INVESTMENT

Tackling climate change

With recent warnings that we have just 12 years to limit climate change damage, European pension funds have stepped up to the challenge. So, what have been the most recent developments in pension funds' efforts in this area?

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Compared to other global regions, European pension funds have shown a real commitment to taking holistic and systematic approaches towards integrating climate issues into their investment practices.

According to ShareAction's Investor Engagement Officer at the Asset Owners Disclosure Project, Peter Uhlenbruch, they are elevating climate change in their risk assessment frameworks, through combining backward-looking initiatives, such as carbon foot-printing with forward-looking scenario analysis, but also "taking active and bold steps in decarbonising their portfolios".

"We've seen an emergence of policies around phasing out exposure to coal-dependent assets, alongside healthy growth in investments allocated to low-carbon solutions across a range of asset classes. The front-runners have taken one step further by making public commitments to align their investment portfolios with the goals of the Paris Agreement, and issuing public statements linking their climate responses to their fiduciary duties toward their beneficiaries," he says.

Rather than following a blanket approach to divestment from fossil fuels, Uhlenbruch has noticed leading pension funds taking on a broader perspective, by focusing on identifying, and mitigating, the expected impacts resulting from climate change on the real global economy; many European pension funds are now effectively universal owners through their diversified and global holdings, which effectively represents a slice of the world economy.

"These funds recognise that they are unable simply to divest their way out of climate-risk exposure, and have instead adopted the role of active stewards, leveraging their influence as large shareholders to ensure the companies they invest in are taking reasonable measures to align their business models and operations with the low-carbon transition," says Uhlenbruch.

Uhlenbruch also points to the example of the Swedish public pension fund, AP7, which applies its investor influence to hold companies publically to account on breaching the goals of the Paris Agreement, either in their public lobbying activities or their business models, and also undertakes impact-focused dialogue with over 100 companies on a range of important climate issues.

"Denmark's PKA also engages heavily with companies in carbon-dependent sectors who are seen to be misaligned with the goals of Paris," he adds. "Leveraging divestment is a last resort. For example, in 2018 PKA divested from 35 oil and gas companies following a process of focused engagement with 62 targeted companies in the sector."

Systemic risk

Elsewhere, the Church of England Pensions Board's (CEPB) director of ethics and engagement, Adam Matthews, identifies climate change as the chief ethical and financial challenge - posing a systemic risk to its ability to meet its pension obligations. As Matthews explains, CEPB adopts a three-fold approach to climate change that entails

working with other investors via schemes like the Transition Pathway Initiative and engaging with companies to focus on this issue, as well as disinvesting "from the highest-polluting fossil fuel companies". It also divests from those that after engagement it does not believe will manage the transition. The CEPB also considers how it can deliver "below two degree alignment within each asset class" across its whole portfolio.

"Based upon this approach we have been clear that we expect companies in the oil and gas sector, which we remain invested in, to make progress towards the goals of the Paris Agreement by 2023, or else we will consider divesting from them as well," he says.

Meanwhile, PensionDanmark's efforts to tackle climate change begun ten years ago when it acquired half of two of the first Danish offshore wind farms. According to PensionDanmarks' CEO, Torben

CLIMATE CHANGE WILL HAVE MATERIAL IMPACT ON AN INVESTMENT PORTFOLIO'S LONG-TERM RISK AND RETURN

Möger Pedersen, this "set the tone" for its current target to "invest 10 per cent of its assets under management in infrastructure such as wind farms, solar power, biomass-fired power plants and transmission plants".

Through investments in Copenhagen Infrastructure Partners, he also reveals that the fund has recently won bids to build offshore wind farms in the US and Taiwan and is "looking forward to seeing these new markets develop as the European market has".

"We divest from companies violating international conventions and companies breaking our guidelines for responsible investments regarding ESG. But fundamentally, we believe that to make an impact on climate change you need to shift the underlying demand for fossil fuels – not the demand for stocks. Therefore, we practice active ownership and engage with companies to help them with the transition to a low-carbon economy," he says.

Also in Scandinavia, Swedish fund AP4's CEO, Niklas Ekvall, observes that, in a "relatively short period of time, we have gone from a small world on a big planet to a large world on a small planet".

"For a long-term investor like AP4, it is a necessity as well as a responsibility to both manage risks and capitalise on opportunities associated with climate change and the shift to a sustainable world. Climate change will have material impact on an investment portfolio's long-term risk and return, and as such, must be addressed as part of the investment strategy," he says.

THE TRANSITION FROM FOSSIL FUELS WILL BE ONE OF THE MOST COMPLICATED TRANSITIONS EVER UNDERTAKEN

Managing transition

Generally speaking, Matthews believes that pension funds have no choice buwt to develop strategies to address climate change and not to do so "would be remiss" of the industry - both in terms of its fiduciary duty and its ethical responsibilities.

"The transition from fossil fuels will be one of the most complicated transitions ever undertaken, and we need to understand it as an issue, and encourage companies to examine their future business models to manage the transition," he says.

Meanwhile, Uhlenbruch views climate change as a long-term material investment risk that, if not managed appropriately, could lead to "significant financial deterioration of investment portfolios over time". He also stresses that the risks climate change presents are manifold - encompassing both physical risks, like extreme weather events and long-term climate system changes, as well as risks associated with a rapid transition to a low-carbon economy.

"The novel and non-linear nature of climate-related risks, which have never been faced before by investors, also means that a robust forward-looking risk assessment approach is required. Those funds that have developed climate strategies are better positioned to both understand and respond to these risks," he says.

"Moreover, these funds are also better positioned to benefit from the range of financial opportunities that the low-carbon transition is expected to present, with an estimated $90 trillion to be invested by 2030 in the infrastructure required to support a successful low-carbon transition. Pension funds that embrace these opportunities earlier are more likely to benefit financially over the long-term," he adds.

Regional performance

According to Matthews, leadership on climate change can be found in a number of European countries, particularly "France, the UK and the Scandinavian countries". That said, he stresses that the challenge is really that "it is not enough or sufficient to meet the global objective of below 2 degrees, let alone 1.5 degrees".

"We need to see more climate regulation to assist the transition. Pension funds across Europe need to be engaging with policymakers as much as we are engaging with companies if we are to meet the goals of the Paris Agreement. The role of the Institutional Investors Group on Climate Change will be vital to the role investors can play here," he says.

As a Danish pension fund with a huge footprint in renewable energy, Pedersen argues it is also "quite obvious to say that Denmark is doing great in tackling climate change", particularly by "exporting Danish energy solutions across the world" - with PensionDanmark "heavily involved" in financing such moves.

As far as Ekvall is concerned, Dutch and Nordic pension funds "seem to be leading the way" - and he also points out that AP4 is engaged in "significant cooperation with some UK pension funds" that it views as working actively with climate change, such as USS and Railpen.

According to Uhlenbruch, ShareAction research also reveals that Sweden and the Netherlands, where sustainability has been a deeply embedded societal value for many years, exhibit the "strongest cases of climate leadership from pension funds".

"In contrast, the UK was found to show weak performance relative to its European neighbours. We think this may be due to the fact that sustainability is only a relatively recent addition to the UK regulatory landscape for the financial sector, though we expect this to change over the coming years as awareness of the financial risks presented by climate change becomes more mainstream," he says. ■