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Shame! Half the room hadn't heard of our Risk Alert on climate-related risks

Mike Clark



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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Today's Agenda

- The IFoA Risk Alert on climate-related risks
- How are policymakers and regulators responding to climate change?
 - UK and globally
- How are investors managing climate change risk (and opportunity)?
- What initiatives are in place?
- What are the lawyers doing?
- How might we develop our thinking about investments and risk?



IFoA Risk Alert

Supporting DB and DC Guides published, others to come



RISK ALERT Climate-Related Risks

KEY MESSAGE

Actuaries should ensure that they understand, and are clear in communicating, the extent to which they have taken account of climate-related risks in any relevant decisions, calculations or advice.

Source : IFoA, 12 May 2017



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A powerful global start



Key Goals of the Paris Agreement

- A strong signal to political and economic actors, everywhere
 - 2 degree goal, plus 1.5 degree aspiration
 - Nationally Determined Contributions
 - 5-yearly review process: ratchet effect
 - Art 2.1c on financial flows
- Has stimulated extensive policymaking and regulatory work at the national, regional and global level...
- ...which is accelerating



Task Force on Climate-related Financial Disclosures

Recommendations are generating extensive activity

Core Elements of Recommended Climate-Related Financial Disclosures



Governance

The organization's governance around climate-related risks and opportunities

Strategy

The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

Risk Management

The processes used by the organization to identify, assess, and manage climate-related risks

Metrics and Targets

The metrics and targets used to assess and manage relevant climate-related risks and opportunities

Source: TCFD



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Climate Change Act 2008 (UK)

- Requires government to set quinquennial carbon emissions budgets
- Established Committee on Climate Change
 - Provides independent advice to government
- Established an Adaptation Reporting Power (ARP), exercised by Defra
 - Quinquennial power, Round 3 (ARP3) is underway
 - Bank of England report on insurance and climate change (ARP2)
 - Expect ARP3 update from BoE
 - FRC, tPR and FCA invited by Defra to report under ARP3
 - (To date) FRC have confirmed they will report



Green Finance...Taskforce and EAC inquiry



House of Commons
Environmental Audit
Committee

Green Finance inquiry



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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:

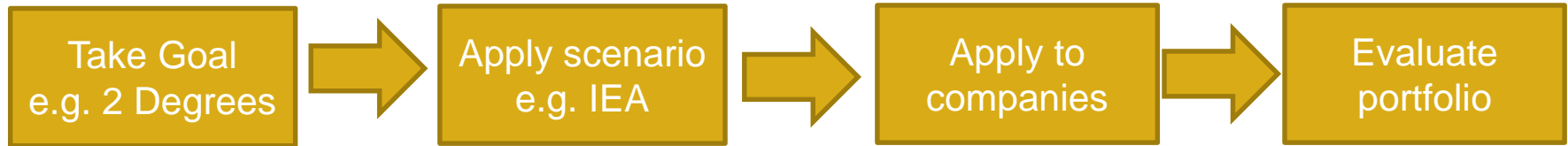
- **Taxonomy**
- **Investor Duties/Disclosures: Fiduciary Duty**
- **Low carbon benchmarks**
- **Sustainability: advice/products**



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Switzerland (Ins/Pen) and California (Ins) regulators

Assessing financial organisations' alignment with the Paris Goals



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BoE/PRA: Consultation on Draft Supervisory Statement

Banks and insurers: Managing financial risks of climate change well?

- Desired PRA outcome is that firms take a strategic approach to managing the financial risks of climate change
- PRA's proposed expectations cover:
 - Embed consideration of the financial risks in governance arrangements
 - Incorporate the financial risks into existing risk management practice
 - Use (long term) scenario analysis to inform strategy, risk assessments and identification
 - Develop an approach to the disclosure on these financial risks
- Window for an orderly transition “is finite and closing”
- Excessive accumulation of financial risks in investment portfolio?
 - Firms should not rely on existence of liquid market to sell assets



EAC letter to top 25 UK pension funds: Evaluation

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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Investment Regulations: DWP consultation on changes

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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Asset owner activity

- Growth in climate-aware resources and capabilities
- Insurer (and bank) risk management embracing liabilities and assets
- Evolving investment strategies, based on the asset owner investment beliefs
- Low carbon portfolios
 - HSBC (LGIM), NEST (UBS)
- Disinvestment from coal and tar sands, wider fossil fuel divestment
- Increased focus on ownership activity: proxy and engagement
- TCFD reporting, actual and commitments
- Regulatory interest in DC Independent Governance Committees



Collective Engagement – Aggregating ownership power



GLENCORE



RioTinto

ExxonMobil



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A helpful guide

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 practices landscape, identifies barriers, and presents a framework of ten building blocks for other asset owners introducing and developing climate strategies.

ShareAction»

ASSET OWNERS'
DISCLOSURE PROJECT

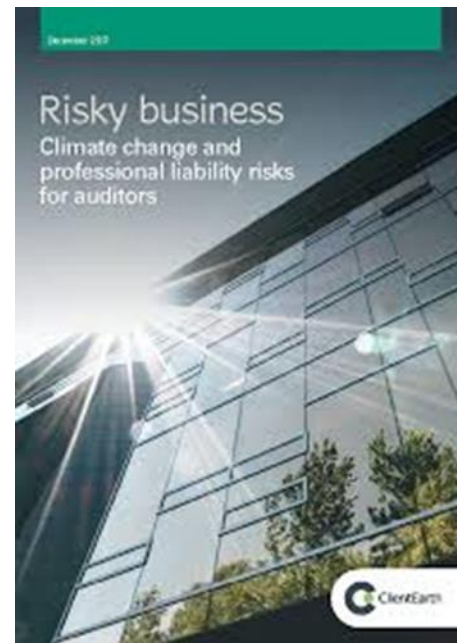
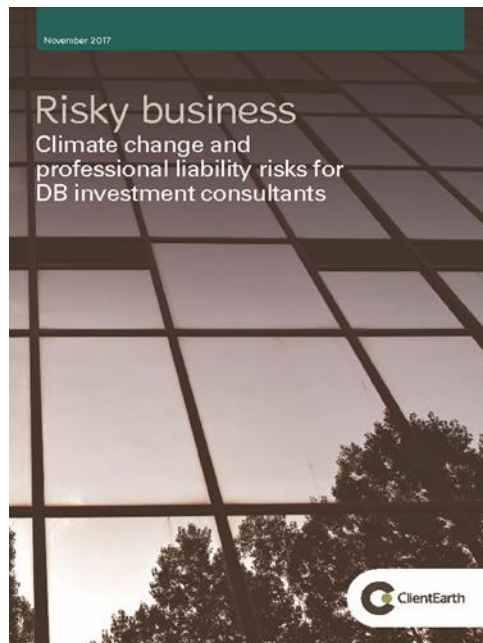
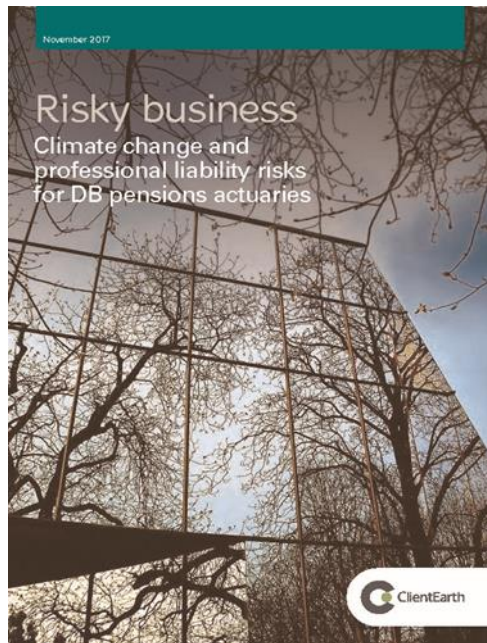


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Initiatives, Initiatives, Initiatives



Risky Business: actuaries, inv. consultants, auditors



Interventions using existing law and regulation

- Three insurance firms reported to FCA for failure to disclose climate risks in their annual reports
- Four UK companies reported to the FRC over perceived failures to address climate change trends and risks in their reports to shareholders.
- Plus letter to the auditors of the four companies
- Letters to trustees of 14 pension schemes as follow up to (25) letters written by House of Commons' Environmental Audit Committee (EAC) as part of their Green Finance inquiry
- Member of Shell pension fund may go to the Ombudsman (maladministration) unless fund can show it is managing its climate-related risk



All Swans are Black in the Dark

How good are financial markets at pricing long term risk?

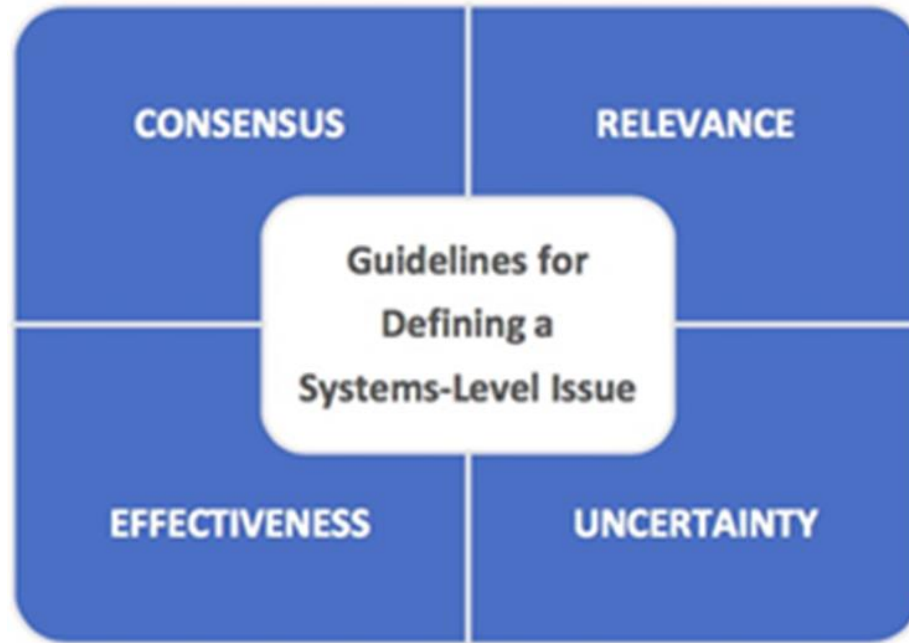


Source: Generation Foundation, 2 degrees Investing Initiative



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So what issues *should* asset owners consider?



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



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Two ways to think about risk and value



Finance Theory Metrics/Models

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



Modern Portfolio v2.0?



systemic risk

alpha

beta



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Summary

- Extensive policymaker and regulator activity around climate change
- Climate change risk is a strategic issue
- Investors developing their capabilities, strategies and activity
- Legal risk increasing
- Do we need to develop our thinking?
- ***How will you view the Risk Alert tomorrow?***



Questions

Comments

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