Don’t miss the boat

Julia Dreblow explains why climate change and stranded asset issues are far too important for investors and fund providers to ignore

When organisations such as the G7 and companies like BP and Shell shift their positions on climate change, it is clear that change is on its way... and that there will be both winners and losers.

Investors call for action

Investors have been collaborating on this issue for a number of years, forming different groups for different purposes. Their aim has been to gain a better understanding of the issues, risks and opportunities - and in many cases, to also help drive positive progress.

A good summary of the views of leading investors is set out in an open letter to G7 Finance Ministers by the IIGCC (the Institutional Investors Group on Climate Change) in May. The IIGCC letter was signed by 120 investor CEOs, representing $12 trillion of assets. The letter called for:

“a renewed signal of high-level political commitment, which includes: 1. A long-term global emissions reduction goal in the Paris agreement; 2. The submission of short to medium-term national emissions pledges and country level action plans.”

Explaining their position, the group said:

“As institutional investors responsible for managing the retirement savings and investments of millions of people or managing endowments, we believe climate change is one of the biggest systemic risks we face...

“With the right market signals from policymakers, investment in low-carbon and climate resilient opportunities can flow and climate impacts and resulting economic damages can be mitigated...”

On a more upbeat note, the IIGCC went on to say:

“The benefits of addressing climate change outweigh the costs. According to the IEA, by using today’s technologies, it is possible to set the global energy and transport system on a 2°C pathway at no net cost. Marginal upfront costs in energy efficiency are offset by savings over time. This decoupling of energy use and economic growth is possible and already happening in certain regions.”

Their concluding sentence, which is worthy of the attention of any investor, reads:

“With the appropriate policies in place, we will be able to accelerate our investment in low carbon assets and advance the shift to a low carbon economy.”

Two months later (in July 2015), the G7 made landmark progress. G7 leaders publicly set out their support for the IPCC findings (including the need to keep global temperature increases below 2°C) and called for major reductions in carbon emissions.

Although important, the IIGCC is not alone. The CDP (Carbon Disclosure Project) powers investor awareness by gathering data on emissions and its implications on, for example, water supply. ClimateWise, the insurers group, works to assess climate change-related risk. And in October, Chatham House will run their 19th Annual Conference on Climate Change.

Meanwhile, the United Nations-backed PRI (Principles of Responsible Investment) goes from strength-to-strength with 1,260 signatories accounting for $45 trillion of assets. And on the Government policy side, the Aldersgate Group - which brings together big business, investors and policymakers - has recently launched a study introduced by Lord Deben, Chairman of the UK Government's committee on climate change ('A brighter, more secure future. Low carbon priorities for the new government').

On more radars

Concern about climate change has risen particularly rapidly since Hurricane Sandy in 2012. Reports predicting water scarcity, crop failures, famine, coastal flooding, increasingly severe weather patterns, mass migration and civil unrest do not make easy reading.

Attention has therefore turned to how best to avert or, if necessary, manage its impacts, which has put the role of investors under the spotlight. The public-facing, high profile Divest campaign has caught public and media attention. MoveYourMoney, GoFossilFree and 350.org, for example, all promote the divestment message, making the case for ending investment in coal, oil and gas (in that order). Investors with remits that include social, environmental or ethical considerations are proving to be particularly responsive.

Meanwhile, the Carbon Tracker Initiative and 350.org claim that we are in a 'carbon bubble'. The carbon bubble theory is based on research that 75% of oil reserves are unburnable if temperature rises are to be held below the IPPC agreed maximum of +2°C.

Analysts at Kepler Chevereux quantify this in their report 'Stranded Assets: Fossilised Revenues', estimating that $28 trillion of fossil fuel revenues (mainly oil related) will be at risk as we shift towards the 'maximum 450ppm (parts per million) CO2 equivalent' world. Unsurprisingly, numerous banks and investors with a keen eye on 'risk' are taking this very seriously. And, as discussed previously, the Governor of the Bank of England has also spoken on this subject more than once.

A further related area of activity that individual investors may do well to be aware of was a campaign that made this year's AGM season more interesting than usual...

Action at Shell and BP

This spring, the £160bn investor coalition 'Aiming for A' tabled a resolution calling on the management of BP and Shell to transparently:

1. Stress-test their business models against the requirement to limit global warming to 2°C, as agreed by governments at the UN Climate Change Conference in 2010.
2. Reform their bonus systems so they no longer reward climate-harming activities.
3. Commit to reduce emissions and invest in renewable energy.
4. Disclose how their public policy plans align with climate change mitigation and risk.

The shareholder resolutions were supported by both sets of management and passed, in both cases, with 98% of votes in favour.

Commenting on how 'Aiming for A' relates to financial advisers, Catharine Howarth, CEO of ShareAction, said: "We are seeing massively growing evidence that people want to see environmental and social issues built into their wealth management strategies, so staying ahead of this curve makes great sense for financial advisers."

This activity, coupled with the investment communities' signals that it can respond favourably and potentially quickly mean that climate change may soon become a game changer for all concerned.

SRI industry responses

Managers with sustainable and responsible investment (SRI) expertise are particularly well placed to respond to climate related risks and opportunities, yet their responses vary.

One strategy is 'responsible engagement', which involves influencing rather than avoiding companies. Two leading players in this area are Aviva and BMO/F&C. As both an insurer and an investor, Aviva has a strong incentive to understand and manage this issue well - and as such, has recently published a '5 pillar' carbon strategy. Like BMO/F&C, whose Head of Governance and Sustainable Investment team previously worked on the Stern Report, their 'conventional funds' strategies include understanding and interpreting Environmental, Social and Governance (ESG) issues, encouraging positive change through company dialogue and voting shares in ways that help generate shareholder value.

Companies with diverse retail offerings and strong ties to the charities market, such as Quilter Cheviot and Rathbone Greenbank, tend to offer a number of options to match their clients' needs. This can range from selective engagement to advice, or action aimed at decarbonising portfolios.

Gemma Woodward at Quilter Cheviot summed up their house view, saying that "the 'big oil' growth story is not as clear cut as it once was". Meanwhile, their ethical fund manager, Claudia Quiroz, explained that her Climate Assets fund specifically looks for companies that "offer solutions to global and emerging challenges related to the need to deliver 'more with less', responding to factors such as dwindling resources, a growing population, the need to manage carbon footprints and regulatory change".

Indeed, most funds that are regarded as retail, adviser friendly, screened 'ethical' options - such as those from F&C, Kames, Friends, Standard Life or EdenTree - do not normally advocate absolute avoidance of this sector. Instead, such funds typically focus on 'best in sector' fossil fuel companies that do not breech other related screens. Indeed, using Parmenion's 'Ethical Leaders' portfolio as a guide, such funds tend to be significantly underweight as this 'regular ethical' portfolio has just under 2% exposure to oil and gas, rather less than the FTSE All-Share at 12%.

Funds with an environmental or sustainability focus, such as those offered by Jupiter, Alliance Trust, Impax and WHEB, generally take a more explicitly positive or 'themed' approach. Peter Michaelis, Head of Equities at Alliance Trust, explained the view of the ATI Sustainable Futures range: "Because of our sustainable investment approach, we see much greater opportunities in companies benefiting from reducing dependence on fossil fuels. Renewable energy, energy efficiency and companies that are finding new ways of doing things - like video conferencing instead of flying - all offer opportunities. As a result, we are, and have been for many years, structurally underweight in fossil fuels."

This diversity and the measured responses of experienced investors makes sense given the realistic knowledge that our use of oil will not cease overnight. The fact that most oil reserves are state owned - and therefore beyond the reach of investors - is also a major factor. Yet the dynamics of this market are changing thanks to the rising cost of exploration, falling fuel prices and growing competition from alternatives (e.g. tidal, large-scale solar) and advances in battery technologies.

So what next for advisers?

Stock picking may not be within an advisers' remit these days, but understanding clients' diverse preferences and their views on opportunities and risk most definitely are.

The UNFCCC COP21 climate talks in Paris, which start on 30 November, mean that activity of this kind looks set to continue and public awareness will most probably continue to rise, too.

Post-December, the climate related investment landscape could be quite different - particularly if an emissions reduction deal is struck, carbon pricing improves or an oil major shifts its position faster than expected - so watch this space. And, as set out in the IIGCC letter, things could move quite swiftly if investors believe the time is right.

The investment community may not talk with a single voice on this topic all of the time but the general direction of travel is clear. Like individual investors, some may fear being stranded while others will want to make sure they don't miss the boat with emerging opportunities.

This area is indeed fast-moving and complex, but advisers are well placed to help clients interpret their opinions and discuss options.

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