EU PUSHED TOWARDS 'CLIMATE DISCLOSURE' REGIME FOR INVESTORS

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Pressure is building on global regulators and the European Commission to stress-test portfolios of large institutional investors against long-term objectives to reduce climate change, in a move that could shift billions in investment away from fossil fuels.

Climate risks should be further integrated in investment portfolios, said Alexis Dutertre, the Deputy Permanent Representative of France to the European Union in Brussels.

A range of incentives are being considered to steer investment towards low-carbon technologies, Dutertre told an event he hosted on Tuesday (5 April) for the WWF, the global conservation organisation.

A shift of taxation towards cleaner energy is actively being discussed among the EUs 28 environment ministers, he said, adding he hoped those discussions could be concluded soon.

Penalties, for example, could be envisaged for investments in fossil fuel sectors, Dutertre said, while other valuations like renewables could be rewarded positively with a bonus system.

Other ideas include raising capital buffer requirements for holders of fossil fuel assets.

European Commission cautious

France has been leading the way on green finance as it prepared to host the COP21 global conference on climate change in December last year.

In July, it became the first country in the world to introduce mandatory climate change-related reporting obligations for institutional investors. The law, which has been effective since January, is part of the French bill on energy transition for green growth and requires investors to report on how they integrate environmental, social and governance (ESG) considerations in their investment policies.

Sweden took similar steps to force carbon reporting requirements on pension funds and other institutional investors but so far failed to pass any legislation.

These initiatives have built up pressure on EU regulators to streamline national policies in order to prevent a fragmentation of the EU single market.

But the European Commission, the executive body of the 28-member EU bloc, appears cautious

not to rush things through.

We dont have the policy solutions yet, admitted Niall Bohan, head of unit at the European Commission in charge of the Capital Markets Union.

What we have is the willingness to invest in a policy that will take us forward, particularly in the area of disclosures for investors and issuers, he told the event hosted by the French Permanent Representation in Brussels.

Where we see the most potential is disclosures by institutional investors to explain their commitment to climate policies — how their balances sheets reflect taking into account these considerations, Bohan indicated.

The question, he said, was one of method. There has been a lot of experimentation and testing of different approaches, Bohan said. So its going to take a lot of hard work to determine the best set of metrics to underpin a sound disclosure regime.

But that is something that is clearly going to happen, he added, suggesting some reporting aspects could be included as part of the 2017 review of the Capital Markets Union (CMU) action plan.

Evaluating climate risks

For the WWF, which organised the event, this sounds like dithering.

The financial risks of the transition to a low-carbon economy are largely predictable and avoidable, the NGO said in a briefing paper. Those costs will be minimised if the transition begins immediately and follows a predictable path, it contends.

Our concern is that the EU hasnt been doing much until now. There is a surprising silence from the EU as a whole and more specifically from the Commission, said Sébastien Godinot, an economist at the WWF EU office.

The WWFs warning is not isolated to the NGO community. Remarkably, it is also being echoed by some of Europes most prominent economists. In February, the European Systemic Risk Board, an EU advisory body set up in the midst of the 2008 financial crisis, issued a report warning about an abrupt transition to a low-carbon economy triggered by external events.

A sudden transition away from fossil-fuel energy could harm GDP, as alternative sources of energy would be restricted in supply and more expensive at the margin, said the ESRB report, called Too late, too sudden.

Speaking earlier, Jane Ambachtsheer from the Mercer global consulting firm, presented a study showing that climate risk was becoming an emerging topic of focus for investors.

Ambachtsheer is a member of the Task Force on Climate-related Financial Disclosures (TCFD), set up by the G20 last December to develop voluntary climate-related financial risk disclosure for use by companies in their communication to lenders, insurers, investors and other stakeholders.

The Mercer study shows that sectors like real estate, fossils fuels or renewable energy will be affected differently depending on the climate policies being implemented, Ambachtsheer explained, with different asset classes benefiting or suffering unevenly as a result.

Climate change will have an impact, whether the Paris Agreement is implemented or not, she said in reference to the landmark deal reached by global leaders in the French capital to limit global warming to 2°C.

There is no way around it from an investment perspective, she said.

Exposure to climate-related disasters such as sea-level rise can have a huge impact on the valuation of property or infrastructure, she warned. It can happen like this, she said snapping her fingers — insurance rates can change overnight.

But while there was a lot of gloom and doom among the investor community about dropping asset valuations resulting from a switch to low-carbon technologies, she said this does not need to be the case.

An important key finding [from the Mercer study] is that a 2 degree outcome does not need to be bad for a diversified investor, she assured.

BACKGROUND

The European Systemic Risk Board, an advisory EU body set up during the 2008 financial crisis, has warned about the risks of moving too late and abruptly towards a low-carbon economy.

Banks which are exposed to carbon-intensive or CO2-heavy assets could face systemic risks, it warned in a report published in February.

Policymakers could aim for enhanced disclosure of the carbon intensity of non-financial firms, says the boards report, Too late, too sudden. The related exposure of financial firms could then be stress-tested under the adverse scenario of a late and sudden transition.

Central Banks have equally warned about consequences of a sudden transition. Extreme weather events raise costs for insurance companies, reduce investment valuations and lower the value of collateral posted for bank loans, the Bank of Finland said in a statement released on 22 March.

It is important to ensure that the financial markets and their participants, as well as the supervisory authorities, are aware of the effects of climate change on financial stability, said Erkki Liikanen, a former EU Commissioner in charge of digital policy who is now Governor of the Bank of Finland.

The Bank of England issued a similar warning in December, saying investors faced huge potential losses from climate change.

The warning was followed by the creation of a new industry-led global taskforce under the aegis of the G20. Launched during the UN climate conference in Paris, the Task Force on Climate-related Financial Disclosures (TCFD) was set up to develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to lenders, insurers, investors and other stakeholders".

Its final report is expected to be made public in February 2017.

Kaynak/Source: