

ROAD TO RETURN

Institutional investors
and low carbon solutions



Investor Group on
Climate Change

INVESTOR SIGNPOSTS

How institutional investors are
thinking about low carbon investment,
and where they are investing.

INVESTORS ARE STILL DEFINING GREEN INVESTMENT IN THEIR OWN WAY

Despite the proliferation of low carbon investment frameworks and definitional taxonomies, the majority of investors are using their own internal methodology to define green investment

AUSTRALIAN AND NEW ZEALAND INVESTORS HAVE A LARGE APPETITE FOR MORE GREEN INVESTMENT

100% of investors surveyed by IGCC stated that they intend to increase their green investments over the coming years

BUT INVESTORS ARE NOT PUBLISHING TARGETS FOR GREEN INVESTMENT

Despite strong intent, 100% of investors surveyed by IGCC stated that they do not intend to publish a green investment target at this stage (although there are other factors at play)

LACK OF INVESTABLE DEALS AND POLICY UNCERTAINTY ARE KEY BARRIERS

- 90% of investors identified lack of investable opportunities with appropriate risk return factors as the single largest inhibitor to growing investment
- 80% said policy or regulatory uncertainty remained a major challenge for investment
- The two issues may not be entirely unrelated

'Mission 2020'

- Collaborative initiative convened by former UNFCCC Exec Sec, Christiana Figueres
- Critical urgency of bending emissions curve by 2020. “Necessary, desirable, achievable”
- Sets ‘2020 Milestones’ for: energy, infrastructure, land use, industry **and finance.**
Investment in climate action is beyond USD \$1 trillion per year and all financial institutions have a disclosed transition strategy. Will need to:
 - 1) *Invest at least \$200 bn and \$800 bn private resources in climate action each year*
 - 2) *Increase the amount of philanthropic funding for the climate movement by ten-fold*
 - 3) *Multiply the green bond market’s annual issuance tenfold from 2016 levels*
 - 4) *Ensure that institutions disclose climate-related financial risks and that credit ratings fully incorporate them*
 - 5) *Eliminate fossil fuel subsidies*
 - 6) *Cancel the capital expenditure for expanding coal, oil and gas production*
 - 7) *Implement a carbon pricing mechanism within and across all major economies.*

What is the problem (real or perceived)?	What COULD investors do about it?	
COMMERCIAL VIABILITY?	<ul style="list-style-type: none"> • <i>Potential</i> opportunity is large, but not <i>investable</i> yet in many cases (esp. emerging tech); investor risk appetites and risk-adj. return requirements 	<ul style="list-style-type: none"> • Look harder? See the value in learning + ‘readiness’ • Partnering + piloting – e.g. CEFC, ‘climate finance’ • Policy advocacy - investment-enabling policy framework; ‘valley-of-death’ intervention.
POLICY/PATHWAY UNCERTAINTY?	<ul style="list-style-type: none"> • ST fundamentals stack-up, but LT policy uncertainty deters investors 	<ul style="list-style-type: none"> • Policy advocacy – clear, long-term policy signals; bipartisan approach.; integrated plan for transition
ACCESS?	<ul style="list-style-type: none"> • Lack a pipeline of ‘investment-grade’ deals; transaction costs, sovereign risk etc 	<ul style="list-style-type: none"> • Market intermediaries – e.g. Aligned Intermediary • Innovative forms of PPP – e.g. CEFC, GFC, DBs
RISK & ASSET VALUATION MODELS?	<ul style="list-style-type: none"> • Challenges of measurement and internalisation of <i>future</i> impacts (neg/pos) on asset values - compounded by future policy/pathway uncertainty; factoring in the portfolio benefits of contributing to <i>systemic</i> risk management. • Evidence on whether markets are pricing? 	<ul style="list-style-type: none"> • Collaboration on better data/tools (incl. scenario analysis and stress testing); note NCP/SCP initiatives • Board decision to move <i>ahead</i> of the pace of policy/market, based on investment beliefs: strategic tilt or hedge – e.g. NZSF [implicitly aligning with LC pathway to an extent?], AP4 (within TE constraints)
INVESTMENT MANDATES or STRATEGY?	<ul style="list-style-type: none"> • Constrained by mandates/legal duties (sole purpose test, fiduciary duty) • Lack of clarity on investment beliefs (market pricing of CC downside risk/upside); overarching objectives (resilience vs 2DC alignment); principles for dealing with trade-offs - real or perceived - between objectives. 	<ul style="list-style-type: none"> • Mandate change/reinterpretation: via government intervention (e.g. France) or collective industry leadership/policy advocacy. (Mercer: “<i>future taker or future maker</i>”?) • Set clear investment beliefs, objectives and principles.
THEMATIC vs. MAINSTREAM?	<ul style="list-style-type: none"> • Thematic products vs integrating climate change considerations across the board??? 	

Contributing to positive climate outcomes

- For a mainstream institutional investor - i.e. without an [overriding] green investment mandate or ethical policy – they can seek out ‘win win’ outcomes where possible, but ultimately bounded by duty to maximise risk-adjusted returns.
- So will continue to be constrained in how far they can go, **using the lever of portfolio construction (including investing in climate mitigation/adaptation solutions)**, without one or more of the following:
 - 1) Long-term policy certainty and investment-enabling conditions
 - 2) Social + environmental impacts, and systemic risk dimension, are internalised by markets into asset valuations.
 - 3) Boards take a long-term strategic tilt – e.g. based on adoption of investment beliefs about LT direction of travel and market pricing of climate downside/upside.
 - 4) Mandate change or re-interpretation (sole purpose test/fiduciary duty):
 - Enabling or requiring investors to take a broader interpretation of delivering ‘value’ to members/beneficiaries – e.g. consistent with ‘system value creation’ model of corporate sustainability.
 - Driven by societal/collective industry view about the role and responsibilities of business and institutional investors (as universal owners) in society generally or regarding climate change specifically
 - Prescribed by government or led by industry
- In the meantime, investors can use the other tools in their arsenal to contribute to positive climate outcomes and and orderly, just transition. E.g. public policy advocacy, collaboration on data + tools.