HOW CLIMATE CHANGE IS CHANGING ASSET MANAGEMENT

By Dylan Tanner

The financial sector is increasingly treating the climate emergency as a mainstream business driver and not just another ESG topic.

The IPCC's October 2018 Special Report[1] on Global Warming of 1.5°C laid out the urgent need to transition the global energy mix and in particular speed up the introduction of renewable and transport electrification technologies. Given the urgency of the climate crisis, increasing attention has turned to the finance sector to drive meaningful progress. In April 2019, the Governor of the Bank of England, Mark Carney, published an open letter[2] stating that the financial sector has a 'crucial role to play' in tackling climate change, calling on the industry to address the significant risks posed to financial stability.

An important part of the financial system that is providing clear signals of concern on climate are asset owners, which include giant pension funds Calpers, NY State Common and large northern European players such as the Swedish AP system. Collectively, this group owns over US $ 28 trillion in assets globally (OECD, 2018). In terms of listed equities, they are generally invested in the entire market and concerned with long-term risks to the economy and portfolio as 'universal owners'. Thus, climate change is an increasing priority and pensions providers are likely to require their own asset manager service providers to demonstrate recognition of this priority. This was starkly illustrated in early 2020, when the UK's £ 30 billion Brunel Pension Partnership's Chief Investment Officer issued a stern warning: 'Climate change is a rapidly escalating investment issue. We found that the finance sector is part of the problem, when it could and should be part of the solution for addressing climate change.'

Photo: Archive InfluenceMap

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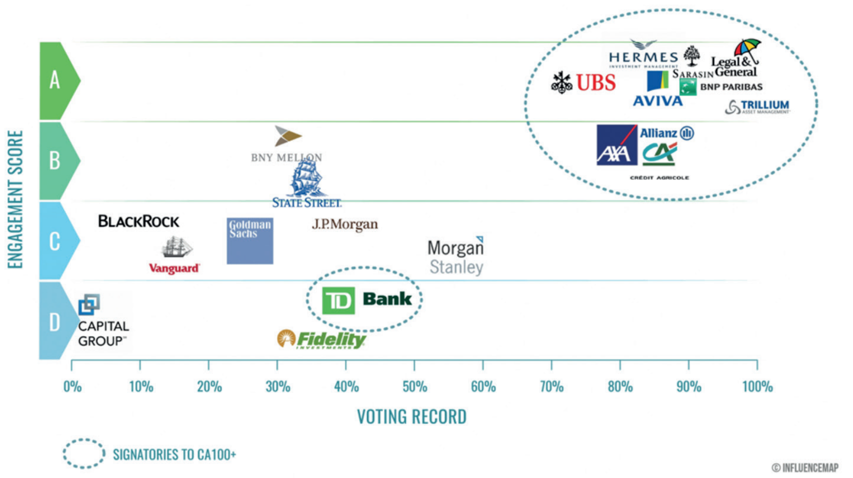
The pensions sector in Europe is itself facing increasing pressure from civil society groups and potentially regulators for not acting swiftly enough on climate change. In a survey[3] in October 2019, the Dutch Association for Investors in Sustainable Development (VBDO) scored ABP well on climate, but noted that only 12% of Dutch schemes had explicit climate policies. In February 2020, the UK Sustainable Investment and Finance Association (UKSIF) urged the UK Pensions Regulator[4] to investigate whether the UK industry was properly disclosing their own climate plans. Pressure from regulators, beneficiaries and NGOs on asset owners concerning climate change can be seen percolating down the financial supply chain, challenging asset managers to demonstrate that they can provide meaningful services to their pension fund clients in terms of both portfolios and company stewardship.

The asset management sector plays a pivotal role in the financial system, given the vast portfolios that the leading players manage and their interactions with companies in the real economy. InfluenceMap's analysis in the November 2019 report 'Asset Managers and Climate Change'[5] shows that the sector as a whole is currently not demonstrating the kind of leadership that the recent escalation in the urgency of climate change demands.

The research shows portfolios held by the 15 largest asset management groups remain significantly misaligned with the targets of the Paris Agreement, even under the fairly conservative IEA 'Beyond 2 Degrees' Scenario (B2DS). This misalignment is concentrated in the climate-risk automotive, electric power and fossil fuel production sectors (with aggregate market values of at least US $ 8 trillion in widely held listed companies). This reflects the fact that the majority of companies in these sectors are themselves misaligned.

If global investors wish to remain active in these sectors and at the same time show Paris alignment in their portfolios, then more robust engagement with the relevant companies should be a priority.

Figure 1: How Asset Managers Score on Climate Engagement and Resolutions



Source: InfluenceMap, 2020

This engagement should ideally focus on the twin goals of accelerating the individual corporate transitions to low carbon technologies and getting the companies to align their policy lobbying in line with Paris.

At present, only a portion of the leading asset managers are showing evidence of engaging with companies on these two goals. Of the largest groups, leadership is being shown by the asset management arms of Legal & General, UBS, AXA, Allianz and Credit Agricole, along with Aviva Investors and BNP Paribas Asset Management. These players are all participants in the Climate Action 100+ process, around which this forceful climate stewardship on business models and lobbying appears to be coalescing. The collaborative approach appears to be showing signs of working, especially on driving the issue of climate lobbying governance through the corporate sector.

US-based giants with significant pools of actively managed funds, like the asset management operations of BlackRock, Goldman Sachs and JPMorgan Chase, appear absent from this shift in company engagement on climate from the sector. They also score poorly in support of climate-relevant shareholder resolutions in contrast to their large European counterparts. Given their huge clout over markets/companies and the risk management resources that they command, a swift ramp-up in the ambition of this engagement is likely necessary to achieve changes in sectors and companies most impacting the global emissions pathway. Since the report publication, BlackRock unveiled a dramatic climate policy in early 2020 and the entire industry will be watching carefully to see how this translates into action on portfolios and company stewardship.

While the current COVID-19 pandemic has shifted the climate crisis from the spotlight, it will doubtless return to center stage as an issue of primary concern for global investors. Perhaps a silver lining for climate will be a new appreciation for the necessary role of both central government guidance and clear, evidence-based decision making in formulating solutions. «

1 https://www.ipcc.ch/sr15/
2 https://www.bankofengland.co.uk/news/2019/april/open-letter-on-climate-related-financial-risks
3 https://www.ipe.com/many-dutch-schemes-lack-concrete-climate-policy-says-pressure-group/10034142.article
4 https://www.ft.com/content/29582442-482a-11ea-aeb3-955839e06441
5 https://influencemap.org/report/FinanceMap-Launch-Report-f80b653f6a631cec947a07e44ae4a4a7

- The climate issue is now being described as an emergency and there is increased pressure on finance to do more;
- Pension funds are demanding more meaningful action from their investment managers, in both portfolios and stewardship of companies in the real economy;
- InfluenceMap's research shows the entire asset management sector to be lagging on portfolio alignment with Paris climate goals, which is reflective of the underlying companies they hold in climate risk sectors;
- Several large European players are showing more ambition on climate engagement with real economy companies in oil, gas, power and other key sectors. Their powerful US counterparts continue to lag behind, although BlackRock has shown signs of making progress;
- Post-COVID, climate is likely to regain center stage as an issue of global concern. It will also escalate as a key competitive factor in the financial sector.

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