IIGCC
Institutional Investors Group on Climate Change

Investment fit for the future

Addressing climate risks to secure a well-managed transition to a sustainable low carbon economy

IIGCC input to preparations for the G20 summit 2017 in Hamburg, Germany

1 Introduction

This paper is intended to support the efforts of the 2017 G20 German Presidency, which institutional investors across Europe view as a key opportunity to accelerate global economic growth and minimise the risks to such prosperity arising from the physical impacts of climate change and the transition to a low carbon economy.

Strong investment in productive assets such as sustainable, climate friendly infrastructure as well as the technologies, manufacturers and service supply chain needed to deliver that sustainable infrastructure will substantially raise the long-term growth potential of the global economy. Failing to address climate change, however, will generate systemic risks to the economy and to the stability of financial markets.

In this paper the Institutional Investors Group on Climate Change (IIGCC) suggests how the G20 can support a framework that will enable institutional investors to provide the capital required to drive an orderly transition to a sustainable low carbon economy consistent with their fiduciary responsibilities towards pension and insurance policy holders. To echo the theme of Germany's G20 Presidency, in the interconnected world, closer co-ordination and co-operation between public and private actors is essential to deliver the low carbon transition.

IIGCC urges G20 leaders to develop integrated climate-energy action plans at national level that include a clear pathway with intermediate and long-term targets to drive investment for sustainable economic growth. This should contain the following elements:

- **Carbon pricing measures – in the form of taxes or emissions trading schemes coupled with carbon performance standards**
- **Phase out of fossil fuel subsidies**
- **Specific measures for three key sectors: energy, transport and property:**
  - **Energy – continued support for renewables which are nearing cost parity with conventional fuels, alongside greater regulatory openness to new technology and business models afforded by the digitalisation of the electricity sector**
  - **Transport – increased vehicle mileage and efficiency standards, with support for greater electric vehicle charging infrastructure, particularly in major cities**
  - **Property – compulsory disclosure of energy performance particularly with regard to the *operational* phase of each building coupled with requirements to phase–out or upgrade the worst performing properties**
- **Adopt corporate reporting guidelines that require companies to disclose climate risks as recommended by the FSB's Task Force for Climate-Related Financial Disclosure**
- **Strengthen global institutions to drive climate action**
- **Advocate forcefully for the science and impacts of climate change, and for the investment, job and growth opportunities that come from the low carbon transition**

2 Developing national integrated climate-energy action plans. Setting intermediate and long-term targets to drive investment for sustainable economic growth

The Paris Agreement is now in force but it will be the national policies framed and implemented by individual governments that determine whether this agreement will succeed. National policies will also determine whether capital is invested to support sustainable economic growth.

The decisions G20 leaders make this year will shape national policy processes through 2020, which in turn will inform the costs of realising the Paris Agreement. Ultimately, most of the investment required will be in low carbon infrastructure, but to deliver that investment will also require investment in the supply chains of new and emerging technologies, manufacturing and services.

Institutional investors such as the members of IIGCC will only be able to invest in low-carbon assets and supply chains consistent with their fiduciary obligations to pensioners and policy holders. To facilitate this investors need consistent and predictable energy and infrastructure investment policy frameworks in every country seeking capital.

For this reason IIGCC argues that integrated climate-energy and infrastructure action plans must send vital signals to investors and should contain the following elements:

Carbon pricing measures – to level the playing field for low carbon technologies and factor in the costs of greenhouse gas externalities. These measures can either be in the form of a tax or a trading system coupled with stronger carbon performance standards. There is an inter-relationship between carbon pricing and subsidies: the better the negative externalities can be internalised, the more competitive low-carbon technologies become and the fewer subsidies are necessary to enable their successful development and deployment.

IIGCC welcomed the news in 2016 that Mexico, several US states and several Canadian provinces want to create a common CO2 emissions trading system. Investors also see potential in further cooperation on carbon pricing between G20 countries. We would encourage those G20 countries who have not implemented some form of carbon pricing to do so promptly as part of their national climate-energy action plans.

Phase-out of fossil fuel subsidies: Despite an overarching commitment to decarbonisation, the G20 has not been able to agree on a timetable for the phase-out of fossil fuel subsidies. Even though some low-carbon technologies are now available at a similar – and sometimes even lower – cost, they often cannot yet be deployed because of the way in which pre-existing (energy or fuel) subsidies distort markets. Given the importance of this issue, IIGCC would strongly encourage the German G20 Presidency to make another attempt at securing agreement for such a timetable.

Specific measures and targets for three key sectors: In addition to carbon pricing and the phase-out of fossil fuel subsidies, governments will also need to enact specific measures and targets to accelerate the pace and scale of investment in low-carbon technologies across three key sectors **(property, energy, transport)** covered by decarbonisation targets.

Energy

Great strides have been made in the cost and reliability of renewable energy, and costs continue to fall – while conversely the costs of new fossil fuel plants and nuclear is rising. Simultaneously, technological advances are allowing increased choice (e.g. distributed PV generation) and the penetration of lower or zero marginal cost generation is lowering wholesale power prices and destabilising traditional utility finances. In Europe and many other countries price levels are as such that no new plant, renewable or conventional, can be built without long-term price support, whether via public or private contracts or tariffs. These ultra-low prices mean that renewables still come at an incremental cost to existing fossil fuel plants.

Overall, we remain in a transition period in which renewables will still require support through 2020, though at declining levels. Post 2020, whether support is still required will be driven largely by fossil fuel prices, retirement of existing excess fossil capacity and, importantly, the evolution of technology and business models.

During this transition, stable regulatory and pricing regimes will be essential to continue to attract investment. Likewise, retroactive changes must be avoided in order to keep the cost of capital low. However, well-signposted changes and staged reductions in support of new plants (such as the US five year "glide path" to reduce the production tax credit for wind and solar).

It is also important to be alert to the technological changes that are affecting the electricity sector and enabling new business models. 30 years after the digital telecoms revolution, the electricity sector is embarking on its own digital revolution. Falling renewable costs, improved storage technologies and greater interconnectivity and "bid data" are offering industrial, commercial and consumers a wider range of energy choices than ever before – purchases from traditional utilities, direct purchases from renewable energy projects or on-site self-generation using wind, solar, biomass or storage.

In the past, regulation has been used to drive technology, especially in renewables. Now technology is poised to drive regulation. Governments should embrace these new technologies and business models which also means they must take a more dynamic and informed approach to regulation. At the same time, policy-makers need to find a fair way to deal with legacy assets such as coal and gas plants, which might have to close before the end of their useful lives (i.e. become stranded assets) due to their inconsistency with climate objectives.

Transport

IIGCC believes regulation *and* incentives are required in three key areas: engine technologies, the surrounding infrastructure and digitalisation. To ensure steady progress, incentives for the roll-out of zero emission engine technologies, such as EVs, must be combined with approaches that target engine efficiency, such as EU vehicle emissions standards. The role of publicly funded R&D and the interface between this and automotive companies is also critical.

In parallel, governments must also create a clear incentive sufficient to drive the roll-out of the charging infrastructure for an electric vehicle fleet. Possible approaches include signals regarding market size such as the country-level adoption of mandatory targets for the number of EVs. Other possible approaches include regulation which prescribes the integration of EV charging stations into new buildings or existing petrol stations.

Property

Governments need to combine regulation and incentives. Firstly, better information about the energy performance of a building needs to be made available, particularly with regard to the *operational* phase the building (most certificate schemes currently only cover the performance of building *designs*). This will enable energy efficiency improvements and, consequently, their integration into real estate valuations.

Regulation also needs to ensure the phase-out (demolition) or the upgrading of the worst-performing properties with the worst ratings. Incentives for this include the continued availability of energy efficiency loans from promotional banks, government support programmes particularly for the poorest households, fiscal incentives and the promotion of on-bill repayment mechanisms.

Before the Paris Agreement, roughly 1000 GW of new coal-fired power generation assets were either in planning, commissioning or under construction. While some of these projects have been cancelled already, the construction of those projects that remain in the pipeline will drastically increase the amount of capital tied up in high-carbon assets. This is likely to increase resistance to political action in compliance with the Paris Agreement. However, since climate change is an imperative, the action required to implement Paris will ultimately lead to the premature closure of these assets, stranding significant amounts of capital. Governments, coal plant owners such as utility companies or state owned enterprises, and financiers funding these projects will all suffer as a consequence of these write-offs. Appropriate government policy with a long-term orientation can mitigate the risk that these assets will be developed, and thus reduce the risk across entire asset classes. As investors, we can take steps to ration the flow of capital to such projects if we have *confidence* in government policy.

Developing 2050 strategies

Although action plans should be the priority to make sure NDCs are implemented, they will be more successful if complemented by intermediate & longer-term target setting at a national level to help ensure companies and investors can prepare better for the low carbon transition.

Investors believe the development of a mid-century greenhouse gas emissions reduction strategy is a crucial component of the Paris Agreement that will be critical for achieving the goal of limiting warming to 1.5–2°C and sending appropriate signals to investors. Germany therefore deserves praise for its decision to become the first country to publish a Climate Protection Plan 2050 shortly before COP23 in Marrakech.

China and India, which have not yet identified when their own national emissions will peak or the year by which they intend to ensure their economy becomes carbon neutral in particular, are encouraged also to provide a 2050 plan. Spelling out a vision for net zero emissions will mobilise key actors around a common objective. This vision should include the development of sectoral emissions pathways, including phase-out dates for high-carbon assets and technologies.

IIGCC encourages the G20 Presidency to call for the development of 2050 strategies by all countries.

3 Adopting guidelines that require corporate disclosure of climate risk

Emission reductions required under the Paris Agreement as well as changing technology and demand dynamics imply a potentially disruptive move away from fossil fuels that will transform all major sectors. It follows from this that investors must become far better able to assess, price and manage effectively the risks and opportunities of transition to a sustainable, low carbon, global economy.

Robust disclosure has a critical role to play in enabling financial markets to price risks correctly, reward corporate strategy that is aligned with political objectives and technological progress, sanction corporate strategy that is uninformed by climate risk, and improve the efficiency of the low carbon transition by ensuring capital is put to most efficient use.

If climate risks are left less than fully exposed, we will continue to see ill-informed management decisions that drive up the cost of the transition for policy-makers, investors and – ultimately – for consumers and communities, forcing governments to step in to address the consequences of market failure.

IIGCC therefore actively supports the work of the FSB Task Force on Climate-Related Financial Disclosures (TCFD), wrote to the TCFD outlining its recommendations during the public consultation process undertaken in the spring of 2016 and has presented to the TCFD plenary. Several IIGCC members also formed part of the task force.

European investors welcome the TCFD's voluntary framework for standardised forward-looking quantitative and qualitative disclosures. While we cannot yet comment in detail, we believe the Task Force's framework will ultimately – if fully implemented in all key markets – help investors to better assess whether companies are adapting their business strategies to a 2°C climate change pathway, as well as to changing market and technology dynamics.

For institutional investors to make robust decisions that accurately reflect physical risks posed by climate change and transition risks arising from swift adoption of clean and efficient technologies, IIGCC believes that material climate disclosures must become a routine part of annual reporting practice. This would help to secure business resilience over the time horizons relevant to the needs of long term institutional investors and their beneficiaries.

IIGCC also supports investor disclosure alongside company disclosure. It believes disclosure standards for investors should be non-descriptive in order to allow best practice to emerge and to encourage innovation. It expects TCFD's proposals for company disclosures related to governance, strategy, risk management and metrics/targets to support the evolution of tools and methods for financial institutions to also improve their own reporting practices and curb their portfolio-level exposure to climate-related risks.

IIGCC encourages the German G20 Presidency to ensure that the work begun by TCFD can be taken forward by the Green Finance Study Group as part of a clear commitment from the G20 as a whole to implement TCFD recommendations in full and under the shortest possible timeframe.

One possible approach would combine hard law spelling out general disclosure principles with soft law giving guidance by sector. IIGCC is confident that combined with the investor demand for this kind of information, companies will be sufficiently compelled to disclose and integrate risks appropriately.

4 Strengthening the right global institutions to drive climate action

The implementation of the NDCs is essential in order to maintain credibility of the Paris Agreement. Governments – particularly in countries with less experience of taking climate action – need to believe they can achieve their objectives, need to be convinced that others are taking comparable action, and need the necessary support to ensure they can implement their own policies and programmes. To that end IIGCC believes the United Nations system along with other international organisations providing policy advice and implementation support should be strengthened. In particular, the UNFCCC secretariat should monitor progress towards the overall objectives of the Agreement, and inform the review and ratcheting mechanisms built into it.

IIGCC has also noted the German G20 Presidency's clear desire to give greater prominence to what G20 does to improve the economic situation in Africa. Given the open commitment of existing UN institutions to drive greater convergence between international action to address the climate crisis and that required to realise the Sustainable Development Goals, IIGCC would like to see more stress placed on the importance of the development finance institutions, particularly the development banks, in providing policy advice and bringing private capital into the financial infrastructure of less developed economies.

Echoing recent comments made by Germany's development minister in the direction of The World Bank, IIGCC hopes the G20 as a whole will commit to using its influence on development bank governance to ensure the financing of high-carbon infrastructure and power generation assets comes swiftly to an end.

Likewise, IIGCC would urge the G20 to couple that commitment with another to ensure all new investment by development banks in the three key decarbonisation sectors of transport, energy and real estate is geared in future towards the realisation of objectives set out under the Paris Agreement.

Finally, as institutional investors are universal owners with a keen interest in the long term health of the global economy, we may have views that are distinct from those of companies that may be driven by other considerations. IIGCC would therefore welcome the establishment of a new G20 forum that while similar to the B20 is *exclusively* dedicated to dialogue between investors and governments.

5 Advocacy for Climate Science and Opportunities

2017–2020 will be a critical time for combatting climate change and implementing the Paris Agreement. In the current political climate, we suggest that it is critical for the G20 to reaffirm the science of anthropogenic climate change. Similarly, the G20 should work to dispel the myths of the costs associated with action to avert climate change, which are often based on out of date technology costs, and work to emphasise the economic and job growth opportunities arising from the low carbon transition. The International Renewable Energy Agency now reports that 8.1 million people are employed globally in renewable energy, a 42% increase since 2012.

6 Conclusion

The G20 Summit in Hamburg is a critical opportunity to set the world on a higher sustainable growth path through concerted effort to drive swifter and more comprehensive climate action.

G20 leaders have the opportunity to address the complexities of the current state of the global economy through an integrated approach that fully utilises the opportunities for sustainable growth while mitigating the risks to that growth. Coherence between the objectives of the Paris Agreement, realisation of the SDGs, energy policy, infrastructure investment and some aspects of financial regulation will ensure that the transition necessary to implement the Paris Agreement will occur with the least disruption and the highest possible efficiency.

As the performance of our portfolios is closely tied to the sustainability and strength of global growth, we will continue to follow these developments closely and look forward to continuing our collaboration with the German G20 Presidency.

Membership – December 2016

Aegon
Allianz GI
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AP2 (Second Swedish National Pension Fund)
AP3 (Third Swedish National Pension Fund)
AP4 (Fourth Swedish National Pension Fund)
AP7 (Seventh Swedish National Pension Fund)
APG Asset Management
ATP
Aviva Investors
AXA Group
AXA Investment Managers S.A.
Baillie Gifford & Co
BBC Pension Trust
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BlackRock
BMO Global Asset Management (EMEA)
BNP Paribas Asset Management
BT Pension Scheme
Caisse des Dépôts
CB Richard Ellis
CCLA Investment Management
Central Finance Board of the Methodist Church
CF Partners (UK) LLP
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Climate Change Capital
Danske Bank
Deutsche Asset Management
DIP
Dragon Capital Group Ltd.
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Edentree Investment Management
Environment Agency Pension Fund
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ERAFP
Ferrostaal Capital
First State Investments
Fonds de Réserve pour les Retraites (FRR)
Generation Investment Management LLP
Greater Manchester Pension Fund
Guardian Media Group Plc
Henderson Global Investors
Hermes Investment Management
HgCapital
HSBC Investments
Impax Asset Management
Inflection Point Capital Management
Insight Investment
Janus Capital International
JOEP
Joseph Rowntree Charitable Trust
Kempen Capital Management
Kent County Council Pension Fund
Kleinwort Benson Investors
La Banque Postale
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London Borough of Islington Pension Fund
London Borough of Newham Pension Fund
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Low Carbon Ltd
M&G Real Estate
Marguerite Advisor S.A.
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Ohman
OU Endowment Management (OUem)
PBU
PenSam
PensionDanmark
The Pensions Trust
PGGM Investments
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URC Ministers Pension Fund

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The Institutional Investors Group on Climate Change is the pre-eminent European forum for investor collaboration on climate action. IIGCC has 132 members, including some of the largest pension funds and asset managers in Europe, who represent over €14 trillion in assets. IIGCC's mission is to provide a common voice for investors to encourage public policies, investment practices and corporate behaviour which will address long-term risks and opportunities associated with climate change.

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