Should bankers care about climate change?

Marianne Fay
The World Bank
October 2014

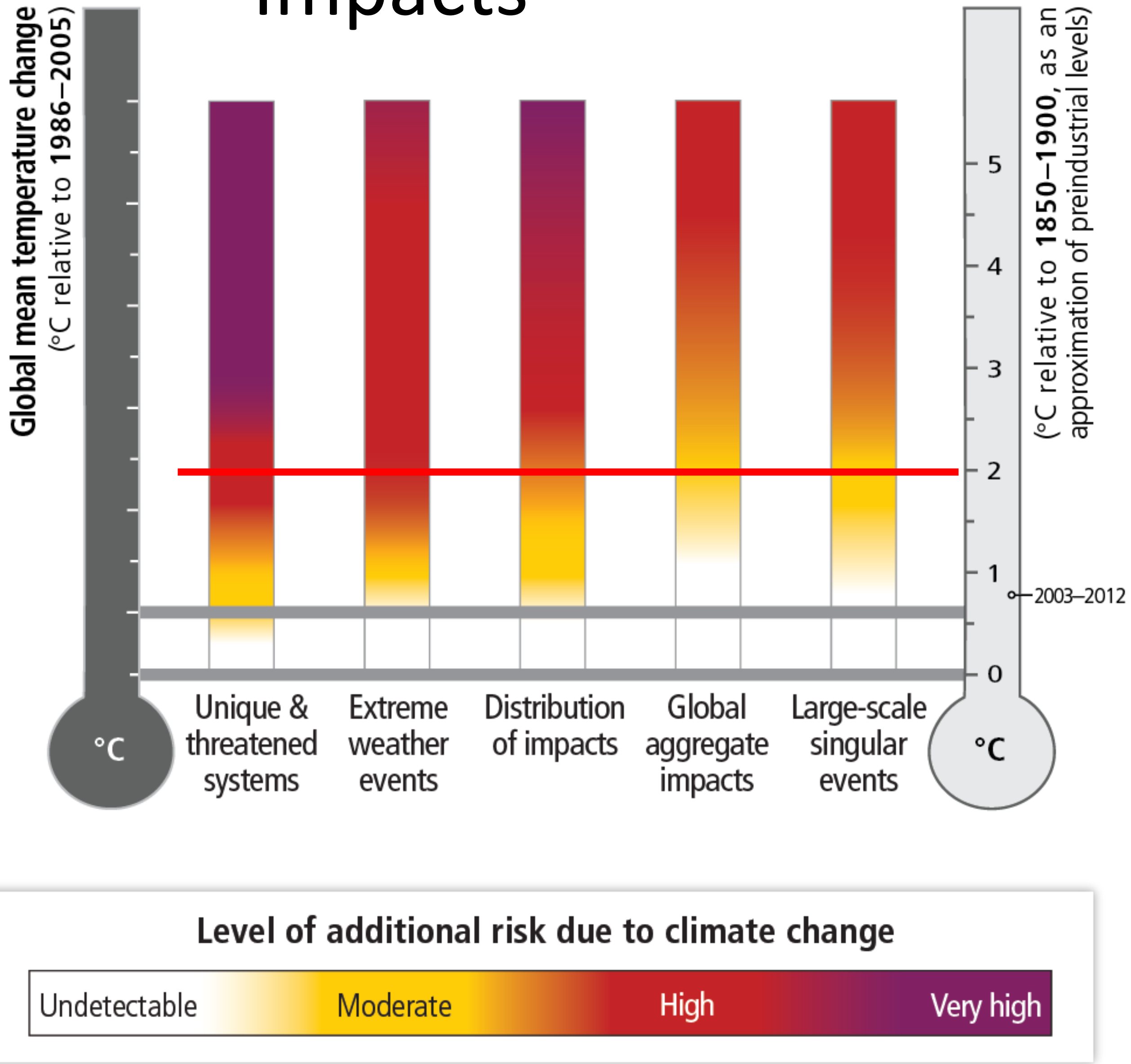
Should bankers care about CC?

- Some facts:
  - Impacts affects the bottom line
  - Climate policies will affect the bottom line
  - Climate change cannot be solved without bankers' help
- But will we have climate policies?
- Does it matter what you think about the future?
- What are the writings on the wall?

Fact

CLIMATE CHANGE IMPACTS AFFECT THE BOTTOM LINE

Impacts



ipcc
INTERGOVERNMENTAL PANEL ON climate change

Destroy assets….

…disrupt supply chains

…affect labor productivity

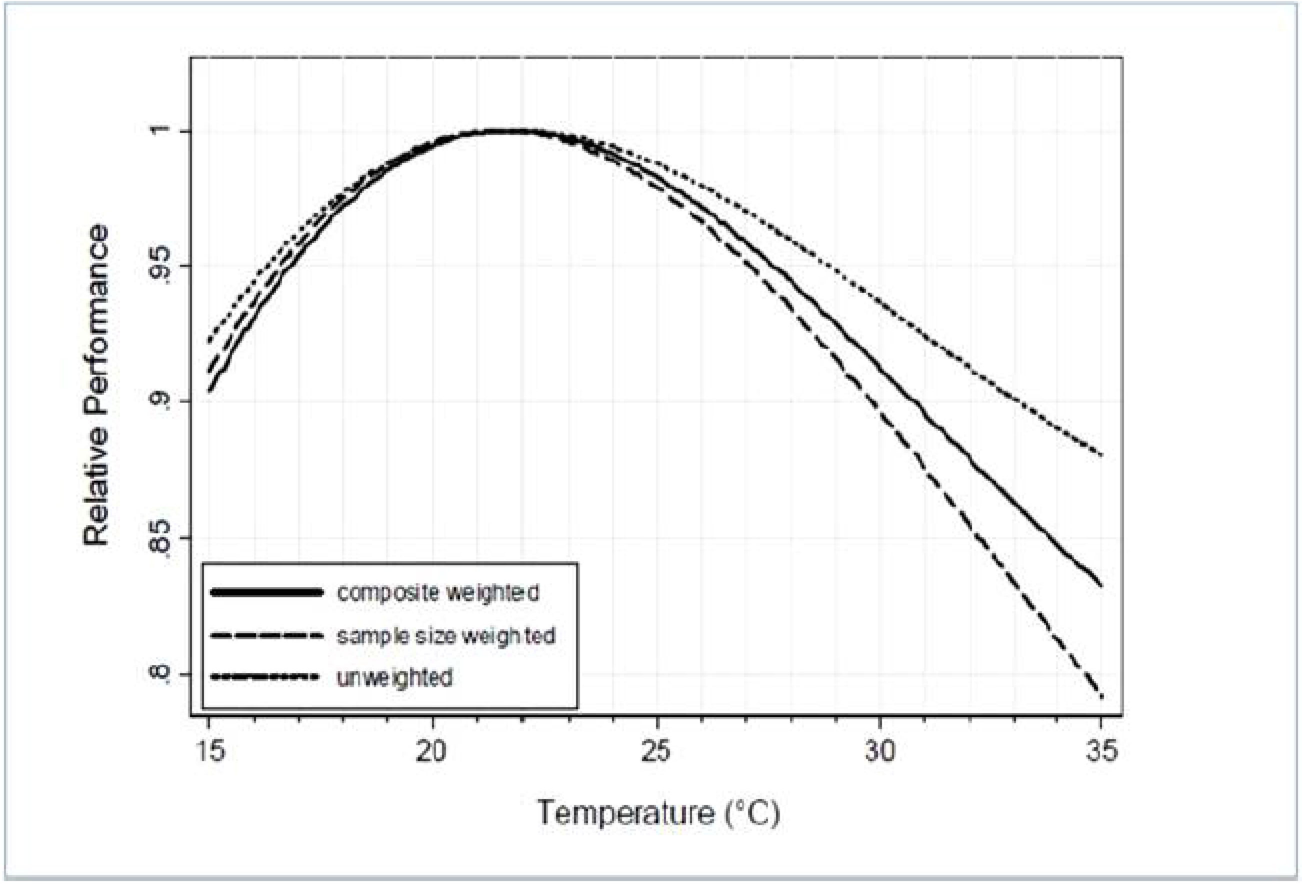


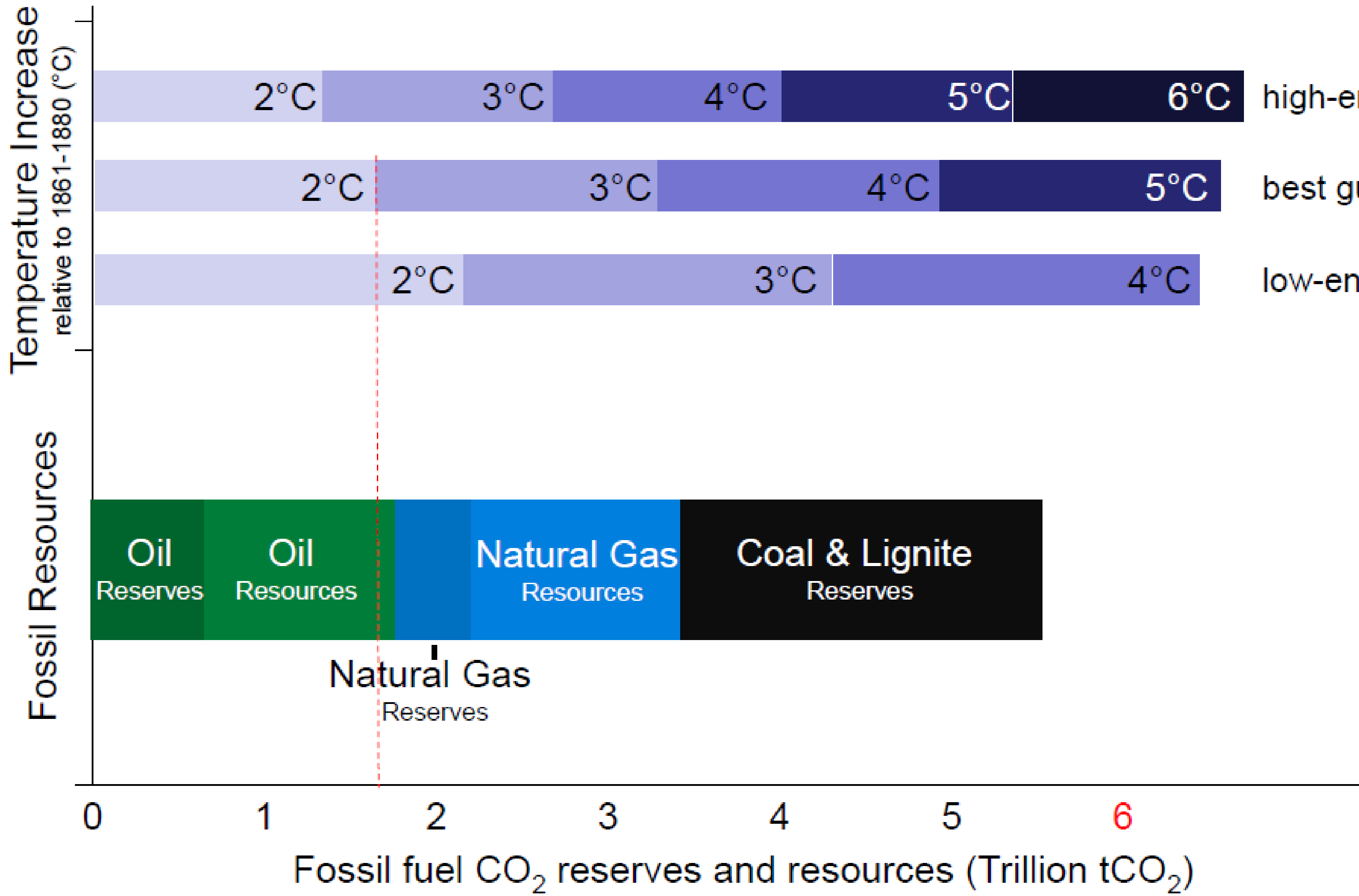
FIGURE 3.1. Task performance vs temperature. Maximum performance is normalized to 1 at 22 C. Source: Seppanen et al. [2006]

As cited in Heal 2014

Fact

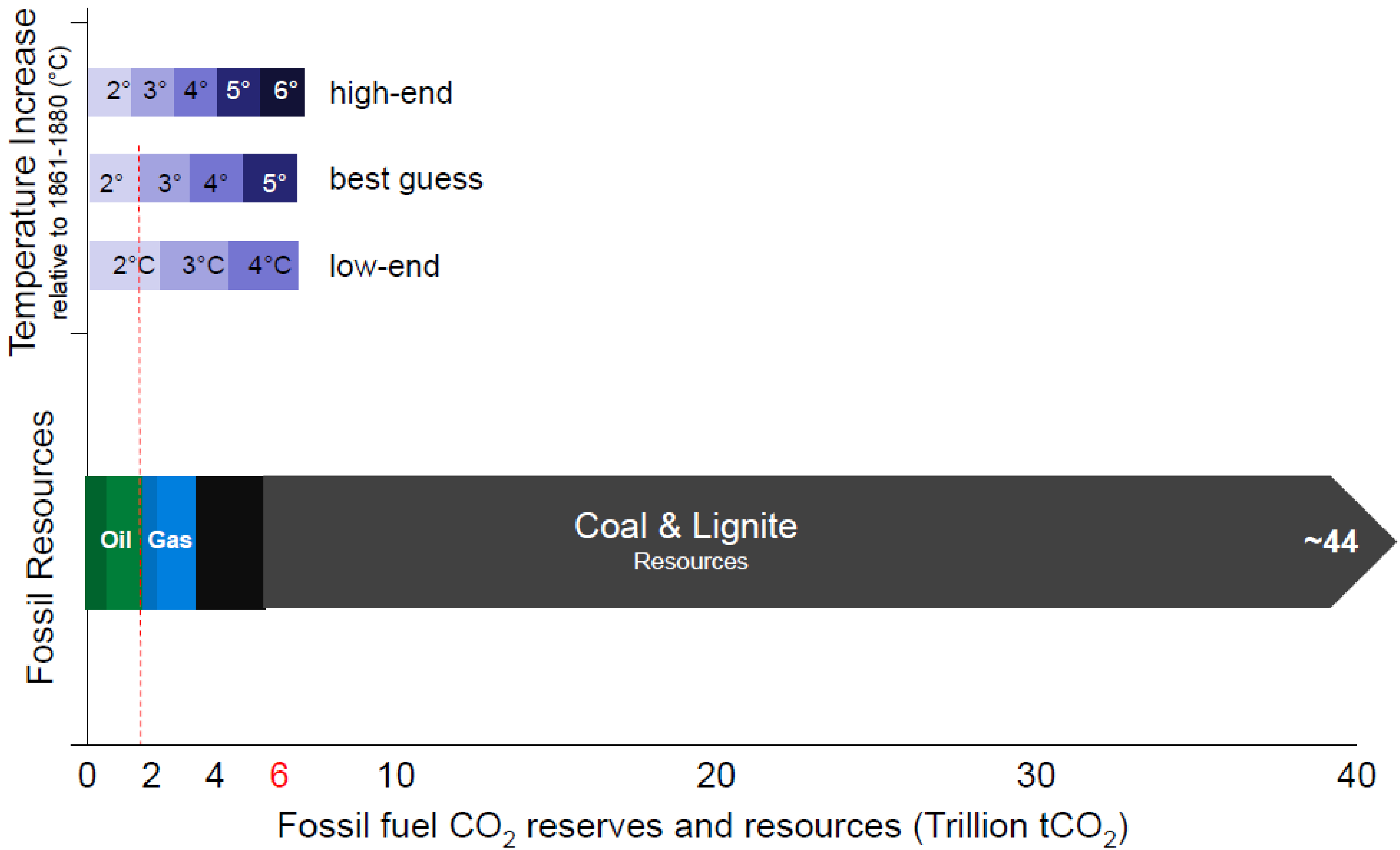
CLIMATE ***POLICIES*** WILL AFFECT THE BOTTOM LINE

The spectre of stranded assets (1)



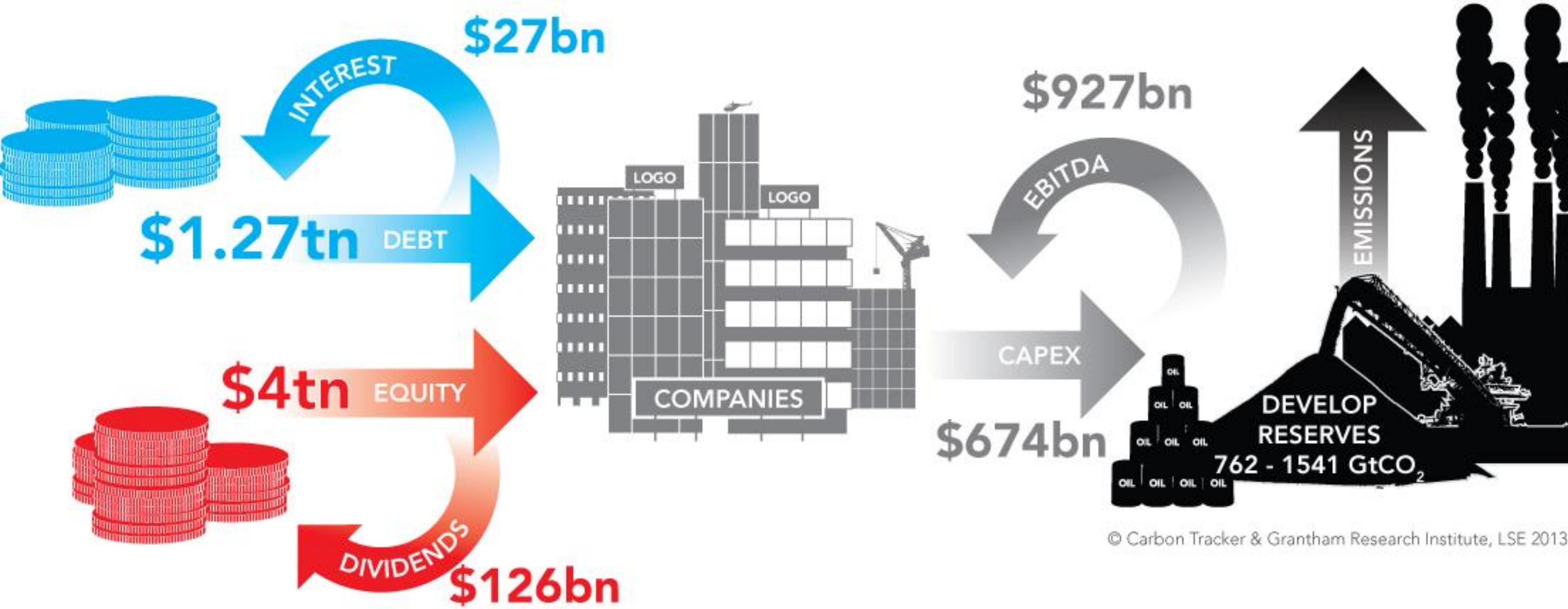
Source: Alexander Otto based on IPCC data, courtesy of Cameron Hepburn

The spectre of stranded assets (1)



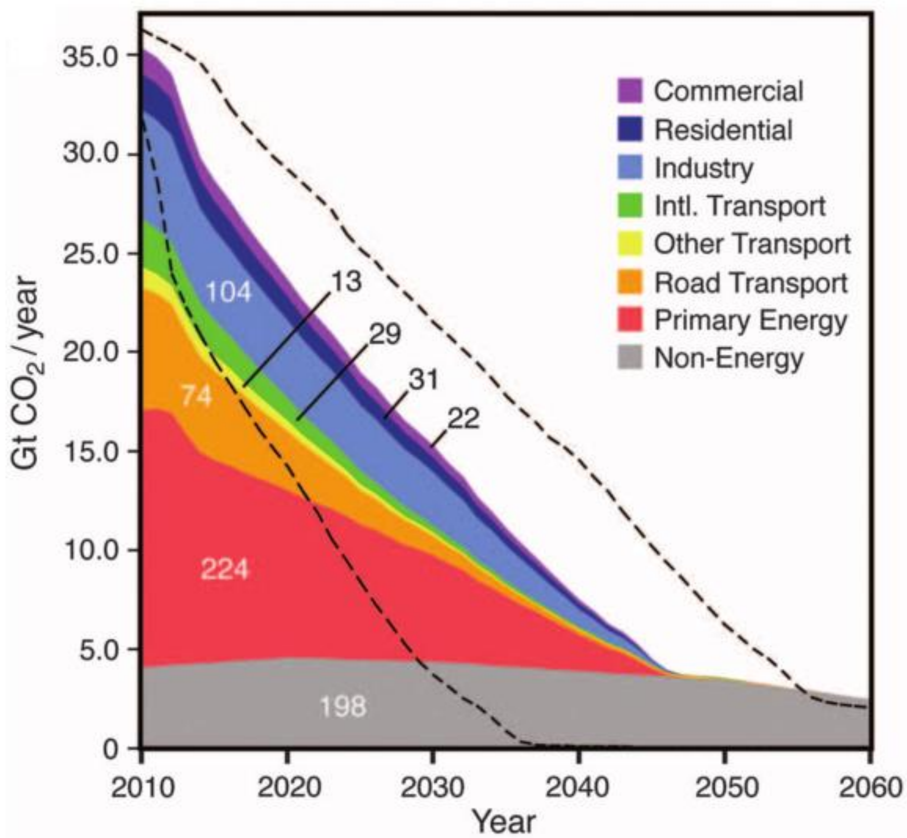
Source: Alexander Otto based on IPCC data, courtesy of Cameron Hepburn

Bad business?



Source: Carbon Tracker and Grantham Institute, LSE
www.carbontracker.org/wastedcapital

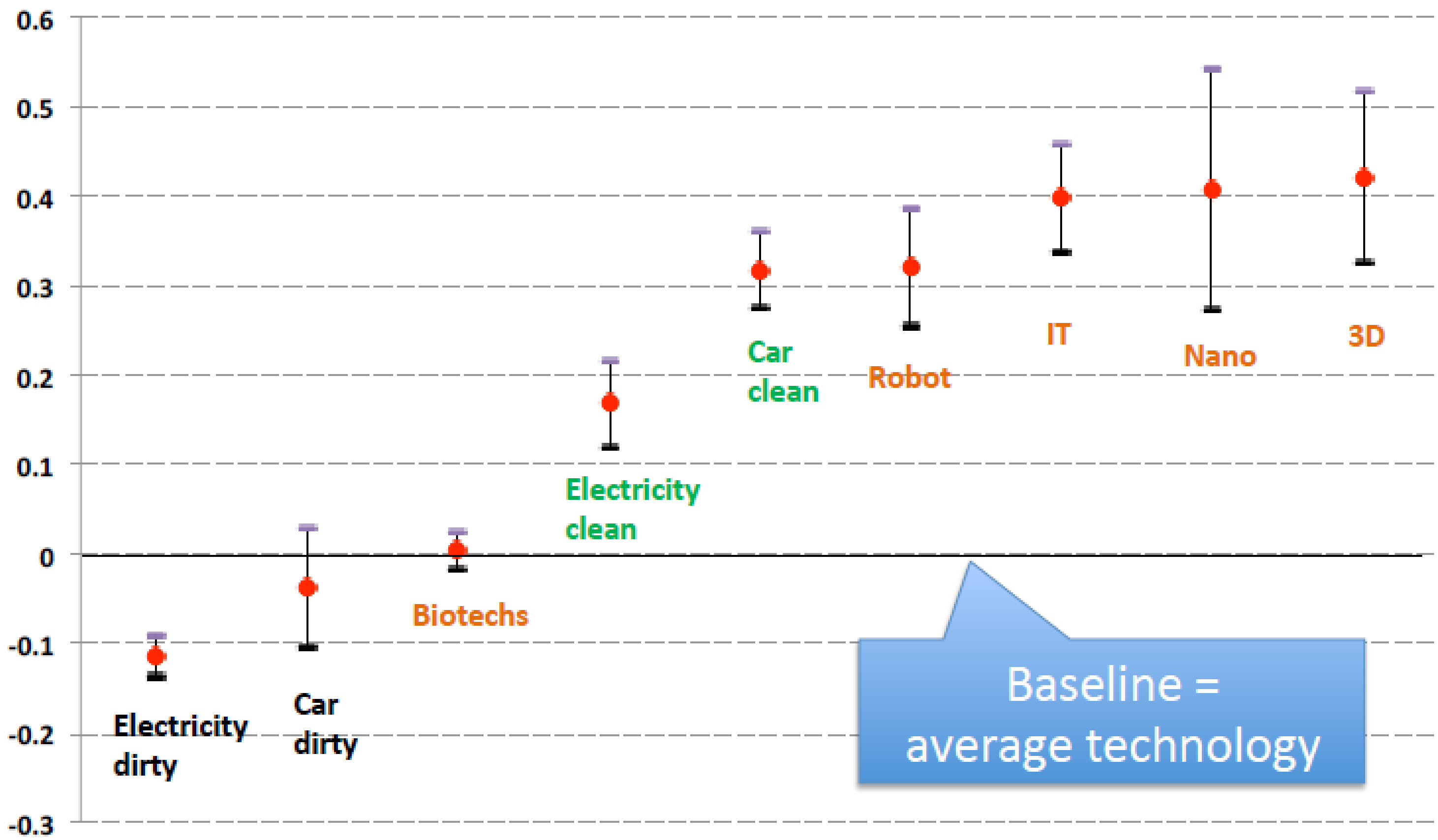
The spectre of stranded assets (2)



Note: Numbers in the graph represent the total emissions associated with particular capital – for example, existing capital for primary energy (in red) will generate some 224 Gt of CO2 over its lifetime unless it is retired early. Source: Davis et al 2010.

Good business?

Clean technology generates innovation spillovers

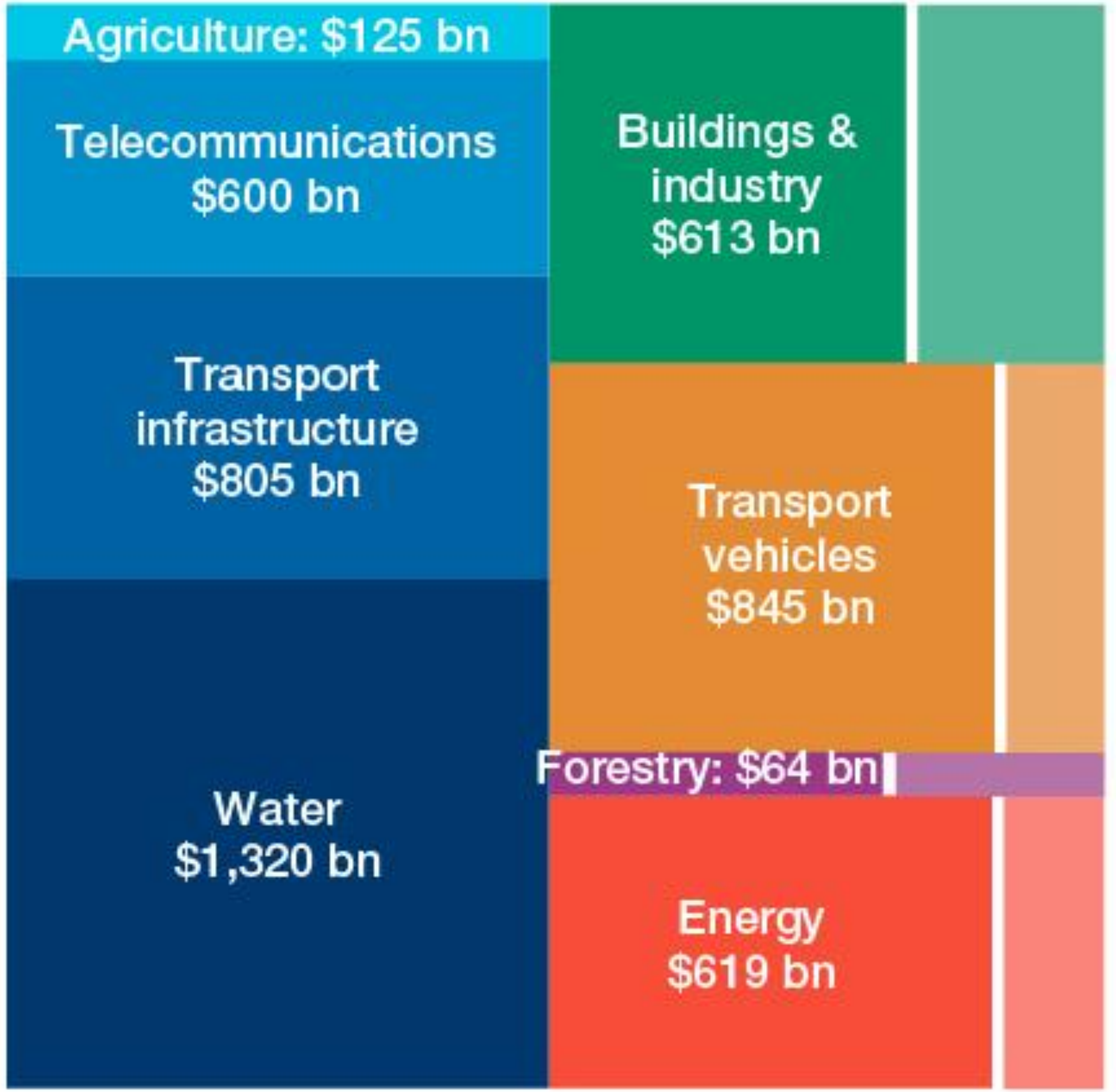


Source Dechezlepretre, Martin and Mohnen 2013

Fact

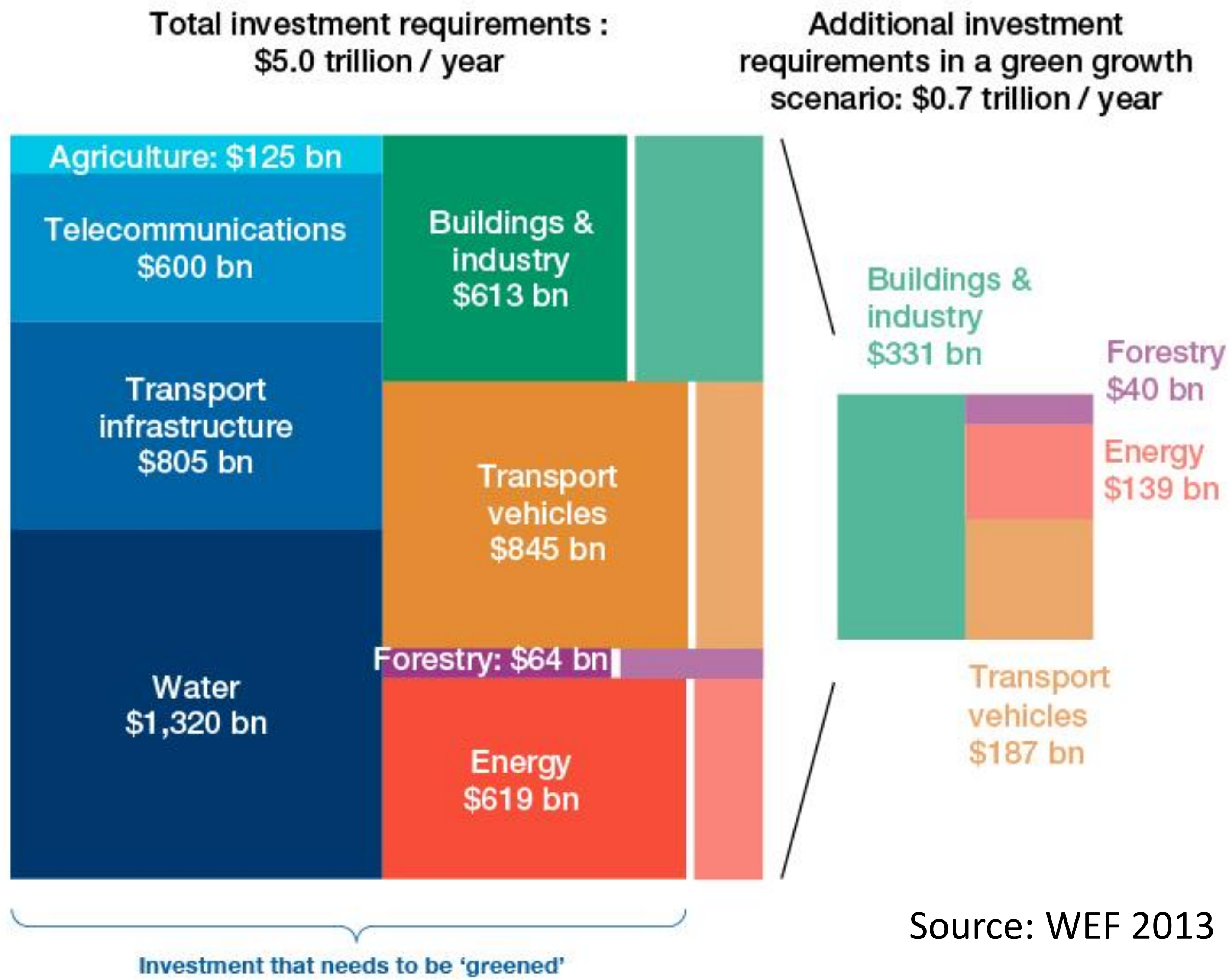
CLIMATE CHANGE CAN'T BE SOLVED WITHOUT BANKERS

Neither can growth:
Total investment requirements $5 tr./yr



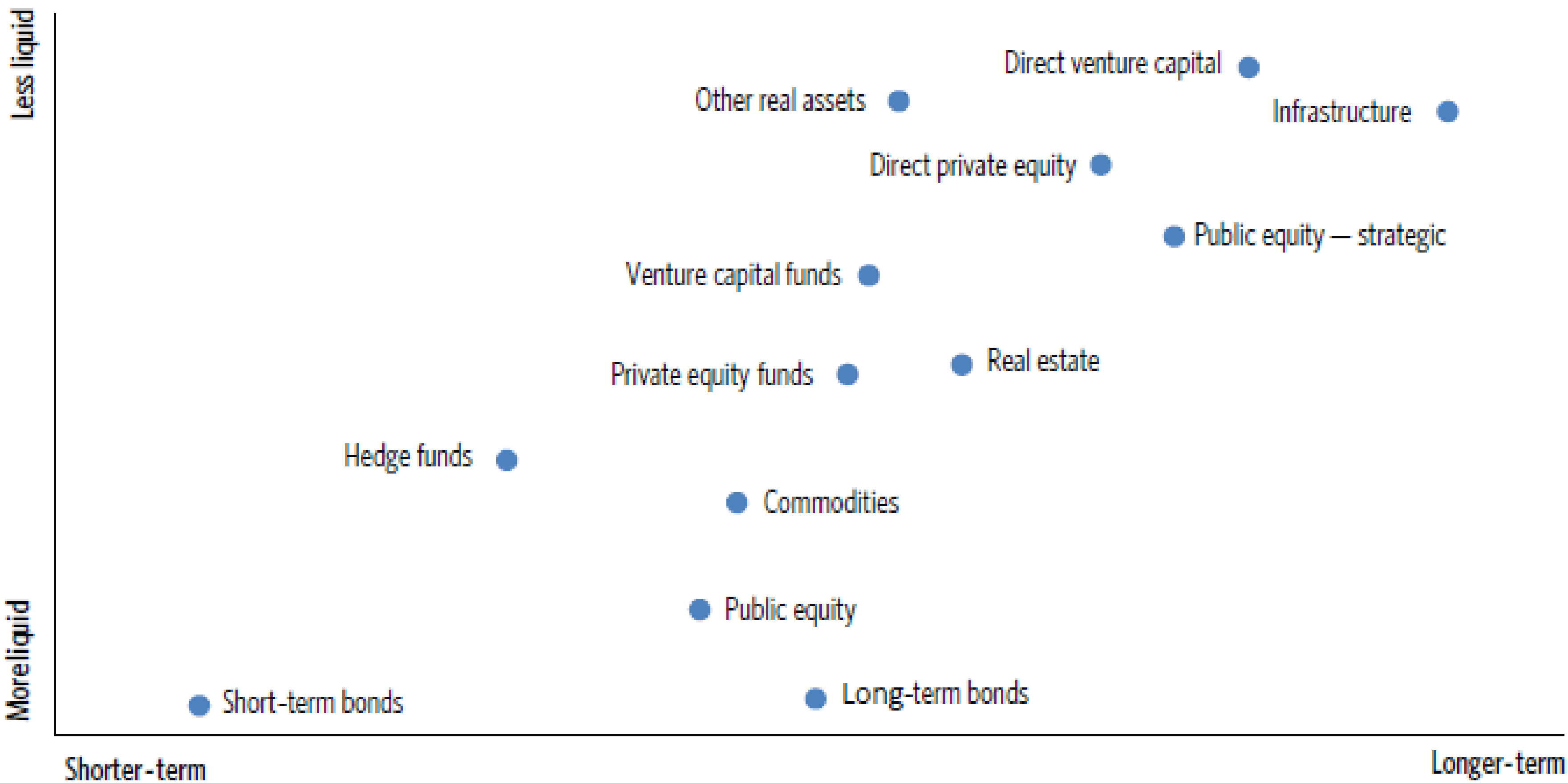
Source:
WEF 2013

Greening growth:
Adds some, but not a lot



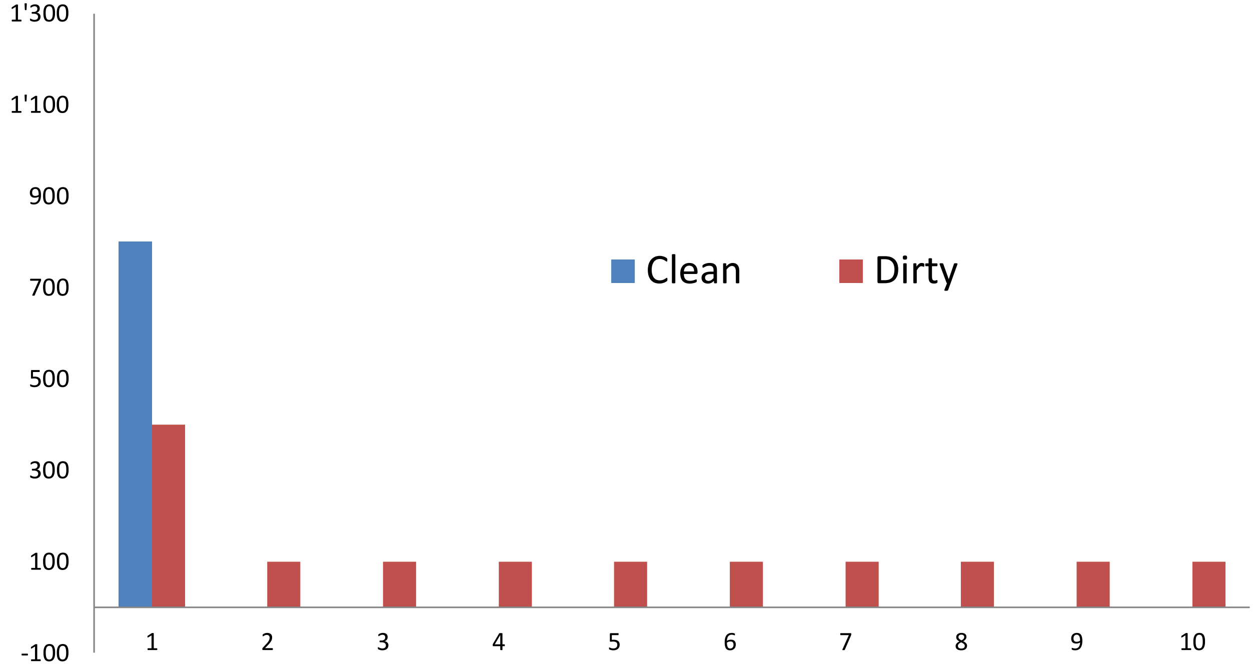
Source: WEF 2013

But the infrastructure challenge remains



Source: Climate Policy Initiative 2013

With an additional twist



It's all in the financing…

- Massive investments but not much more than for dirty
- But very different investment profile
- Need financiers to:
  – Invest in infrastructure…
  – Clean infrastructure…
- And start reflecting stranded asset risk to exert pressure on firms…

The implication is that climate policy will include finance and banking regulations

- Financial disclosure
- Credit ratings
- Differential reserves for green investments
- ….

Regulations to address short termism in financial markets, risk return biases, systemic risks….

…BUT WILL THERE BE CLIMATE POLICIES?

Reframing the question….

WILL WE EVER STABILIZE THE CLIMATE?

Stabilizing the climate

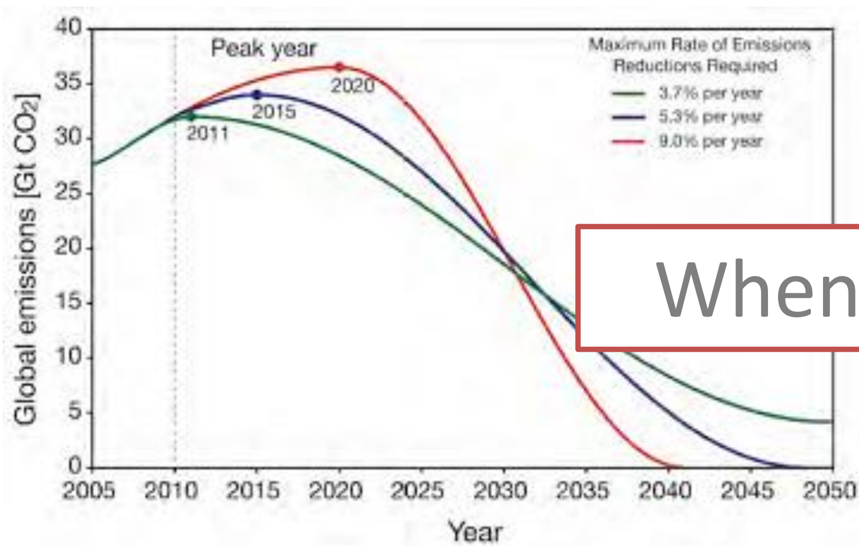
=

Full decarbonization

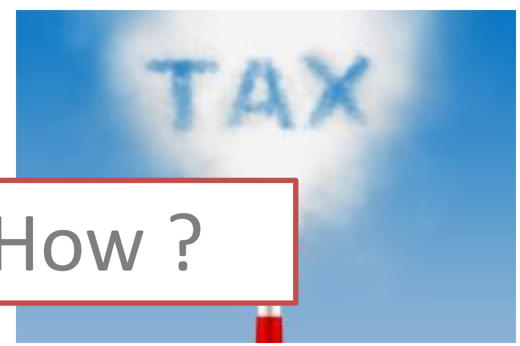
=

Climate policies

It’s not whether to decarbonize, but



When?



How ?

Stabilizing at 2 or 3°C means full decarbonization by 2100

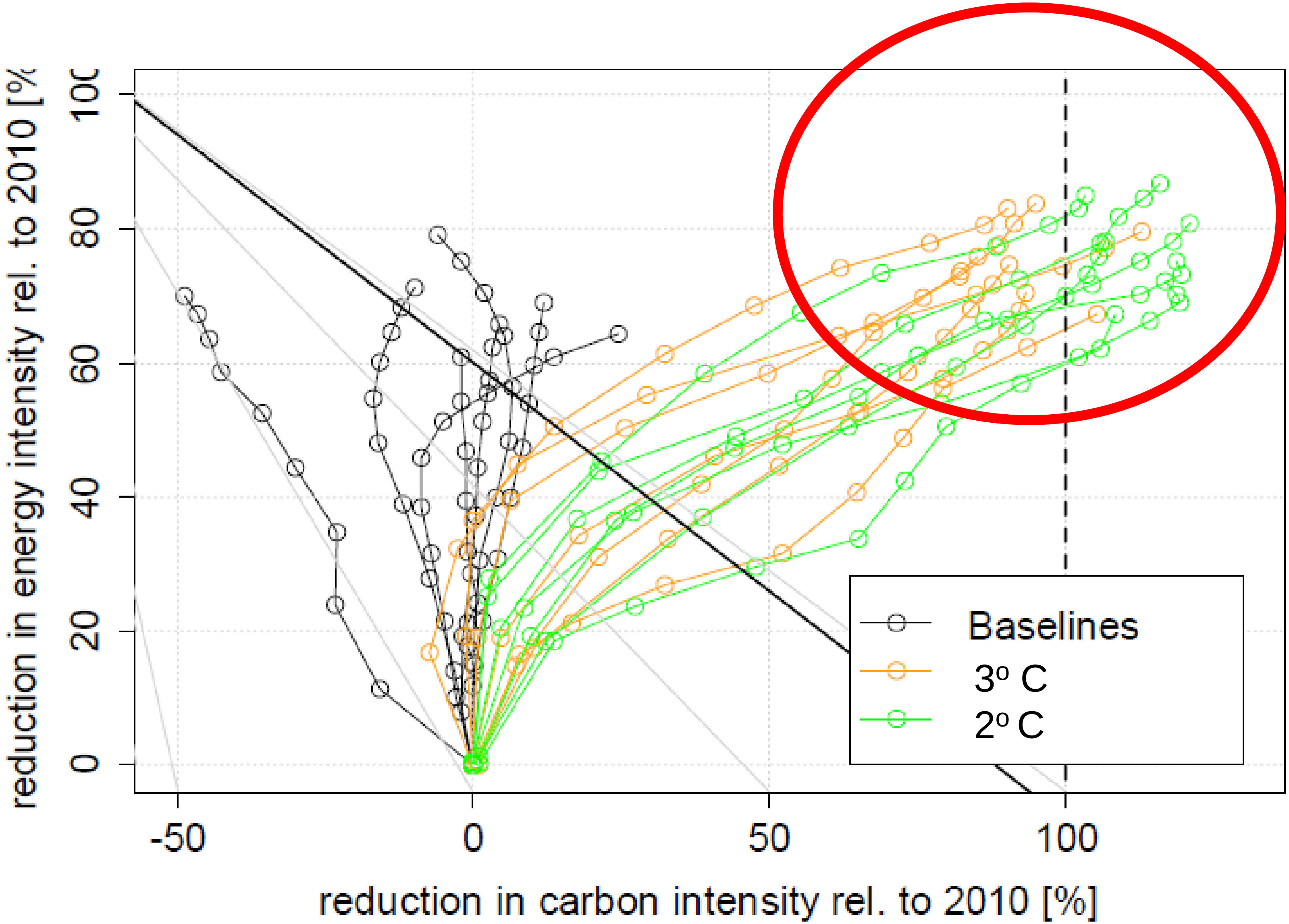
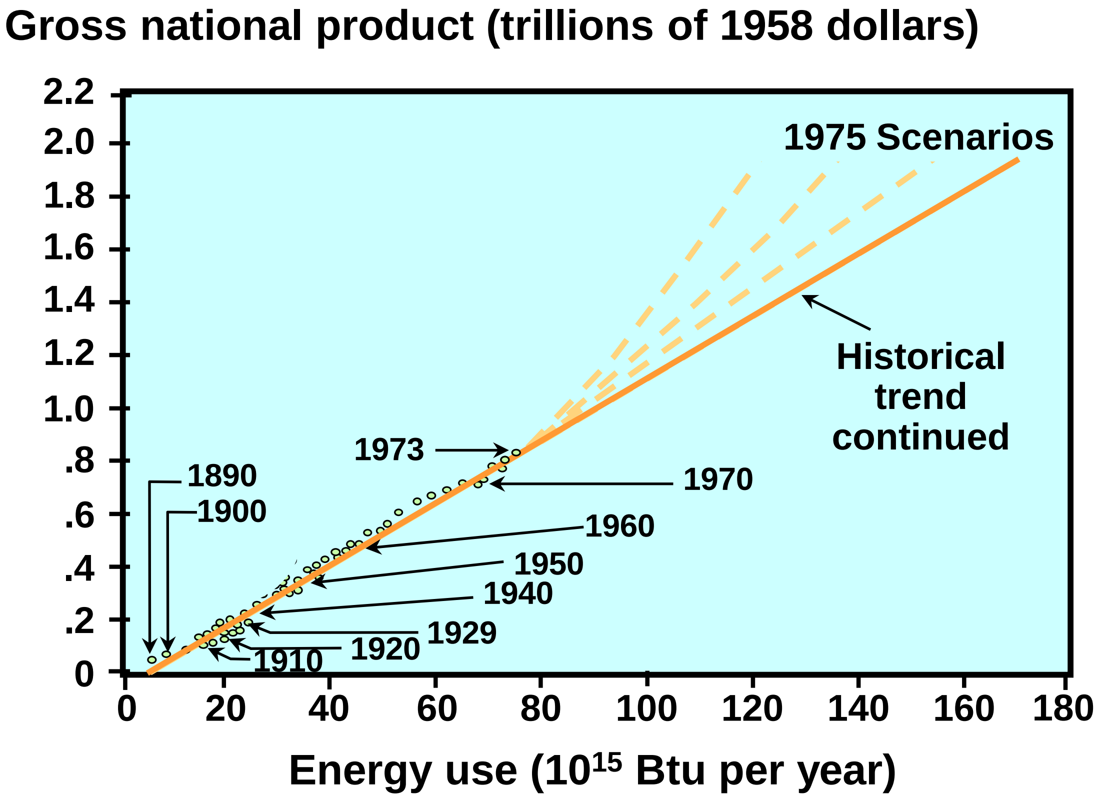


Figure WG3.6.17. Development of carbon intensity vs. final energy intensity reduction relative to 2010 in selected baseline, and mitigation scenarios reaching 550 and 450 ppm CO2-e concentrations in 2100 . IPCC, 2014.

DOES IT MATTER WHAT YOU THINK ABOUT THE FUTURE?

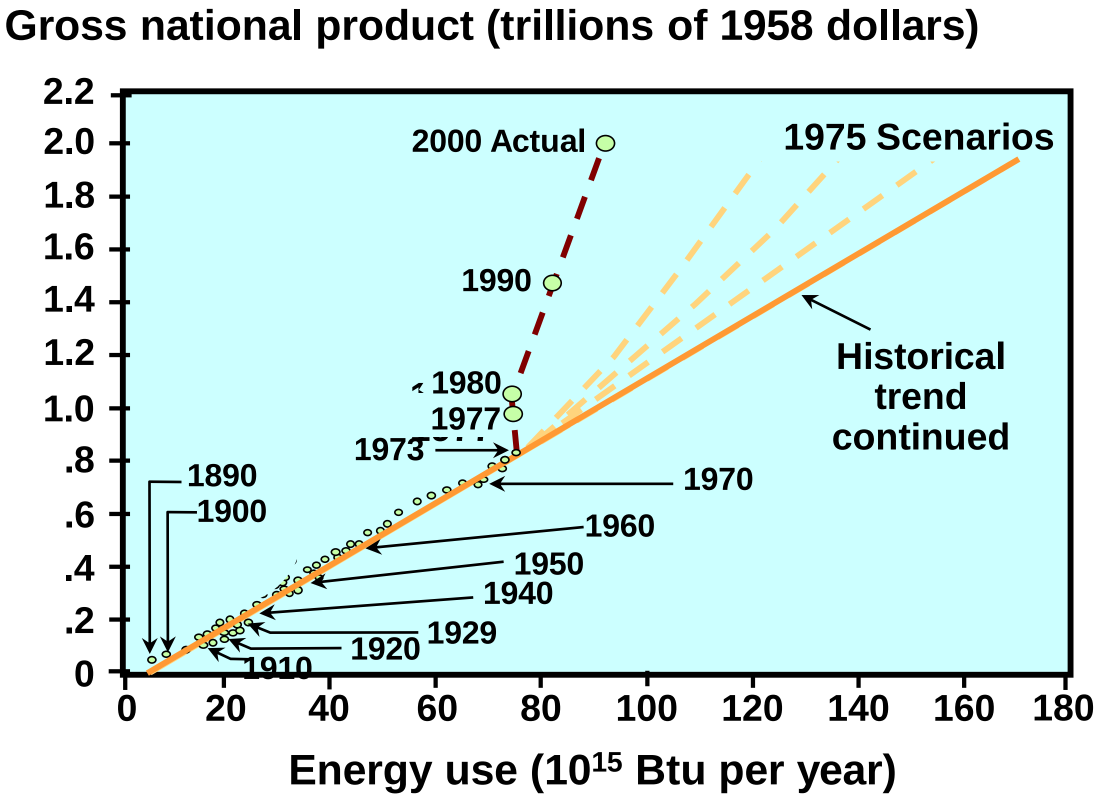
- In the early 1970s forecasters made projections of U.S energy use based on a century of data



Believing Forecasts of the Unpredictable Can Contribute to Bad Decisions

- In the early 1970s forecasters made projections of U.S energy use based on a century of data

…they were all wrong



Few Anticipated The Global Economic Crisis

The crystal ball says…

- Either climate impacts or climate policies will hurt
- Maybe both
- But it matters what your time horizon is… or does it?

Robust approaches

How will your strategy fare in different scenarios?

Robust approaches

How will your strategy fare in different scenarios?

Robust approaches

How will your strategy fare in different scenarios?

A glass half full or half empty?

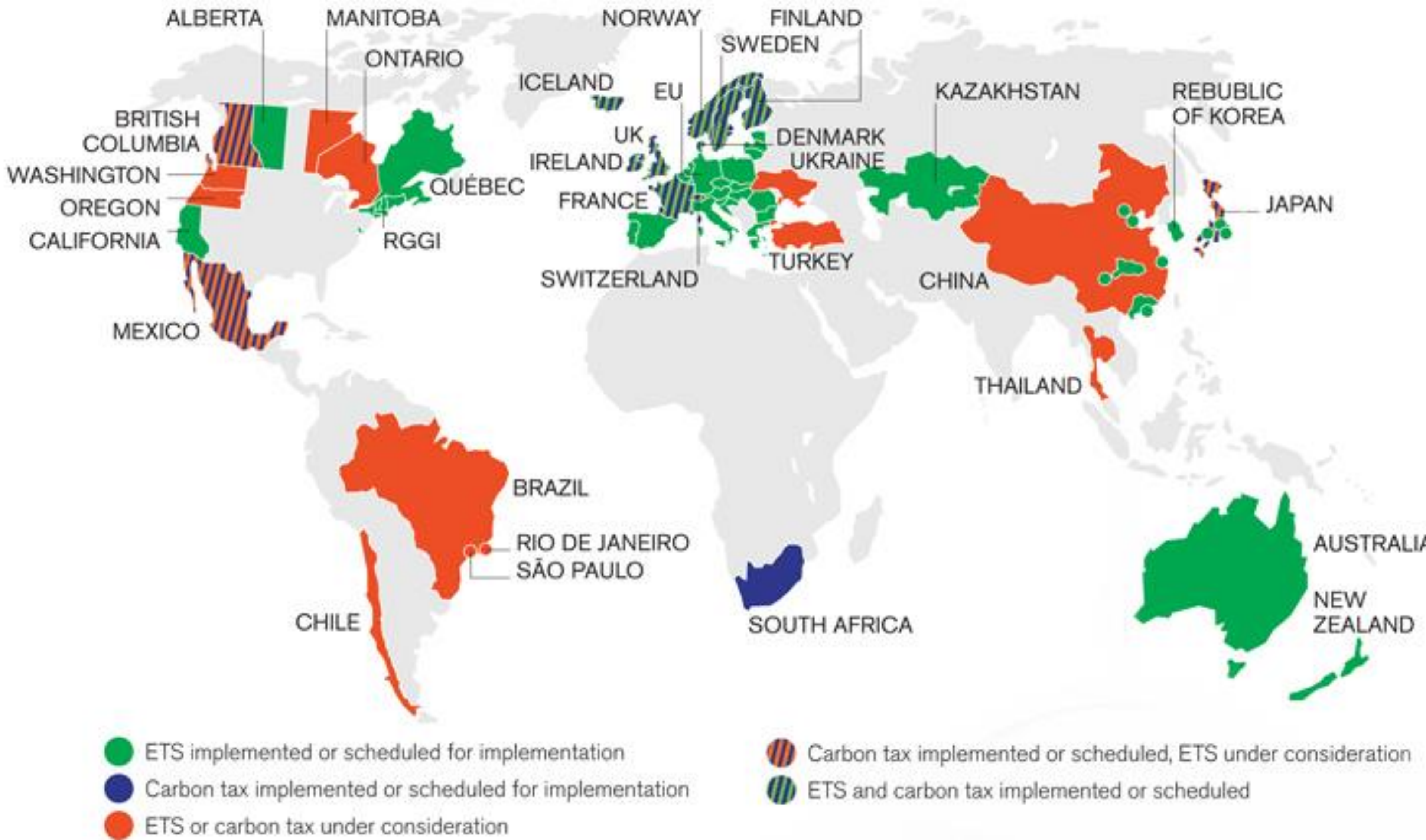
WHAT ACTUALLY IS HAPPENING?

Some actors are moving

BANGLADESH	EUROPEAN UNION
The Central Bank is acting on sustainable development objectives, targeting funds towards SMEs and green infrastructure.	The traditional focus on disclosure is moving onto the critical question of mobilizing long-term capital for a sustainable recovery.
BRAZIL	**SOUTH AFRICA**
New central bank requirements on environmental and social risk in the banking sector have evolved out of a long national dialogue.	The Financial Charter delivered a new social contract for post-Apartheid transformation and sustainable development.
CHINA	**USA**
A system-wide focus on green finance is taking shape, involving banking, insurance and capital markets.	New research on the economic risks of climate change provides extra impetus to make disclosure on sustainability factors routine in capital markets.

Source: Simon Zadek & Nick Robbins , UNEP Inquiry into the design of a sustainable financial system

Carbon pricing gaining momentum



New actors taking up the bully pulpit

Mark Carney warning about “the carbon bubble”

Hank Paulson: “We’re staring down a climate bubble that poses enormous risks to both our environment *and* economy.”

Should bankers care about climate change?

- Climate change will have an impact on the bottom line – with or without climate policies
- Earlier action massively reduces costs and disruption
- Solving climate change requires financial sector's active participation
  - Will it be a leader or a follower?
- Whether you should care depends on your time horizon…although
- …we may be seeing the beginning of a real shift

Go for robust strategies

Marianne Fay

MFAY@worldbank.org

4 Options for investors

In terms of active stewardship of equities, there are a range of approaches which reflect the different investment approaches and cultures across the world.

What can institutional investors do

gulation: Firstly investors need to sure that the market frameworks y are operating in are conducive tackling the issue of systemic nate change risk. The current ntradiction on the markets shows t regulators need to improve nsparency of the future emissions ich companies are relying on deliver the revenues they are dicting.

Engage: Engagement is a popular approach, however the fundamental shift in business model needed for these companies will require clear direction from investors. This will require interventions that challenge the capital investment strategy of the company going forward. Investors will need to feel strongly enough to make a clear requirement for a change of direction by the company, rather than pushing for slightly greener business as usual.

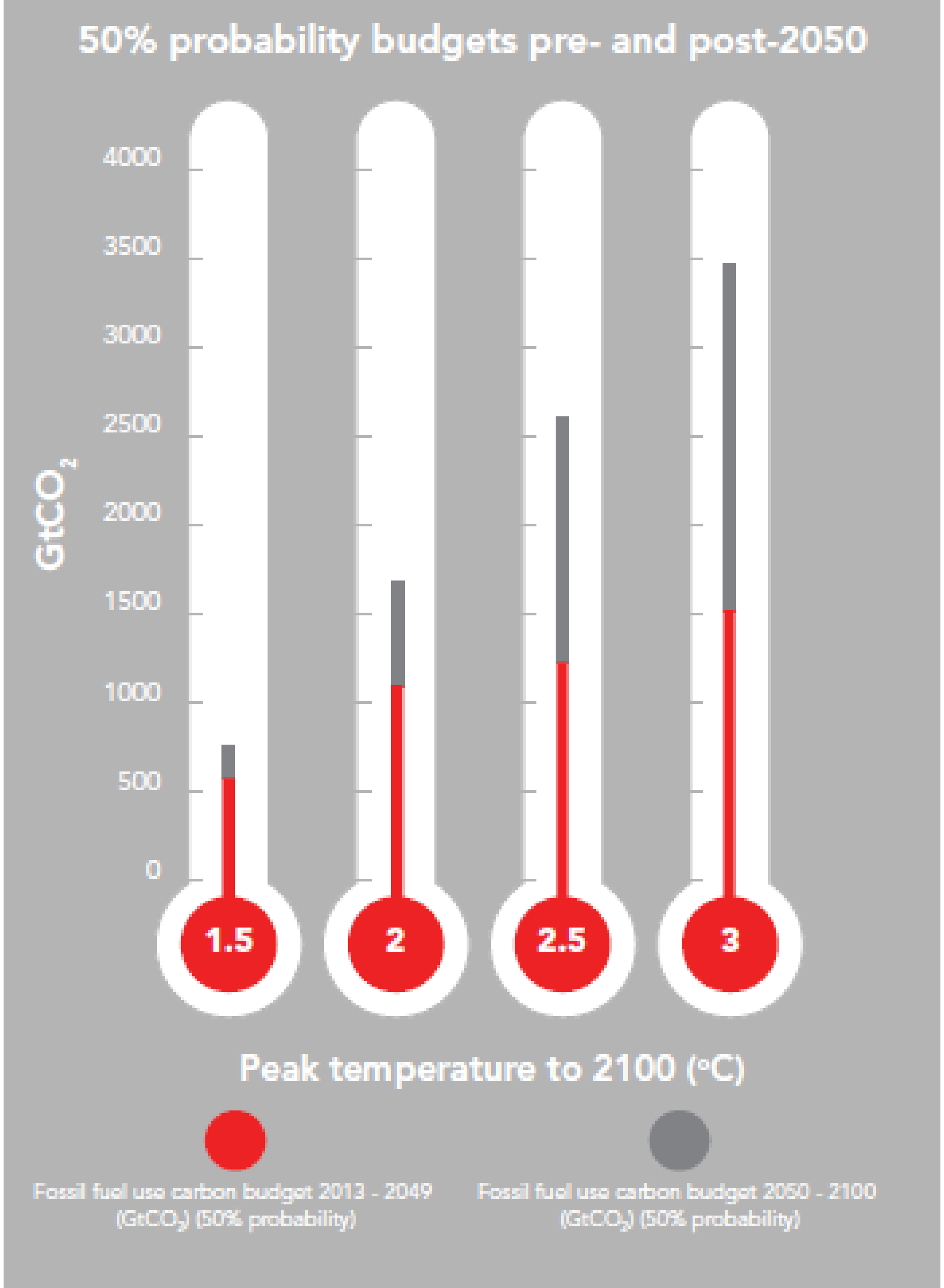
Return: A more mainstream approach which has been seen recently in the extractives sectors is for shareholders to push for share buybacks which boost the share price, or increased dividends which increase income. This shows that the company recognises it doesn't have a better plan for the capital than to return it to shareholders.

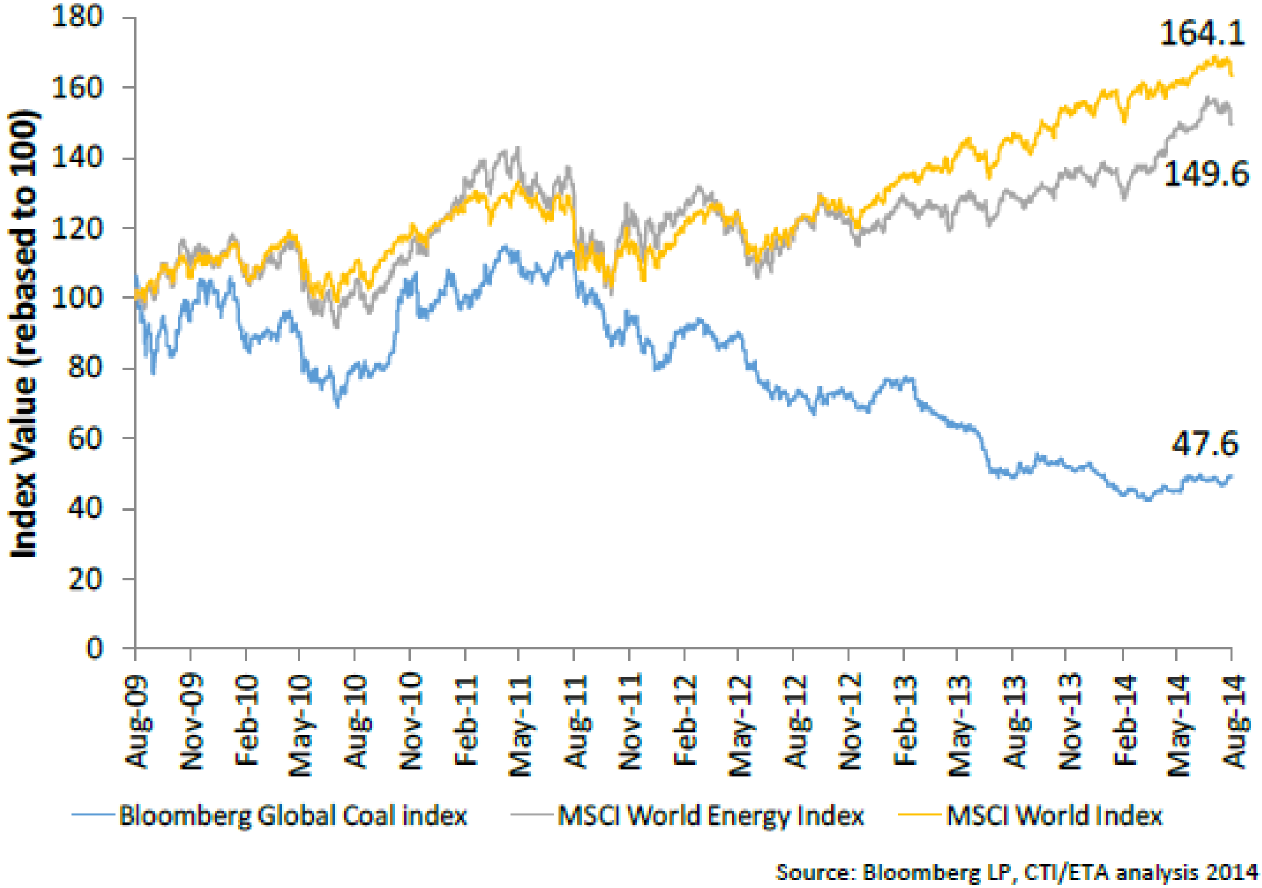
Divest: This is the ultimate sanction for many investors which would require some of the previous options to have been exhausted, and may only apply to the most extreme cases where companies have refused to take other action. This may require investors to believe that the company's strategy puts value at risk.

Risk: Using some alternative measures of value at risk will change the rules of the game for investors. If systemic risks such as climate change are to be avoided, then investors will have to go beyond the traditional definition of risk as underperforming the benchmark.

Resolution: Where engagement is not fruitful, US shareholders in particular, file shareholder resolutions to put the issue on the agenda. Few shareholder resolutions achieve the necessary levels of support to direct the board to take action. However the process, dialogue and publicity can contribute to generating pressure for change which can result in a response from the company.

Re-distribute: Extracting capital from developing more fossil fuels then requires the asset owners to use it in low-carbon or non-energy investments which are well-placed for a low-carbon future. Some companies are already repositioning their businesses to support mitigation of emissions or be resilient to climate change impacts. Work is ongoing to develop investment products which fulfil the investment needs of institutional investors (eg the Climate Bonds Initiative).


50% probability budgets pre- and post-2050
GtCO2
4000
3500
3000
2500
2000
1500
1000
500
0
1.5
2
2.5
3
Peak temperature to 2100 (°C)
Fossil fuel use carbon budget 2013 - 2049 (GtCO2) (50% probability)
Fossil fuel use carbon budget 2050 - 2100 (GtCO2) (50% probability)



http://www.carbontracker.org/wp-content/uploads/2014/09/Coal-Financial-Trends-ETA.pdf