty and government inaction pose some barriers to expanding climate change investments. More needs to be done at the international level to ensure regulatory frameworks are consistent with climate change objectives (especially binding commitments to reduce carbon emissions which will translate into an appropriate price on carbon) and help build investor confidence for the long-term financial performance of climate change assets. But pension funds and their trustees can take proactive steps; they have an important role in seeing that climate risks and opportunities are integrated into investment decision-making to ensure that future liabilities can be met.

# ACTIONS:

### *Development a formal statement or position on climate change to help drive further decisions and actions and communicate with plan members*

- Have a discussion at the Board/committee level on climate change risks
- Establish a formal statement on climate change for your fund (as an overarching policy and/or incorporated into investment beliefs, mandates, etc.)[16]
- Communicate with plan members on the need to enhance investment policies to address climate change as a material issue[17]

### *Assess the fund's current capacities and practices for addressing climate change*

Climate change projects have specific risks that need to be mapped out, clearly understood and monitored.[18] Some classes of asset and investment vehicles – infrastructure funds and asset-backed securities – require strong in-house pension funds expertise and access to data.

- Map out the fund's in-house management capacities and expertise and role of outside consultancies
- Review your portfolio holdings to determine where greater exposure to climate risks would be best managed[19]

### *Incorporate climate considerations in asset manager selection and monitoring*

Asset managers play a key role in the integration of climate risks and opportunities in your fund's investment management.

- Survey investment managers at selection phase and during ongoing assessments as to how climate change is integrated in investment management processes[20]
- Align reward structures to provide incentives for ong-term investment performance
- Have service provider include climate risks in regular monitoring reports

### *Define and communicate with plan members on a multi-year roadmap*

The roadmap would set a gradual shift in the portfolio composition including a stated objective of overall exposure – for example, 5% in four years' time[21] – and per asset class (infrastructure funds, green bonds, sustainable-themed equities, etc.)[22]

- Ensure the roadmap, as prepared by the board, is shared by key stakeholders and communicated to plan members
- Set up metrics and regular reporting instruments to measure progress in implementing the roadmap

### *Encourage companies to improve climate risk management*

Beyond the roadmap, ensure that the fund's investor encourage invested companies to address climate risk and improve both environmental outcomes and financial returns.

- Consider climate change when making key decisions on asset allocation strategy[23]
- Engage companies on management of climate change risks and opportunities[24] and request (further) climate disclosure from companies, through participation in the Carbon Disclosure Project and other climate change initiatives
- Participate in shareholder engagement initiatives on climate change through the UN PRI clearinghouse or other investor networks, proxy voting campaigns, etc.

### *Raise climate change policy with governments and policymakers*

As stewards of workers' capital, it is crucial that trustees and funds demand clear and coordinated international climate policy to ensure a prosperous future for workers globally.

- Call on policymakers and regulators to take measures to reduce barriers and increase the supply of appropriate climate-related investment products, including:
  - implementing climate policy – in particular through economy-wide emission reduction objectives and carbon pricing – to encourage low-carbon investment and identify true costs of carbon-intensive assets
  - taking on the risk of investments through government-backed green bonds
- Join climate change investor initiatives for global climate policy and action

## Conclusion

Climate change-related investments can provide pension funds with long-term responsible investment opportunities that will help address climate risks and stimulate job creation. Pension funds have the potential to invest an estimated USD 300bn to climate change-related assets by 2015 based on the current financing opportunities available, but governments need to help by improving the flow of appropriate climate investment products. Trade union trustee and pension fund leadership on climate change investment and risk assessment is needed to ensure long-term, stable returns for pension funds as well as a secure and sustainable future for workers.


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# KEY RESOURCES FOR TRUSTEES

### Trade unions

International Trade Union Confederation (ITUC) – Just Transition:
http://www.ituc-csi.org/what-s-just-transition.html

- Provides the rationale, meaning and examples of "Just transition" policies

Sustainlabour (International Labour Foundation for Sustainable Development)
http://www.sustainlabour.org

- Initiative to involve trade unions in environmental debates, integrate labour issues in the environmental agenda, and encourage changes in favour of labour & the environment

### Non-government organizations

World Wildlife Fund
http://wwf.panda.org/

- Global initiatives on climate change as well as sustainable finance

Greenpeace
http://www.greenpeace.org/

- Campaigns on climate action, impacts and solutions

### Tools for climate risk best practices

Asset Owners Disclosure Project (AODP) and the Climate Institute.
*Climate Change Best Practices Methodology.*
http://aodproject.net/index.php/best-practice

- a step-by-step guide and toolkit designed to assist funds in designing and implementing a program that will raise the standard of climate change management in their organization to the highest global industry benchmarks

Mercer Investment Consulting. (2011)
*Climate Change Scenarios – Implications for Strategic Asset Allocation*.
http://www.mercer.com/climatechange

- provides a framework to examine probable climate change scenarios that can assist institutional investors in risk management and strategic asset allocation processes

Australian Institute for Superannuation Trustees (AIST) & the Investor Group on Climate Change (IGCC).(2009)
*A climate for change II: A trustee's guide to addressing climate risk.*
http://www.igcc.org.au/resources/Documents/18.10.09_tpg_A_climate_for_change_II.pdf

- updated version of the 2005 Carbon Trust and IIGCC guide for Australian trustees, includes trustee's toolkit (starts p. 28)

### OECD facts & figures

OECD project on institutional investors and long-term investment
http://www.oecd.org/finance/lti

- in-depth policy research & analysis on pension fund investments in infrastructure, project co-sponsored by the Club of Long Term Investors, Dutch APG and Canadian CPPIB.

### Investor networks on climate change

- Institutional Investors Group on Climate Change (IIGCC): www.iigcc.org
- Investor Network on Climate Risk (INCR): www.ceres.org/investor-network/incr
- Investor Group on Climate Change ( IGCC): www.igcc.org.au;
- Asia Investor Group on Climate Change (AIGCC): http://aigcc.asria.org;
- Network for Sustainable Financial Markets (NSFM): www.sustainablefinancialmarkets.net
- Asset Owners Disclosure Project (AODP): http://aodproject.net
- CDP (Carbon Disclosure Project): www.cdp.net
- United Nations Principles for Responsible Investment (PRI): www.unpri.org

## Endnotes

**1** ITUC/TUAC, 2012. "What role for pension funds in financing climate change policies?" Joint TUAC - ITUC issues paper, May 2012 http://www.ituc-csi.org/what-role-for-pension-funds-in,12358.html

**2** AIST and IGCC, 2009, A climate for change II: A trustee's guide to addressing climate risk, http://www.igcc.org.au/resources/Documents/18.10.09_tpg_A_climate_for_change_II.pdf; UNEP, 2009, Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment, UNEP FI Asset Management Working Group. http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf; FairPensions, 2011, Protecting Our Best Interests: Rediscovering Fiduciary Duty. www.shareaction.org/rediscovering-fiduciary-duty

**3** The Actuarial Profession. 2013. Resource constraints: sharing a finite world. 17 January 2013. http://www.actuaries.org.uk/research-and-resources/documents/research-report-resource-constraints-sharing-finite-world-implicati

**4** ITUC, forthcoming. Raising International Climate Finance.

**5** G20-OECD work on long-term financing http://www.oecd.org/daf/fin/private-pensions/g20long-termfinancing.htm

**6** ILO/UNEP. 2012. Working towards sustainable development: Opportunities for decent work and social inclusion in a green economy. http://www.ilo.org/global/publications/books/WCMS_181836/lang--en/index.htm

**7** ITUC. What's Just Transition? http://www.ituc-csi.org/what-s-just-transition.html

**8** Find examples of best practices from these pension funds in the following: Mercer. 2012. Through the Looking Glass: How Investors are Applying the Results of the Climate Change Scenario Study. January 2012. http://www.mercer.com/climatechange; IIGCC, INCR & IGCC, 2012. Global Investor Survey on Climate Change: Annual Report on Actions and Progress 2011. http://www.iigcc.org/__data/assets/pdf_file/0020/15383/Global-investor-survey-on-climate-change-Final.pdf; PRI, UNEP FI, UN Global Compact. 2009. Investor leadership on climate change: An analysis of the investment community's role on climate change, and snapshot of recent investor activity. May 2009. http://www.unpri.org/viewer/?file=wp-content/uploads/climate.pdf

## Endnotes continued

**9** IIGCC, INCR, IGCC, UNEP FI & PRI. 2011. Global Investor Statement on Climate Change. http://www.iigcc.org/__data/assets/pdf_file/0017/15281/2011-Investor-Global-Statement-FINAL-NOT-EMBARGOED.pdf
**10** INCR. 2012. Investor Action Plan on Climate Change Risks & Opportunities. https://www.ceres.org/incr-2/investor-summit/summit-files/2012-investor-action-plan
**11** NSFM & CDP. Climate Bonds Initiative. http://climatebonds.net/
**12** OECD 2011, The role of pension funds in financing green growth initiatives OECD Working Papers on Finance, Insurance and Private Pensions, No. 10, September 2011. http://www.oecd.org/insurance/private-pensions/49016671.pdf
**13** OECD 2012, Trends in Large Pension Fund Investment in Infrastructure, Raffaele Della Croce1, OECD, December 2012. http://www.oecd-ilibrary.org/finance-and-investment/trends-in-large-pension-fund-investment-in-infrastructure_5k8xd1p1p7r3-en
**14** OECD 2012 The Role of Institutional Investors in Financing Clean Energy, Christopher Kaminker, Fiona Stewart, OECD, September 2012. http://www.oecd-ilibrary.org/finance-and-investment/the-role-of-institutional-investors-in-financing-clean-energy_5k9312v21l6f-en
**15** ITUC, forthcoming. Raising International Climate Finance.
**16** For climate policy examples, see: IIGCC/Carbon Trust, 2005 A climate for change: a trustee's guide to understanding and addressing climate risk. http://www.iigcc.org/__data/assets/pdf_file/0010/262/A_climate_for_change.pdf p. 22; and AODP/ Climate Institute. 2012. Climate Change Best Practices Methodology. http://aodproject.net/index.php/best-practice p. 75
**17** For investment policy suggestions, see: IIGCC/Carbon Trust, 2005 A climate for change: a trustee's guide to understanding and addressing climate risk. http://www.iigcc.org/__data/assets/pdf_file/0010/262/A_climate_for_change.pdf. p. 23
**18** For a climate change assessment template, see: Asset Owners Disclosure Project (AODP) and the Climate Institute. 2012. Climate Change Best Practices Methodology. http://aodproject.net/index.php/best-practice p. 11.
**19** For climate risk identification recommendations, see: AODP and the Climate Institute. 2012. Climate Change Best Practices Methodology. http://aodproject.net/index.php/best-practice p. 28.
**20** For examples of questions to ask your asset manager, see: IIGCC and Carbon Trust. A climate for change: a trustee's guide to understanding and addressing climate risk.
http://www.iigcc.org/__data/assets/pdf_file/0010/262/A_climate_for_change.pdf p. 25; and
INCR. 2010. Investors Analyze Climate Risks and Opportunities: A Survey of Asset Managers' Practices. January 2010. http://www.ceres.org/resources/reports/survey-of-asset-managers-practices-2010/view p. 33.
**21** For further analysis on 5% target, see: ITUC/TUAC, 2012. "What role for pension funds in financing climate change policies?" Joint TUAC - ITUC issues paper, May 2012 http://www.ituc-csi.org/what-role-for-pension-funds-in,12358.html. p.7.
**22** For guidance on risks and opportunities in each asset class, see Asset Class impact in: Mercer. 2011. Climate Change Scenarios–Implications for Strategic Asset Allocation: Public Report. February 2011. http://www.mercer.com/climatechange. p. 41.
**23** For asset allocation methodology, see: AODP and the Climate Institute. 2012. Climate Change Best Practices Methodology. http://aodproject.net/index.php/best-practice p. 19.
**24** For examples of questions to ask companies, see: Acclimatise, Henderson Global Investors, Insight Investors, RAILPEN Investments & USS. Managing the Unavoidable: Investment Implications of a Changing Climate. November 2009. http://www.uss.co.uk/Documents/Managing%20the%20Unavoidable%20-Investment%20implications%20of%20a%20changing%20climate%20Nov%202009.pdf p. 22



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