Some investors have been working on addressing the threats of climate change for more than a decade. The main driver for this has been the acceptance of the science of human-induced climate change. The logical next step is to think about the future: what are the ramifications for our environment, communities, economies and investments from the scientific projections of a changing climate?

Long-term asset owners and investors, such as superannuation funds, are bound to act as fiduciaries and make investment decision in their members’ ‘best interest’. These are terms with vague, largely-untested legislative definitions that are entrenched in past and current industry practice. This tends to foster a conservative, business-as-usual mindset and does not often take into account looming systemic risks. However the investment risks (and opportunities) from climate change are complex, covering broad factors such as physical impacts; carbon policy and legislation; anticipating winners and losers in the transition to a lower carbon economy. This complexity is exacerbated as climate risks are considered forward-looking and ‘long-term’ (though as there has been little concerted action to reduce carbon emissions over the last decades, it can be argued that the long term risks are already here and will manifest). So investors need to evolve their investment models to address climate change risks.

Carbon Tracker’s first global ‘Unburnable Carbon’ report, released in 2011, was an important step in building better investment models. It examined a particularly investment-relevant carbon risk not previously analysed – the financial risks and the extent for potential asset price ‘bubbles’ emanating from investing in fossil fuel companies whose financial value may never be fully realised as global carbon policies are set to limit the world to 2°C of warming. This is the scientific-consensus level of warming that avoids ‘dangerous’ levels of climate change and its associated potentially devastating investment consequences.

The second global Carbon Tracker report “Unburnable Carbon 2013” as well as this first analysis of the fossil reserves of Australian coal companies further develops this analysis.

There is little doubt in the logic behind the concept of ‘unburnable carbon’ and that it constitutes a significant investment risk across all asset classes.

The analysis in this report provides one scenario of the large exposure that asset owners could face in a resource-intensive economy such as Australia to a re-valuation of fossil fuel reserves due to enforcement of carbon policy. This results in a ‘carbon bubble’ which must eventually burst and erode shareholder value. It is similar in concept to other bubbles created and endured by the finance industry - from tulips in 17th century Holland to more recent bubbles of the internet and US housing market.

While fund managers may be more nimble and confident that they can trade out at the earliest sign of realisation of the carbon bubble (time will tell as investment models are yet to factor it in systematically), superannuation funds can be likened to super tankers: long-term and universal asset owners managing very large sums of money on behalf of members - it is not easy to brake or change direction.

But there are many things that asset owners can do in regards unburnable carbon and climate change risks. We can insist upon better risk modelling and scenario analysis from our advisers and managers; we can better quantify carbon risks in our portfolio; we can look to develop low carbon investment strategies that may act as a hedge to reduce these investment risks; and we can advocate greater certainty and co-ordination on global carbon emissions reduction policy as well as on accounting standards and fiduciary responsibility.

Unburnable carbon and climate change risks for investors are inevitable and increasing in magnitude, even if timing is uncertain. This report demonstrates once again the investment logic of acting sooner rather than later in order to reduce these risks.

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