



Climate Change

Best Practice Methodology

Improving the management of climate change risks and opportunities in investment portfolios through superior implementation of best practice



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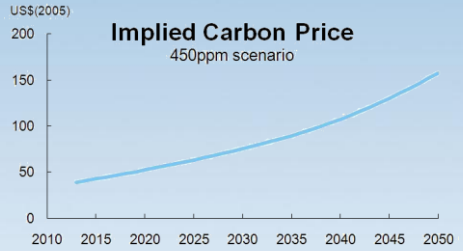
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There is not a single credible scientific institution that disputes the science of climate change.¹

Asset owners recognise that climate change is an investment risk with a unique profile in that it is long-term but also has high certainty and high impact. Therefore climate change represents a unique challenge for them to account for such risks in their existing portfolios and to take advantage of the rapidly emerging new markets.

The physical and policy impacts from climate change already affect specific assets and asset classes but also have the ability to create sudden, widespread repricing of global markets and panic regulation in future which may drive down values across all asset classes.

¹ These include the leading academies in 13 of the world's most powerful developed and developing countries, including the US, Japan, the UK, Germany, Canada, China, Russia and India, who issued a joint declaration on climate change in 2009 stating that "The need for urgent action to address climate change is now indisputable". See, *Climate change and the transformation of energy technologies for a low carbon future* (G8+5 Academies' joint statement). Available at: www.nationalacademies.org/includes/G8+5energy-climate09.pdf, accessed 04/06/10



Source: Australia's Low Pollution Future: The Economics of Climate Change Mitigation, October 2008, Australian Treasury

Whilst an individual investor can make a decision to trade out of any asset that it deems at risk from an 'inevitable' climate policy and carbon price, superannuation funds have a broader responsibility as long-term universal owners to consider the fallibility of short term markets to accurately price climate risk and develop investment strategies accordingly. Trustees and their superannuation funds have had some experience of the manifestation of systemic risks during the sub-prime crisis and this experience should be used to understand the repricing event that is likely to occur when climate regulation with climate science and the chaos that occurs in all asset classes when faced with a market of sellers.





Asset owners and the climate change challenge

The ability of asset owners to build capability in the management of climate change risks and opportunities is becoming core to their business. Not only is it certain that this capability will be required over the long-term but it will become a determining factor in both the risk/return profile of the investment portfolio and also the fund's position in the market place. Our research shows that many funds are already building significant capability in this area and that many more are planning to do so. Additionally, many members are already expecting capability in this area.

As a result of this situation, large asset owners in particular such as superannuation funds, pension funds, sovereign funds and insurance companies are faced with three key challenges:

- Integration of climate change risks and opportunities into investment strategies;
- Restructuring the processes within the investment chain to better account for systemic, long-term risks; and
- Implementing systems to check that the processes in place are sufficient to manage climate change risks and opportunities on an ongoing basis.

The Climate Change Best Practice Methodology has been designed to guide asset owners through the process of building this climate change capability.

The Climate Change Best Practice Methodology

The Methodology is a step-by-step guide designed to assist asset owners in designing and implementing a programme that will raise the standard of climate change management in their organisation to the highest global industry benchmarks. The Methodology is designed to assist asset owners in building capability that will increase members' long-term returns by:

- Measuring climate change risks and opportunities within investments across all asset classes;
- Implementing new business processes and capability for the ongoing monitoring and management of climate change risks and opportunities; and
- Protecting the fund from a sudden climate change event which may cause a global repricing of assets.

The key objective is improved management of climate change-related risks leading to better long-term risk-adjusted returns for members.

The scope of the Methodology

The Methodology provides a project governance framework and resources for asset owners to accelerate their programmes including templates, checklists, evidential dossiers, best practice examples, research databases and implementation guidelines. It guides asset owners from start to finish and includes every aspect of climate change capability implementation.

The scope of the Methodology is:

- Fund governance and change management
- Policy development
- Integrating climate change into investment policy
- Asset allocation
- Asset consultants: mandates and processes
- Investment managers: mandates and processes
- Reporting of climate change data
- Identification of climate change risks
- Fund-level climate change management
- Information systems development
- Active ownership
- Collaboration on climate change initiatives
- Communication with members
- Staff training and education
- Internal (fund) climate change management



1

Climate change assessment

The first step towards best practice is making an assessment of the asset owner's existing climate change capabilities and risk exposures. This initial phase is flexible in that some asset owners may begin with an assessment of their climate change capability while others may just launch straight into the project initiative.

2

Design of the fund's climate change blueprint

The project is initiated and the new policies, processes and systems are defined. In this stage, any portfolio changes identified as important to re-adjusting the climate risk profile of the portfolio are identified.

3

Implementation of new business processes

The investment decisions that will manage any unintended, acquired climate risk in the portfolio will be executed. Additionally, the new business processes are implemented, staff training and education takes place, new information systems are configured and the new processes for managing climate risk and opportunity are executed.

4

Project completion and ongoing management

It may take time to fully adjust the portfolio to account for climate risks and opportunities, but this phase is where the new processes and standards are fully implemented in the fund and its partner organisations. The new policies, processes and systems are closely monitored to ensure they are fully integrated into the normal running of the portfolio.

Using the Methodology

The Methodology focuses on how to affect the risk-return profile of an asset owner's investment portfolio. There are some elements of the Methodology that should be clearly mandatory for an asset owner to implement if they wish to consider themselves best practice, for example formulating a fund-wide policy on the treatment of climate change risks and opportunities, but others will create significant strategic consideration. Either way, the resulting decisions could have a significant long-term impact on how a portfolio survives and/or prospers in a carbon constrained economy.

The Methodology contains detailed reasoning behind each phase of implementation and why best practice is represented in this way. Where relevant examples exist of how leading asset owners have implemented in each area or where key evidence is available to support the reasoning, references and links to specific items are provided.

Where to from here?

The Methodology is available under a free license agreement; however, restrictions are made as to its use, modification, branding, distribution, etc.

The Methodology can be downloaded for free at:

www.climateinstitute.org.au/business/methodology
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