How Can Finance do Its Part to Combat Climate Change

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Climate change presents a societal and economic challenge that we have never seen before. As a global society we must learn to change ingrained behaviors in order to avoid catastrophe down the road.

Unfortunately, inertia is one of the most powerful forces in the universe. We usually don't change until we have to. Well, we are at that point. Our planet is warming, primarily in response to increased levels of carbon dioxide (CO2) and other greenhouse gases (GHGs) that we have been increasingly introducing into our atmosphere since the industrial revolution. Finance can play a part in getting the world to a better place concerning carbon emissions, but time is running out.

The financial cost estimates of climate change have a wide range, but they are all bad. A recent report by the Economist Intelligence Unit estimated the net present value costs of climate change at US$4.2 trillion. Our new report, *Climate Change Analysis in the Investment Process* aims to help investors understand the physical and transition risks presented by climate change, the economic and market impacts that a changing climate will bring, and how carbon markets can function as a tool to better price in the negative externalities brought about by climate change. The report also offers an understanding of the resources available for investors looking for the best climate change integration tools.

The financial world will need to contribute to global efforts to address climate change, and the European Union's taxonomy for sustainable financial activities is a step in that direction, a step that policy makers from Canada to India are also beginning to take. To better understand the current gap between desired outcomes around climate change and processes in the investment business, CFA Institute surveyed its members concerning climate change for its *Climate Change Analysis in the Investment Process* report.

Some of the survey's findings are enlightening. About 75 percent of global C-level executives surveyed believe that climate change is an important issue, but only about 40 percent of all survey respondents incorporate climate change information into their investment process. This gap between understanding and action shows a financial world too frequently behind the curve in analyzing climate change and pricing in climate change risk.

Investors were then asked what information or resources would help them to adequately integrate climate change into their investment decision making. When asked why they do not include climate change analysis into their investment process, a majority of those surveyed (57%) cited a lack of measurement tools. When asked what tools they needed, 49% said more information on climate strategy from companies; and 48% said disclosures from issuers about climate-related risks and scenario analysis (48%).

In order to do the main job of finance—the efficient allocation of capital—investors need better data and better reporting standards to help integrate climate risk into their investment analysis. CFA Institute partnered with 10 international firms to produce case studies focused on climate change integration in analysis. Theses cover a diverse set of investment themes from equity, bonds and ratings agencies assessment of climate risk, to how pension funds integrate climate analysis into everything they do.

In the report we make several recommendations to investors, issuers and policymakers for better integrating of climate change analysis into what they do:

• A price on carbon: To underpin robust and reliable carbon pricing, CFA Institute calls on policymakers to ensure that regulatory frameworks for carbon markets are designed to deliver transparency, liquidity, ease of access for global market participants, and similar standards across jurisdictions.

• Carbon price expectations included in analyst reports: CFA Institute recommends that investment professionals account for carbon prices and their expectations thereof in climate risk analysis.

• Increased transparency and disclosure on climate metrics: CFA Institute notes that the investment industry is coalescing around the Sustainability Accounting Standards Board (SASB) and Task Force on Climate-related Financial Disclosures (TCFD) standards for climate-related disclosures, which are the most relevant and succinct climate-related disclosure standards for addressing the materiality of climate-related risks.

• Engagement with companies on physical and transition risks of climate change: CFA Institute asserts that investors should engage with issuers to ensure that climate data, scenario analysis, and related disclosures are sufficiently thorough to support robust climate risk analysis in the investment process.

• Education within the investment management profession: Investors need to continue to educate themselves about climate change in order to provide clients with the climate-related analysis they require.

• Policymakers: Investors need to continue to urge policymakers to craft regulations to ensure that investors have the tools they need to do the work of finance — that is, the efficient allocation of capital that helps to tackle the existential threat of climate change.

Climate change will be one of the most economically impactful events in human history. The investment profession needs to incorporate the risks of climate change into financial analysis to efficiently management portfolio risks and opportunities. At the same time, the immense changes in society brought about by a climate change transition will present opportunities to investors in both established and nascent industries.