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Swiss Investment Foundation for Sustainable Development

Pension Funds and Climate Change Risks

New UK report urges pension funds to address climate change risk in their investment policy

The Institutional Investors Group on Climate Change (IIGCC), a collaboration between pension funds and other institutional investors among of which the ethos Foundation, representing £1,000 billion in assets, together with the Carbon Trust, a UK-government-funded body that helps companies cut harmful emissions, mandated Mercer Investment Consulting to prepare a guide for pension funds on tackling climate change risk. The final report, called **"A Climate for Change: A Trustee's Guide to Understanding and Addressing Climate Risk"**, was published on August 8th, 2005.

The guide is designed to raise awareness of the relevance of climate change as a financial issue and to demonstrate the opportunities that exist for pension fund managers to take action. It is a first in pension funds' approach to assessing long-term environmental and social risk.

According to the report, virtually all classes of pension assets have the potential to be affected by climate change. This will be felt either directly - for example in terms of damage to agriculture or real estate – or through policy-driven strategies to mitigate climate change, such as in the energy and automotive industries.

Five key areas of risk are identified:

- **Regulatory risk** - results from legislation such as the EU Emissions Trading Scheme on industry, and impacts most significantly on high emitting sectors such as manufacturing, electric power and oil and gas;
- **Physical risk** – caused by droughts, floods, storms and rising sea levels and affects sectors that are dependent on the physical environment such as insurance, agriculture, real estate, tourism and water;
- **Litigation risk** – companies responsible for large volumes of greenhouse gas emissions could be liable for damages associated with the physical effects of climate change;
- **Competitiveness risk** – given increased consumer awareness and rising energy costs, companies that take action to mitigate climate change may secure a competitive advantage. This could mean lower costs and higher profit margins or enhanced reputation or customer loyalty;
- **Reputational risk** – companies viewed negatively in terms of climate change due to their policies or pollution levels may face a backlash from consumers.

Following the identification of these risks, the report recommends and details **three distinct steps towards taking action**:

- Assess your understanding of the issues, develop your investment position and review your investment policy accordingly;
- Determine whether your investment approach reflects your position and policy, and check that your investment consultants and managers understand the issues;
- Consider options such as reviewing your portfolio holdings, active ownership strategies, or making specific investments.

The guide provides a step-by-step toolkit for pension funds seeking to address climate risk.

Ethos' approach to climate change

The ethos Investment Foundation is a member of the IIGCC that mandated the report. Ethos' investment approach, which integrates sustainable development principles, considers the risks and opportunities linked to climate change. Company's targets and programmes for CO_2 emissions reduction, energy consumption reduction, and increase in renewable energy are systematically taken into account as part of ethos' environmental and social analysis, and so is performance data on CO_2 emissions and renewable energy consumption. This information is provided to us by SiRi Company, the largest network of socially responsible investment research organisations. **Ethos therefore addresses the financial risk posed by climate change** by prioritizing companies that, as part of a wider environmental and social strategy, manage this risk relatively better than their peers.

Furthermore, ethos believes that for investors to appreciate companies' response to climate change and integrate these parameters in their investment strategy, corporations must report transparently on greenhouse gas emissions and climate change strategy. In light of this, **ethos has become a member of the Carbon Disclosure Project (CDP)**, a group of institutional investors representing $20,000 billion that collectively sign a single global request for disclosure of information on Greenhouse Gas Emissions. The CDP sends this request to the 500 largest companies in the world. 300 of the 500 corporations report their emissions through the CDP website, among which around 10 Swiss companies, and 45% believe climate change represents risk and/or opportunity. The latest information request (CDP 3) was sent out in February 2005 and results will be published on the CDP website in September 2005 (for more information see http://www.cdproject.net/).

Finally, ethos approves **shareholder proposals** calling for companies to report on greenhouse gas emissions, as was the case at Anadarko's general meeting in 2004 (28% support).

An eye on Swiss companies and Climate Change

In Switzerland, some companies have been taking a strong stance on climate change, addressing the issue internally by developing a group strategy, and participating to global stakeholder dialogue. By way of example, we mention two companies from the service and the industrial sectors respectively: Swiss Re and Holcim.

Swiss Re has set climate change as one of the "Top topics" shaping the future business environment. The company actively participate in the international negotiations of the United Nations Framework Convention on Climate Change, explores the use of international economic instruments for implementation of the Kyoto Protocol and promotes awareness for climate risks in the public and to its customers by the publication of various studies on the issue. Swiss Re produced its first climate change risk publication some 10 years ago. Furthermore, it is implementing a programme to become greenhouse neutral, combining a commitment to reduce Group CO_2 emissions by 15% with investments in the World Bank Community Development Carbon Fund to offset remaining emissions.

Holcim stands as another example of a Swiss company responding to the financial risks posed by climate change to its industry. Total emissions from cement production amount to around 5% of man-made CO2 emissions, the industry therefore could be strongly at risk if it does not start developing solutions today. In 2002, Holcim committed to reduce its global average specific net CO_2 emissions by 20% by 2010, based on its 1990 emissions on the belief that the need for cement continues to grow, particularly in developing countries, and that society should source these products from the companies that produce them most efficiently in terms of cost-effectiveness and environmental and social impact.

More generally, according to a forthcoming study on the environmental and social reporting of Swiss companies that will be published by ethos this autumn, about half of the 50 biggest Swiss corporations address at least briefly in their annual sustainability reporting some measures taken to tackle climate change such as reducing their GHG emissions or increasing their energy efficiency. Furthermore, around 20 companies provide data on greenhouse gas emissions, and a few companies recognise explicitly the financial materiality of climate change for their business; Swiss Re and Holcim, but also ABB, Georg Fischer and Sulzer count among the few examples of corporations that do so.

Useful links:

- Copies of the report "A Climate for Change: A Trustee's Guide to Understanding and Addressing Climate Risk", are available from the Carbon Trust by emailing carbontrust@fishburnhedges.co.uk or on the Carbon Trust website at www.thecarbontrust.co.uk
- Institutional Investors Group on Climate Change (IIGCC): www.iigcc.org
- Carbon Disclosure Project: www.cdproject.net