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Climate Change is a financial risk: Are you keeping up, or quietly increasing your professional liability?

Mike Clark

25 September 2018

Today's Agenda

- A question
- The policy and regulatory landscape: the UK and beyond
- The special case of climate change
- New DWP consultation on trustees' investment duties
- What are pension funds doing?
- How should we *think* about this?



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IFoA issued a Risk Alert on climate-related risks last year

How would you describe your level of engagement with it?

A: What Risk Alert?

B: I think a colleague may have mentioned it to me, but I've not taken any further action.

C: I've read the Risk Alert, and have a sense of what it says.

D: Prompted by the Risk Alert, I have integrated climate risk into some of my professional work.

E: No need for the Risk Alert – I was already doing that!



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Let's start with policymaking in the UK



House of Commons
Environmental Audit
Committee

Green Finance inquiry



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EAC Green Finance inquiry: Evaluation of responses from 25 largest UK pension funds

TOTALS FROM SAMPLE OF 25 LARGEST PENSION FUNDS	
Considered at Board level	12
Listed at least one action on climate risk	20
Discussed climate risk with actuary	12
Committed to report in line with TCFD	7
Considering whether to report in line with TCFD	8
No plans to report in line with TCFD	10
More engaged	11
Engaged	10
Less engaged	4

Source: House of Commons Environmental Audit Committee



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DWP Investment Regulations: Consultation *Trustees to set out their policy (in SIP)...*

- ...in relation to financially material considerations including...those arising from ESG considerations, including climate change
- ...in relation to the stewardship of the investments, including engagement with investee firms and the exercise of voting rights associated with the investment

And for DC schemes, Trustees to:

- prepare or update their default strategy to set out how they take account of financially material considerations, including those arising from ESG risks, including climate change

And then: Produce an implementation report setting out how they acted on the principles in the SIP

Source: Consultation on clarifying and strengthening trustees' investment duties (DWP, June 2018)



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PLSA: More Light, Less Heat



MORE LIGHT, LESS HEAT:
A FRAMEWORK FOR PENSION FUND
ACTION ON CLIMATE CHANGE
 DECEMBER 2017

Source: PLSA



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Read this!

WINNING CLIMATE STRATEGIES

PRACTICAL SOLUTIONS AND BUILDING
BLOCKS FOR ASSET OWNERS FROM
BEGINNER TO BEST PRACTICE

Based on interviews with 22 leading asset owners, this report explores the current best practice landscapes, identifies barriers, and presents a framework of ten building blocks for other asset owners introducing and developing climate strategies.

ShareAction»

ASSET OWNERS
DISCLOSURE PROJECT



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A day that changed the world forever



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Taskforce on Climate-related Financial Disclosures: Recommendations

Core Elements of Recommended Climate-Related Financial Disclosures



Source: TCFD

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What about Europe?



ARTICLE 173

- CADRE LÉGAL
- RISQUES ESG/CLIMAT
- APPROCHES ESG
- INDICATEURS DE PERFORMANCE
- OBJECTIFS & SUIVI



EU HIGH-LEVEL EXPERT GROUP ON
SUSTAINABLE FINANCE



EUROPEAN COMMISSION
Action Plan: Financing Sustainable Growth

Legislative proposals:

- Taxonomy
- Investor Duties/Disclosures: **Fiduciary Duty**
- Low carbon benchmarks
- Sustainability: advice/products

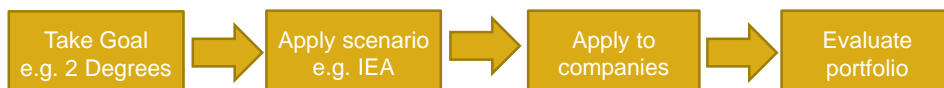


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Regulators in Switzerland and California

Assessing financial organisations' alignment with Paris goals



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Initiatives, Initiatives, Initiatives



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So what are pension schemes doing?

- Developing their investment beliefs, and investment strategy
- Reducing carbon exposure risk
 - HSBC, NEST
- Increasing focus on renewables, green bonds
- Devoting more resources to ownership activities
 - Ownership policy: voting, engagement, collective engagement
 - Monitoring of investment manager reporting on exercise of ownership
 - Pre-announcing voting intentions
- Public policy engagement



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Environment Agency Pension Fund

A policy exemplar

- ...the objective is to ensure that our Fund's investment portfolio and processes are compatible with keeping the global average temperature increase to remain below 2°C relative to pre-industrial levels...
- We have set ourselves three targets for 2020:
 - Invest 15% of the fund in low carbon, energy efficient and other climate mitigation opportunities.
 - Decarbonise the equity portfolio, reducing our exposure to “future emissions” by 90% for coal and 50% for oil and gas by 2020...as at 31 March 2015.
 - Support progress towards an orderly transition to a low carbon economy through actively working with asset owners, fund managers, companies, academia, policy makers and others

Source: EAPF



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Headlines from around the world: SDGs rule!

€45bn Dutch engineering pension scheme commits to Sustainable Development Goals

Sweden's biggest institutional investors commit to UN SDGs in investment approach

Six Danish pension funds back new SDG fund

Sustainable Development Goals will help ensure future pensions, says CalPERS

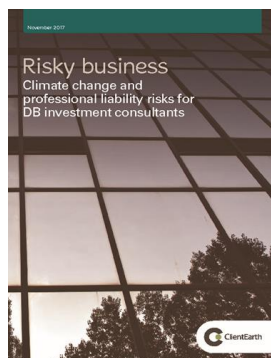
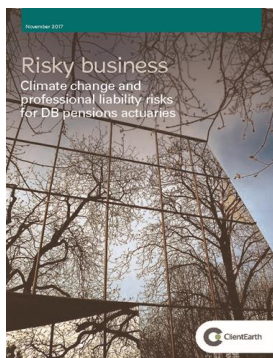
Source: responsible investor, various dates



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Risky Business: Actuaries, Investment Consultants, Auditors – liability risks



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All Swans are Black in the Dark

How good are financial markets at pricing long term risk?



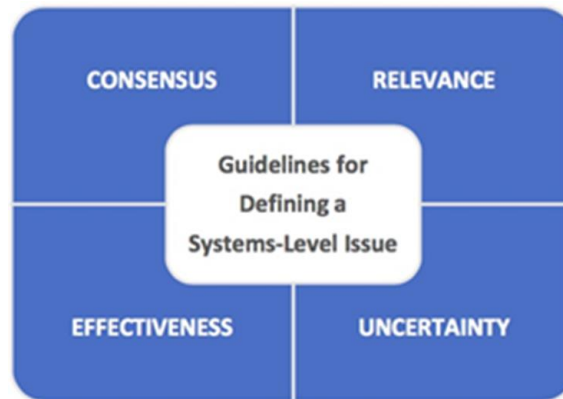
Source: Generation Foundation, 2 degrees Investing Initiative



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So what issues *should* investors consider?



Source: The Investment Integration Project
Systems-Level Considerations and the Long-Term Investor (Lydenberg)



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Two ways of thinking about the world *Is value the same as price?*



Finance Theory Metrics/Models

- beta, alpha
- Expected return, standard deviation, covariance
- Efficient Markets Hypothesis
- CAPM (Capital Asset Pricing Model)
- Tracking Error



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Modern Portfolio Theory v2.0?



Summary

- Climate change, a specific ESG/sustainability issue, is now mainstream
- Regulators and policymakers are moving forward
- Pension funds and other asset owners are growing their capabilities and developing their practice
- Greater focus on the SDGs is coming
- Do we need to evolve our thinking?
- **Might you view the Risk Alert any differently tomorrow?**



Questions



Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

