INVESTOR STATEMENT ON **CLIMATE CHANGE** REPORT 2008

IIGCC

Institutional Investors Group on Climate Change

About IIGCC

The Institutional Investors Group on Climate Change (IIGCC) is a forum for collaboration on climate change for European investors. The group's objective is to catalyse greater investment in a low carbon economy by bringing investors together to use their collective influence with companies, policymakers and investors. The group currently has 52 members, representing assets of around €4trillion. IIGCC's objectives are:

1. **Investor engagement:** To encourage a pro-active approach amongst asset owners and asset managers on climate change (through adapting their own investment activities and processes)
2. **Company engagement:** To improve company disclosure/performance on climate change (in their role as shareholders and bondholders)
3. **Policy engagement:** To encourage public policy solutions that ensure a move to a low carbon economy and which are consistent with long-term investment objectives

Further information can be found at www.iigcc.org.

Acknowledgements

The report was prepared by Stephanie Pfeifer (IIGCC). The IIGCC would like to acknowledge the help of its Steering Committee in reviewing drafts of this report, in particular Rory Sullivan (Insight Investment), Paul McNamara (PRUPIM) and David Russell (USS) and would also like to thank Mercer's Responsible Investment team for their support.

Contents

Foreword

This, the second annual report on the actions that the signatories to the IIGCC Investor Statement on Climate Change have taken, clearly demonstrates that investor awareness of the impacts of climate change on their assets has increased as has the realisation that investors should be part of the solution to this global challenge.

The report suggests that asset owners are increasingly taking steps to encourage their investment managers to integrate climate change into their corporate engagement activities and into their investment analysis. It demonstrates that asset managers are actively engaging with companies on a wide range of climate-related issues and are looking beyond equities to examine how climate change will impact other asset classes.

The report also highlights a number of areas where further progress is required. Perhaps most importantly, the report suggests that policy uncertainty is a barrier to both engagement efforts directed at encouraging companies to significantly reduce their greenhouse gas emissions and also to ensuring that capital flows to companies and investments that support the move to a low carbon economy.

The IIGCC therefore intends to focus much of its efforts on public policy, to encourage governments to develop a strong international climate change regime and to adopt policies at the national and regional levels to give effect to their climate change commitments.

P. W. Dunscombe

Peter Dunscombe
IIGCC Chairman

Executive summary

This is the second annual report considering the actions taken on climate change by signatories to the Investor Statement on Climate Change. The Statement was launched by the Institutional Investors Group on Climate Change (IIGCC) in 2006 and by the end of 2008 had been signed by 22 institutional investors, both pension funds and asset managers.

Key findings

The report highlights that respondents are paying greater attention to climate change in their investment processes and analysis. It suggests that significant steps are being taken particularly with respect to listed equities and property investments, but less so in other asset classes.

The main areas of focus for investors continue to be those where climate policy makes the issue material, for example where there are clear investment opportunities in renewable energy or sectors that are exposed to emissions trading schemes. In their engagement with companies, respondents remain focused on companies' management practices and processes rather than on performance, i.e. delivering greenhouse gas emission reductions.

These findings reinforce the view that strong public policy is critical for investors and companies to move capital towards a low carbon economy. It also suggest that a credible and effective policy framework would increase the effectiveness of investors' engagement because it would provide support to the argument that companies need to prepare themselves for further policy action over time.

Investors have shown increased willingness to engage in the policy process – particularly in collaboration through the IIGCC, and should redouble their efforts, not only with respect to their own processes, but also on policy engagement in order to ensure that policymakers provide appropriate price signals to investors.

Building capacity

- Investors' awareness of climate change as a financial issue is growing and signatories are building their capacity on the issue through staff training, research and collaborative initiatives.
- More than three quarters of signatories have referenced climate change in their policies and belief statements.

Market demand

- Asset owners are taking greater steps to encourage their asset managers to take account of climate change in their investment processes. There has been a rise from 30% to 50% in the proportion of asset owners questioning existing and potential managers on how they integrate climate change into their investment research, analysis and decision-making and shareholder ownership activities.
- There is some evidence that this will increasingly be reflected in more formal requirements for asset managers over time. While the number of asset owners integrating climate change into Requests for Proposal (RFPs) is unchanged and the inclusion of the issue in Investment Management Agreements (IMAs) is still unusual, some asset owners stated that they would consider this approach in future.

- 70% of asset owner respondents monitor their asset managers' performance on climate change and 60% say that their expectations are met at least "often". The area where some asset owners identified room for improvement was amongst their managers for alternative asset classes.
- There was a significant increase in the proportion of asset owners requesting advice on investments in clean energy from 1 in 2007 to 4 out of 10 in 2008, but overall only minority of asset owners instruct their consultants to consider climate change in the advice they provide.

Corporate engagement

- Almost all asset managers and asset owners exercise their voting rights and engage with companies on a wide range of issues related to climate change. Governance issues have moved up the agenda and the focus of engagement is gradually extending to adaptation as well as mitigation.
- Companies' specific policy commitments on climate change received less attention in corporate engagement activities in 2008 compared to 2007, as have companies' lobbying activities on the issue.
- A majority of asset managers report on their engagement activities, but fewer attempt to assess the effectiveness of their engagement with companies.

Considering climate change in investment analysis

- All asset managers and three quarters of the internal managers of asset owners state that they consider climate change risks and opportunities in their investment analysis for listed equity. For asset owners, this is a substantial increase on 2007.
- An increasing number of asset managers are looking at climate change issues for other asset classes. Fixed income is the asset class for which the integration of climate change is seen as particularly difficult.
- Broker reports continue to play an important role in informing investment decision-making. The number of internal managers of asset owners using broker reports on climate change has doubled. However, there are still varying degrees to which this research is distributed across investment teams.
- The most immediate reasons for integrating climate change into investment decision-making continue to be regulation (e.g. emissions trading schemes) and investment opportunities created by government incentives (in renewable energy), highlighting the importance of strong, credible public policy frameworks.
- A large majority of asset managers cover climate-related activities in their external reporting but few have begun to assess the impact their climate change approach has had on the performance of their portfolio.

Public policy engagement

- Respondents are actively engaging with policymakers on a wide variety of climate change issues, including specific targets on greenhouse gas emissions, emissions trading schemes and renewable energy incentives. They have started to pay attention not just to mitigation issues, but are gradually considering policy on adaptation as well.
- In order to leverage their influence, investors are conducting their policy work in collaboration with others and the IIGCC remains the focal point for this in Europe.

Investors have been able to obtain greater access to policymakers and are receiving greater recognition that they have an important role to play in the climate change debate. However, there is still further progress to be made in this respect.

Climate change considerations in property investments

- The majority of respondents consider climate change factors in their due diligence process for direct property investments as well as in their on-site climate activities. The issues most often considered are energy efficiency, energy generation and water management.
- A significant number of asset managers with property investments consider compliance with specific environmental building standards and benchmarks.
- Investors are also engaging with stakeholders, including real estate managers, developers and tenants, and a small majority of asset managers report some evidence of the effectiveness of their engagement.

1 Introduction

The IIGCC Investor Statement on Climate Change (see Appendix 1) encourages investors – both asset owners and asset managers – to take a more pro-active stance on climate change. It sets out the actions that investors can take in their own investment processes and in their engagement with companies, policymakers, other actors in the investment community and wider stakeholders. Signatories to the Statement commit to reporting annually on the actions they have taken on climate change.

By the end of 2008, the Statement had been signed by 22 investors, 11 asset owners and 11 asset managers, representing assets of around €2 trillion. This is the second annual report and it analyses the actions signatories have taken on climate change during calendar year 2008.

The IIGCC commissioned Mercer to carry out and analyse on-line surveys for this report. The previous year's surveys were adapted and improved, specifically to include more detailed sub-questions and also to address how signatories are taking action on climate change in alternative asset classes, such as property investments. Mercer were also asked to verify the data provided through telephone calls with all signatories to the Statement and to focus in detail on the integration of climate change factors in investment decision-making. The report therefore considers the results of both the surveys and the interviews.

The report summarises how investors are responding to the challenge of climate change, both to new regulations and the threat of physical changes. It details how investors are building their knowledge of the issue and its implications for their assets, both through research and membership of collaborative initiatives. The following chapters consider how asset owners are encouraging their investment managers to be more pro-active on climate change and how asset managers are responding in their engagement with companies and in factoring climate change into investment decision-making. The report looks at how investors are ensuring that public policy supports long-term investment decision-making and the move to a low carbon economy. There is a new chapter devoted specifically to how climate change is treated in property investment.

The report tries to highlight best practice and allows signatories to gauge their performance against that of their peers. Where possible, it suggests where investors are making progress compared to the previous year. Case studies are used to illustrate the wide variety of ways in which the issue of climate change is being addressed in practice. Finally, the report considers what factors continue to prevent investors from taking account of climate change in their processes and decisions and how investors could become more effective in their response to climate change.

2 Building capacity

Investors' awareness of climate change as a financial issue continues to grow. Both asset owner and asset manager signatories to the Statement provide staff training, support climate change-related research and participate in collaborative initiatives.

Staff training

The surveys show that a large majority of asset owners (8 out of 11) and asset managers (9 out of 11) provided staff training on climate change issues in 2008. This is delivered mainly through attendance at seminars or workshops, followed by information sharing through regular staff meetings.

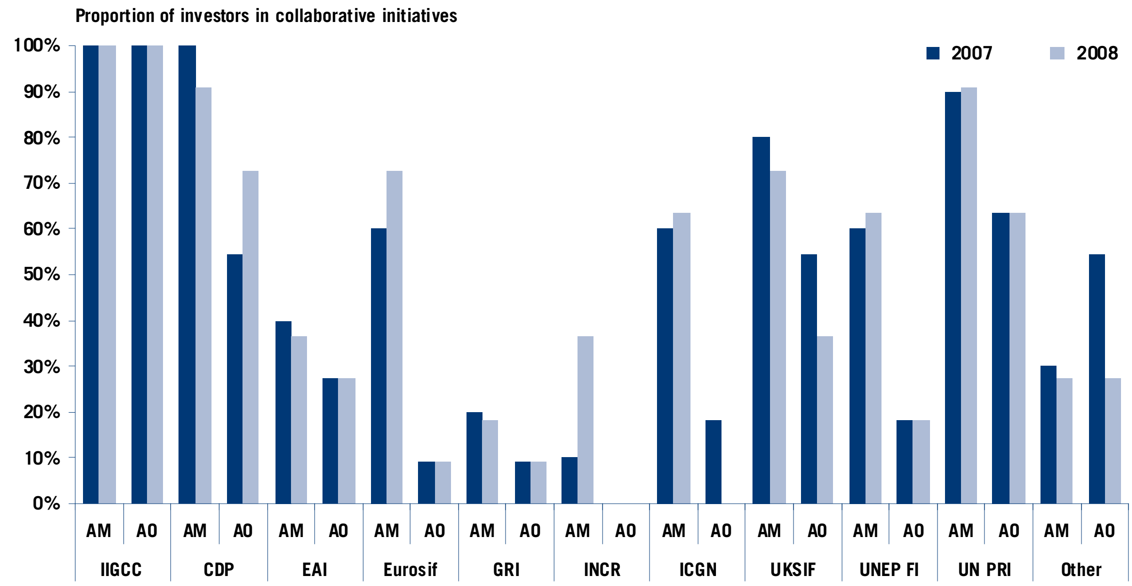
Research

Almost all asset managers stated that they have supported climate change research over the last three years. Research papers are either published or commissioned internally or produced by collaborative initiatives or academics. Approximately half of asset owners have supported climate change research over the last three years, mainly through research published by collaborative initiatives.

Collaborative initiatives

Collaborative initiatives remained a popular way for investors to build capacity on climate change and all asset manager respondents are IIGCC members. The other most popular initiatives amongst signatories are the Carbon Disclosure Project (CDP) and the UN Principles for Responsible Investment (UN PRI).

Chart 1 **Membership of collaborative initiatives**



* Other includes, for example LAPFF, Corporate Leaders Group on Climate Change, EU Corporate Leaders Group and ClimateWise.

Box 1	Collaborative initiatives
IIGCC	Institutional Investors Group on Climate Change
CDP	Carbon Disclosure Project
EAI*	Enhanced Analytics Initiative
Eurosif	European Social Investment Forum
GRI	Global Reporting Initiative
ICGN	International Corporate Governance Network
INCR	Investor Network on Climate Risk
IPCC	Intergovernmental Panel on Climate Change
UKSIF	UK Social Investment Forum
UNEP FI	United Nations Environment Programme Finance Initiative
UNPRI	United Nations Principles for Responsible Investment

*EAI is now linked with PRI

Referencing climate change

More than three quarters of respondents (8 out of 11 asset owners and 9 out of 11 asset managers) have specifically referenced climate change in their investment policies and belief statements. These policies generally apply to all assets under management.

Overall, the surveys and interviews covering 2008 show that respondents' awareness of climate change and its financial impacts is growing and that both asset owners and asset managers are building their capacity on the issue through staff training, research and collaborative initiatives. Most investors have referenced climate change in their policies and belief statements.

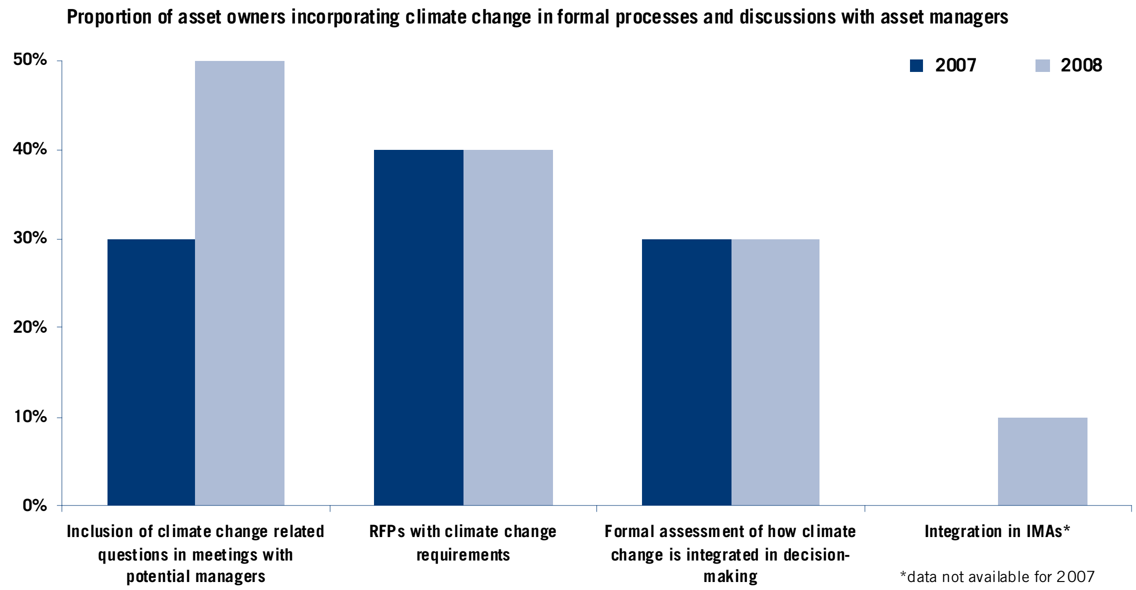
3 Market demand

Asset owners have a critical role to play in encouraging a more pro-active approach to climate change by their internal and external asset managers. Demand from pension funds is a key determinant of how climate change is integrated into fund managers' investment activities and decision-making and ultimately the contribution that companies and other assets make to climate change. This chapter considers to what extent climate change considerations are integrated into asset owner processes for appointing and evaluating fund managers.

Asset owner processes: appointing and evaluating external managers[1]

The results of the surveys suggest that there has been some increase in the number of asset owners that are integrating climate change considerations into their processes for appointing and evaluating external investment managers on climate change.

Chart 2 Asset owner processes



Appointing new managers

A small majority asset owners (6 out of 10) stated that they consider the extent to which climate change is integrated in investment research, analysis and decision-making and shareholder ownership activities when appointing a new manager. Only 1 out of 10 asset owners does not consider climate change integration in their selection process at all.

There has been an increase in the proportion of asset owners that include climate change-related questions in meetings with potential investment managers (5 out of 10 in 2008 compared to 3 out of 10 in 2007). However, the proportion of asset owners integrating climate change requirements into Requests for Proposal (RFPs) is unchanged at 4 out of 10.

[1] The questions in the survey covering 2008 were more detailed and therefore comparisons with 2007 are not always possible. One asset owner is excluded from the analysis in this section as it manages all of its assets internally.

The number of asset owners that undertake formal assessments of how investment managers are integrating climate change into investment decision-making also remains unchanged at 3 out of 10. More innovative approaches, such as inclusion of a statement on climate change into Investment Management Agreements (IMAs) or carbon footprint analysis are still fairly unusual, with only 1 out of 10 asset owners taking this approach. However, 2 out of 10 respondents are considering including a statement on climate change in their IMAs during 2009.

Evaluating existing fund managers

The surveys show that 7 out of 10 asset owners monitor the extent to which their existing fund managers integrate climate change into their investment research, analysis and decision-making and shareholder ownership activities. The evaluation is done mainly through the inclusion of climate change-based questions in quarterly meetings and by asking managers to report on their engagement and voting activities with respect to climate change. 3 out of 10 respondents have also developed tools for benchmarking climate change integration and undertake carbon footprint assessments of their existing managers.

Case Study: The Environment Agency Pension Fund
Encouraging investment managers to take account of climate change

The Environment Agency Pension Fund's (EAPF) responsible investment strategy seeks to exploit the relationship between good environmental management and long-term sustainable businesses. Consistent with this view, the EAPF believes financially material issues like climate change are increasingly important and will increasingly affect the performance of companies.

The pension fund believes its main areas of influence are through its strategic asset allocation, investment portfolio structure, investment manager stock selection, performance targets, monitoring, and reporting. However, the pension fund is clear that its role is not to get involved in the day-to-day investment decision-making, which is the role of its investment managers.

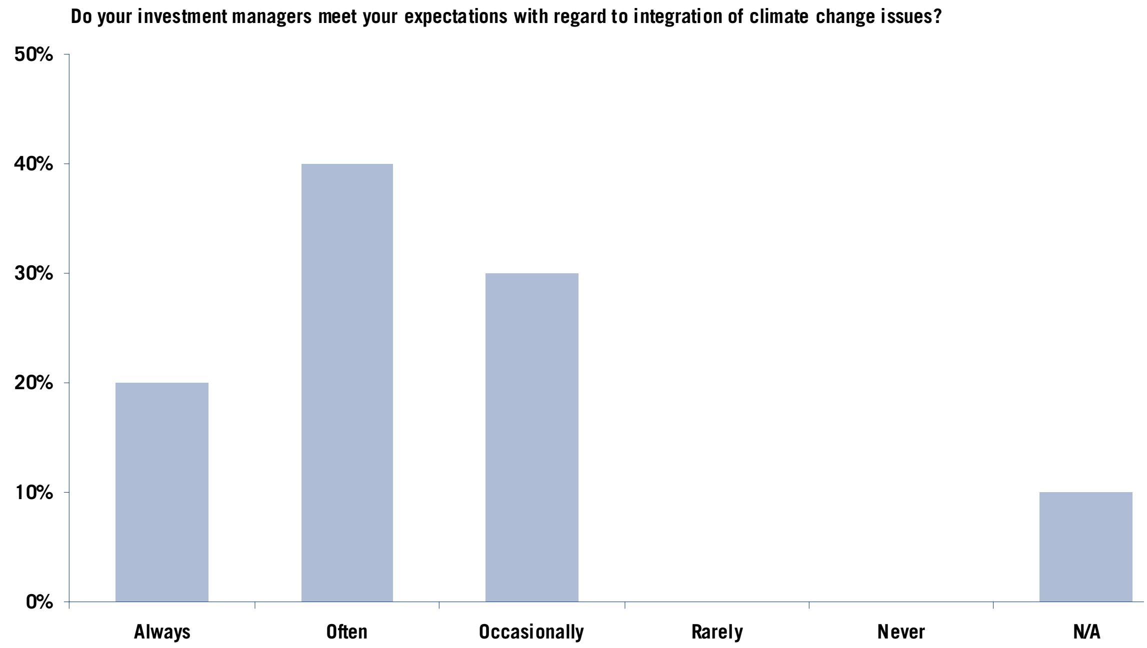
EAPF has deployed an environmental overlay strategy (EOS) across 100% of its pension fund, including all asset classes and investment activities. The strategy includes specific requirements for each asset class. Using the strategy, the pension fund selects investment managers that integrate environmental risk assessment into their investment decision-making and monitors both financial and environmental performance.

The EAPF encourages its investment managers to undertake and use research on environmental issues to identify opportunities that arise from innovative solutions such as renewable energy and technology, as well as research to assist in avoiding financial risks attributable to environmental issues. Using quarterly reporting, and in the case of active equity managers environmental and carbon foot printing, the EAPF looks for its managers to demonstrate the application of such research in their stock or fund selection[2].

The 2008 survey contained a new question about whether or not investment managers meet their clients' expectations with regard to the integration of climate change issues. The responses show that 6 out 10 of asset owners believe that their managers meet their expectation at least "often". Some asset owners suggested there was scope for improvement amongst their managers in relation to alternative asset classes.

[2] www.environment-agency.gov.uk/pensions.

Chart 3 Evaluating investment managers

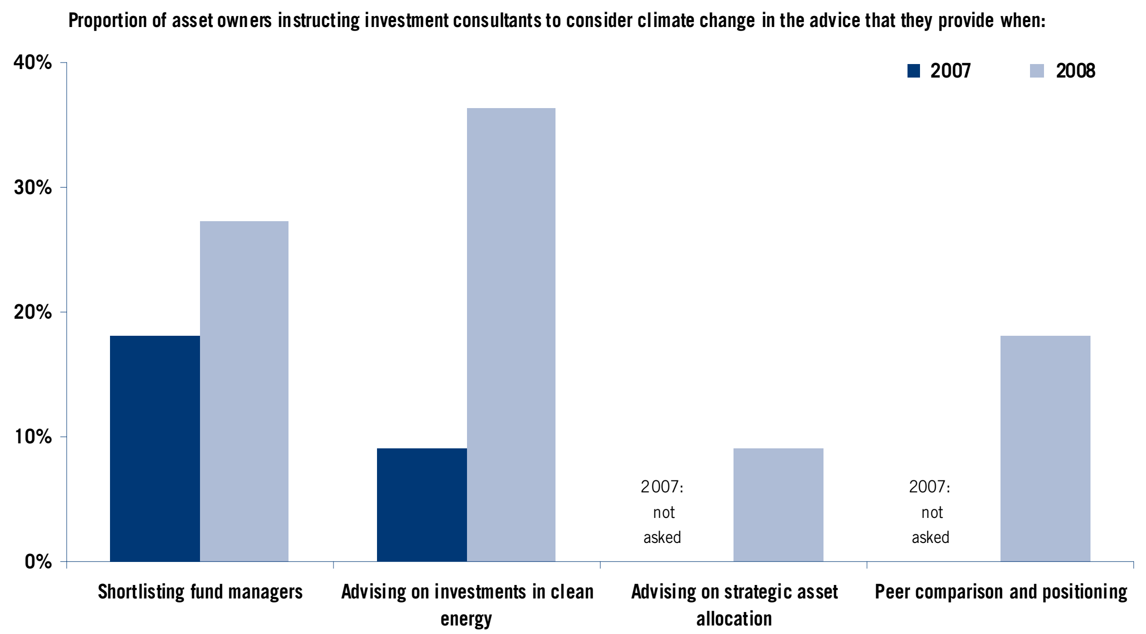


Instructing investment consultants to consider climate change[3]

The surveys show that there are still only a few pension funds that instruct their advisors and consultants to consider climate change in the advice that they provide (4 out of 11)[4].

However, there was a significant increase in the number of asset owners asking about investments in clean energy, from just 1 in 2007 to 4 out of 11 in 2008. There was also a small increase in the number that asked consultants to consider climate change when shortlisting fund managers, from 2 out of 11 in 2007 to 3 out of 11 in 2008.

Chart 4 Investment consultants



3 This section analyses the actions of all 11 asset owner signatories.

4 2 asset owners do not use investment consultants.

Overall, the surveys and interviews suggest that asset owners are taking greater steps to encourage their asset managers to take account of climate change in their investment processes. A greater proportion are questioning existing and potential managers on how they integrate climate change into their investment research, analysis and decision-making and shareholder ownership activities.

There is some evidence that this will increasingly be reflected in more formal requirements for asset managers over time. While the number of asset owners integrating climate change into Requests for Proposal (RFPs) is unchanged and the inclusion of the issue in Investment Management Agreements (IMAs) is still unusual, some asset owners stated that they would consider this approach in future.

The surveys suggest that a large majority of asset owners monitor their asset managers' performance on climate change and a reasonable majority say that they are meeting their expectations at least "often". There is most scope for improvement in integrating climate change in managing alternative asset classes.

There was a significant increase in the number of asset owners requesting advice on investments in clean energy but overall only a minority of asset owners instruct their consultants to consider climate change in the advice they provide.

4 Corporate engagement

The Investor Statement encourages investors to exercise their shareholder voting rights with respect to climate change and to engage with companies on their climate strategies and disclosure. This section considers how asset managers and asset owners with internal managers that invest in equities vote on climate change issues, how they engage with companies on climate change, how they assess the effectiveness of this engagement, and how they report on their activities internally and externally.

Engagement and voting by type and issue

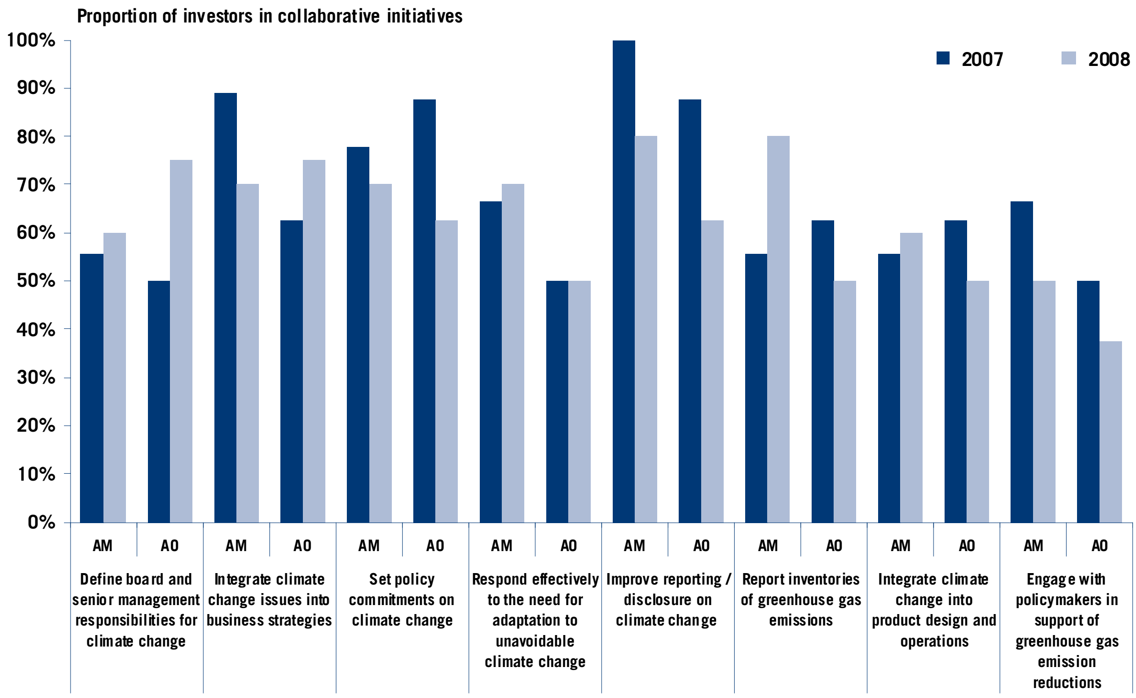
The surveys show that a majority of respondents engage with companies on climate change issues. A majority of asset managers (9 out of 10) engage directly with their investee companies, either individually and/or in collaboration with others.

5 out of 8 asset owners state that they engage with companies directly, whilst 3 out of 8 do so through an outside provider. For asset owners, this represents a small increase on 2007. Both asset owners and asset managers also exercise their voting rights on climate change.

Investors address a wide range of climate issues with companies. The issues most frequently addressed include:

- defining board and senior management responsibilities for climate change
- integrating climate change issues into business strategies
- setting policy commitments on climate change
- improving reporting/disclosure on climate change
- reporting inventories of greenhouse gas emissions

Chart 5 **Engaging on specific climate change issues**



A comparison between 2007 and 2008 appears to suggest that governance issues on climate change have moved up the agenda for both asset managers and asset owners. The issue of adaptation to climate change has also gained in importance for asset managers. However, it seems that engagement on setting specific policy commitments on climate change received less attention during the course of 2008, as have companies' lobbying activities on the issue.

Case Study: Hermes Equity Ownership Services (EOS) Carbon engagement with power generation companies

Our clients, as institutional shareowners with significant holdings in a broad range of companies across the world, have a vested interest in minimising the costs of climate change and maximising related opportunities across our portfolio. In our view, the costs of climate change for CO_2 intensive companies in particular are unlikely to diminish in the foreseeable future and those with low CO_2 energy mixes will be best positioned to generate shareholder value in the long-term.

Power generation accounts for roughly one quarter of global greenhouse gas emissions, driven mainly by coal used to generate electricity. Policymakers in regions including the EU, the US and Australia are increasingly favouring policies such as cap-and-trade schemes to facilitate emissions reductions.

In 2008 we intensified our carbon engagement programme with power generation companies on the question of how well positioned they are to address their exposure to increased carbon costs under such schemes. With the price of allowances rising over time and a move away from free allocation of allowances, carbon-intensive power generators are facing escalating costs to comply with emissions limits.

Where our screening process revealed that a company is particularly exposed to carbon price risks, for example from emissions which are high relative to sector peers, EOS sought to engage with the company. In most cases, our objective was to encourage companies to develop ambitious but realistic carbon emission reduction targets, implement a flexible climate change strategy and put into place effective carbon and energy management systems. This gives stakeholders confidence that the board is appropriately managing carbon risk and preparing the business effectively to generate future returns.

During our engagement we encouraged companies to take a long-term view on the price of carbon when making major capital expenditure decisions. Where appropriate, we encouraged companies to consider long-term investments in cost-effective alternative technologies as we believe this will put them at a competitive advantage.

Case Study: Insight Investment
Climate change benchmarking as an engagement strategy

Insight Investment benchmarked 125 companies – the FTSE100 (excluding investment trusts) and large cap continental European stocks – on how they are managing their greenhouse gas emissions as a subset of their broader approach to managing the risks and opportunities presented by climate change[5].

Most companies have clear management accountabilities for climate change issues and have published climate change policies and greenhouse gas emissions inventories. Just over one third have stabilised or reduced their total greenhouse gas emissions in recent years and almost two thirds have stabilised or reduced their emissions intensity.

The benchmark also highlighted areas of concern. Most importantly, 21 companies – including four companies in high-impact sectors and a number with potentially significant greenhouse gas emissions – scored less than 20%, suggesting that there may be significant gaps in the way they are managing their greenhouse gas emissions. Other areas of concern are the common absence of explicit commitments to achieving significant greenhouse gas emissions reductions over the longer term, mixed quality inventory data, and the general expectation among a majority of the companies that their emissions will continue to rise over time.

We have used the benchmarking in two ways. First, we can identify leaders and laggards, in particular companies where their exposure to climate change policy risk seems at odds with their management strategies. Second, the benchmark gives us a structured framework for company engagement, enabling us to better understand their strategies for managing greenhouse gas emissions, to point out their strengths and weaknesses (in absolute and relative to their sector peers terms), and to make suggestions for areas for improvement.

Assessing the effectiveness of engagement

The surveys show that 6 out of 10 asset managers, but only 2 out of 8 internal managers of asset owners have attempted to assess the effectiveness of their engagement activities. Methods used to assess this include, for example, establishing specific engagement objectives and assessing success or commissioning brokers to assess companies' compliance with IIGCC disclosure frameworks.

Reporting on engagement activities

The surveys show that the majority of asset managers report on their activities to clients as well as internally. Less than half report publicly on their engagement activities.

[5] Rory Sullivan (2008), *Taking the Temperature* (Insight Investment, London). http://www.insightinvestment.com/global/documents/riliterature/367922/taking_the_temperature.pdf.

Almost all respondents exercise their voting rights and engage with companies on a wide range of issues related to climate change. Governance issues have moved up the agenda and the focus of engagement is gradually extending to adaptation as well as mitigation.

Companies' specific policy commitments on climate change received less attention in corporate engagement activities in 2008 compared to 2007, as have companies' lobbying activities on the issue.

A majority of asset managers report on their engagement activities, but fewer attempt to assess the effectiveness of their engagement with companies.

5 Considering climate change in investment analysis

Investors are using a wide variety of approaches to consider climate change in their investment analysis. This section illustrates how asset managers and asset owners with internally managed assets are considering climate change in their investment processes and assesses how climate change is having an impact on investment decisions.

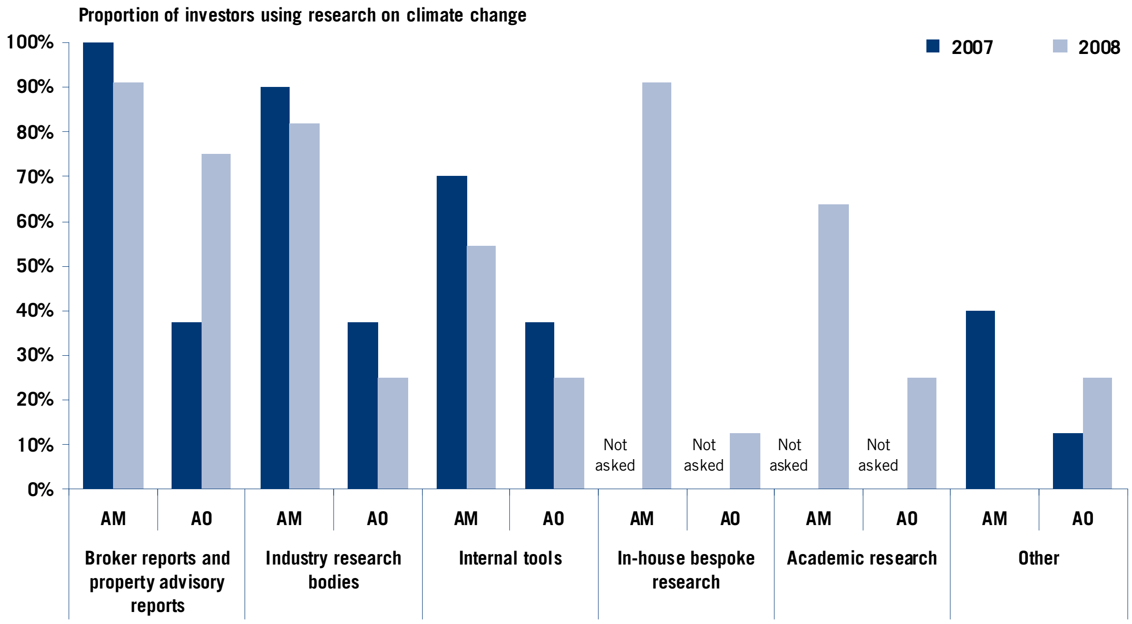
Considering climate change in investment analysis

As in 2007, all asset managers state that they consider climate change risk and opportunities in their investment decision-making, although more detailed questioning reveals that this depends on the asset class, sector and materiality of the issue (see below). There has been a marked increase in the proportion of internal managers of asset owners reporting that they consider climate change in investment analysis, with 6 out of 8 giving a positive answer in 2008 compared to only 4 out of 8 in 2007.

Research

The majority of investors use advisory generated material (e.g. broker reports, property advisory reports) in their investment processes. There has been a significant increase in the proportion of the internal managers of asset owners using broker reports (from 3 out of 8 in 2007 to 6 out of 8 in 2008). More than three-quarters of asset managers also use industry research bodies and in-house bespoke research.

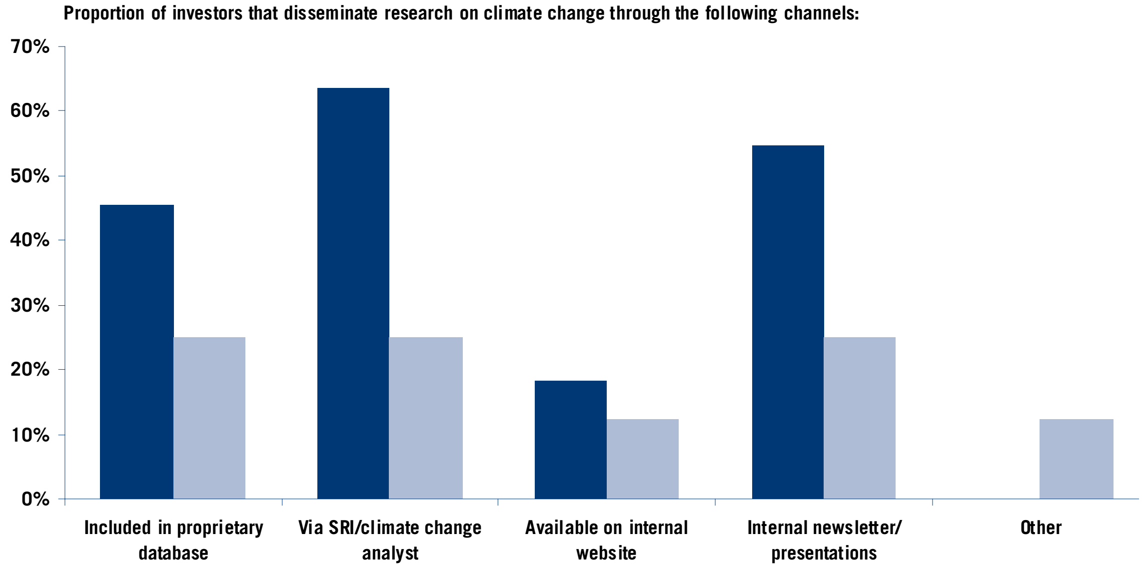
Chart 6 **Climate change research used in investment analysis**[6]



The surveys also show that asset managers use a variety of methods for disseminating research, including via an ESG/climate change analyst, internal newsletters and/or presentations and proprietary databases. Only a few internal managers of asset owners use these methods.

[6] Asset owners in this chart refers only to those with internally managed assets.

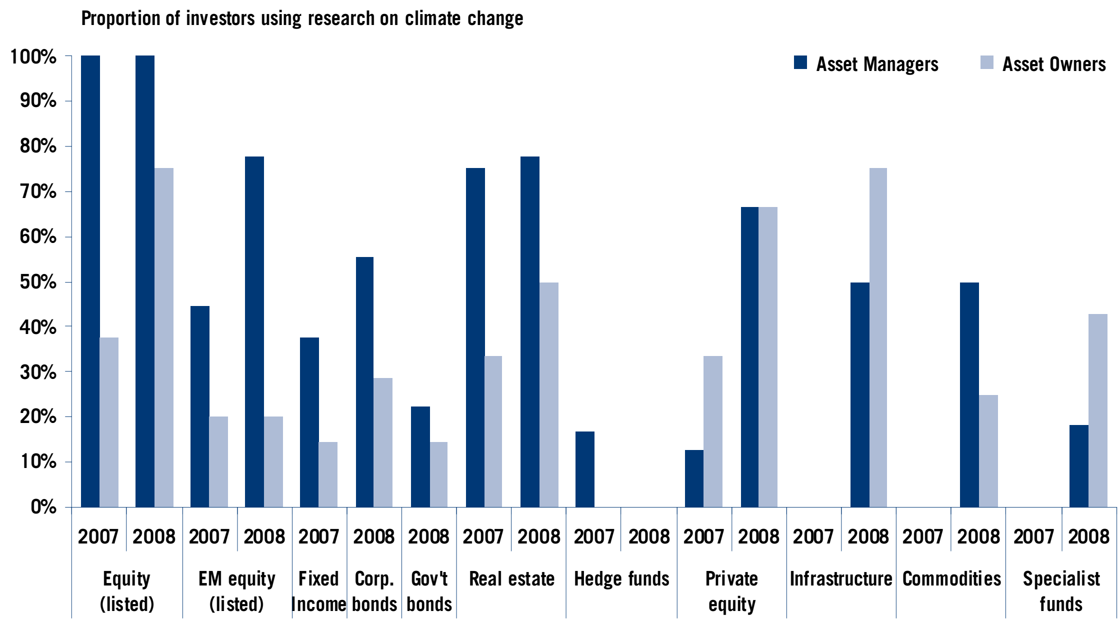
Chart 7 Disseminating research on climate change



Asset classes

The majority of investors consider climate change issues for listed equity. Real estate, private equity and infrastructure are the next three asset classes that the largest proportion of investors consider from a climate change perspective. During 2008, an increasing number of asset managers have also started to look at climate change issues for emerging markets equity, fixed income and alternative asset classes such as hedge funds and commodities. Fixed income is the asset class for which the integration of climate change is viewed as particularly difficult.

Chart 8 Climate change integration by asset class[7]



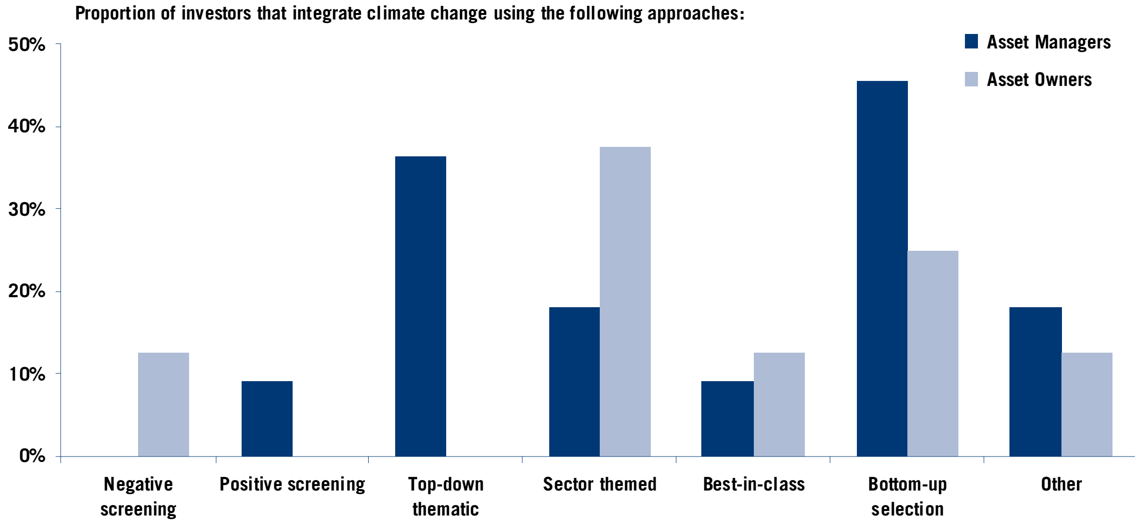
Investment approaches

The vast majority of asset managers (9 out of 11) responded that they take a combined qualitative and quantitative approach when considering climate change risks and opportunities in investment analysis. 3 out of 8 of the internal managers of asset owners take purely qualitative approach and 3 take a qualitative and quantitative approach.

[7] In 2007, fixed income was not separated into corporate and government bonds.

Only a small number of respondents state that they use a use a screened or best-in-class approach to take account of climate change. A bottom-up approach is the most popular way to consider climate change (5 out of 11 asset managers and 2 out of 8 of the internal managers of pension funds), followed by sector-themed and top-down approaches.

Chart 9 Investment approaches

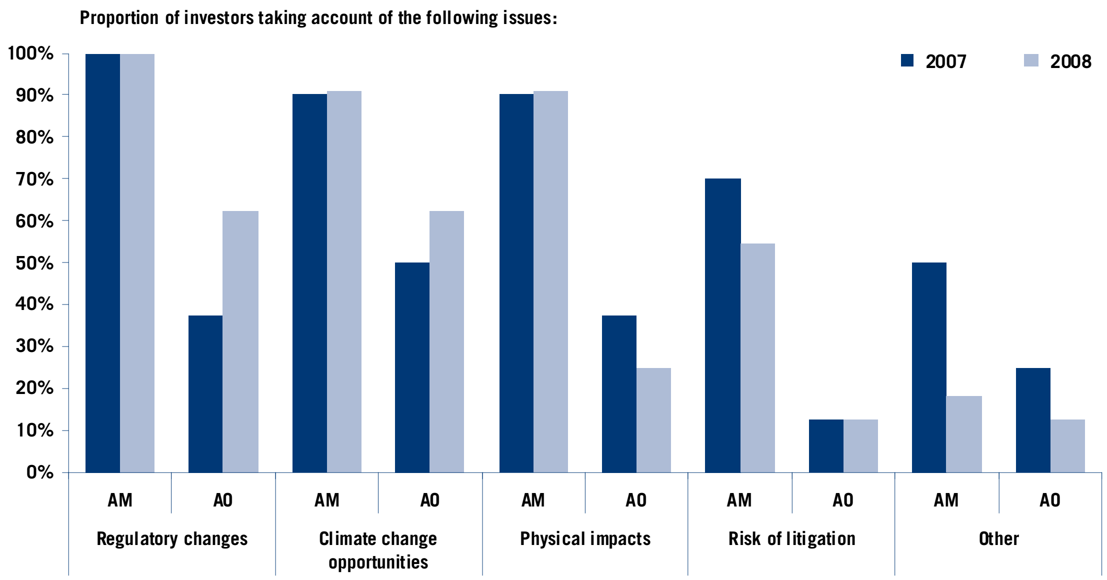


Climate change issues

Regulation, including emissions trading schemes (which provide a price for carbon which can be integrated into carbon pricing models), and investment opportunities created by government incentives (for example in clean energy technologies) are the climate-change related issues that are considered by the largest number of investors. There has been a notable rise in the number of internal managers of asset owners taking account of these issues.

A majority of asset managers also continue to pay attention to the physical impacts of climate change, e.g. drought and flooding, although this issue seems to have slipped down the agenda for asset owners. The risk of litigation appears to have become a less important consideration for asset managers.

Chart 10 Climate change issues considered in investment decision-making



Case Study: BNP Paribas Investment Partners
Improving company disclosure on climate change through investor collaboration

Collaborative initiatives are a popular and effective way for investors to encourage improved disclosure from companies on the risks and opportunities from climate change. BNP Paribas Investment Partners has led several working groups for the IIGCC on producing sector-based disclosure frameworks on climate change. These were developed in collaboration with Ceres in the US, the Australia/New Zealand IGCC, with the help of sell-side analysts, and in consultation with the Carbon Disclosure Project, the Global Reporting Initiative and companies in the different sectors.

The groups have produced two disclosure frameworks thus far, one for the electric utilities sector and one for the automotive sector. The frameworks contain sector-specific guidelines for disclosure of greenhouse gas emissions and provide a format to present both quantitative and qualitative issues in a clear, concise and consistent way. Companies are requested to provide an overview of their climate strategies and targets as well as emissions data and other quantitative data related to climate change. They are asked to report on this information through existing communication channels and the frameworks have been successfully integrated into the CDP questionnaires.

The aim of this collaboration is to overcome the gaps and inconsistencies that exist in the data that companies provide on climate change and to make it easier for investors to analyse and compare the risks and opportunities posed by climate change for individual companies. They also help companies better understand how they are positioned in their sector, and where new opportunities and risks may exist.

Challenges in integrating climate change in investment analysis

The surveys and interviews highlighted several issues that hinder greater integration of climate change factors into investment analysis. For example, several respondents suggest that they are still struggling to access high-quality, accurate and, importantly, standardised information on corporate exposure to climate change issues. This is making it difficult to analyse and compare climate impacts between companies.

In addition, there are still varying degrees to which external and internal research on climate change is widely distributed across asset management organisations. Whilst some ESG analysts consider climate change issues with their investment teams on a regular basis, others only consider climate change within their SRI funds. However, some asset managers suggest that they are working towards more integrated approaches between their responsible investment analysts and fund managers.

Importantly, regulation or government incentives are the key driver for taking account of climate change in investment analysis. Lack of clarity on public policy, including the degree of government support for international policy action on climate change, the specific targets and policy instruments that will be adopted at the international and national levels, make it more difficult for managers to take account of the issue.

Case Study: USS
Integrating climate change into investment strategy

USS has taken a leading role in highlighting climate change as an investment issue. When few investors were even aware of climate change as an environmental issue in 2001, USS commissioned a report entitled 'Climate Change: A Risk Management Challenge for Institutional Investors'. The report considered what climate change would mean for a pension fund's assets over the long-term.

Since then the fund, which manages 90% of its assets in-house, has integrated climate change into its investment strategy in a variety of ways.

The Responsible Investment team works closely with the in-house portfolio managers, consultants and service providers to build capacity and knowledge and to provide integrated analysis at individual stock, sector and market levels.

The fund uses either broker research or in-house research to determine whether or not climate change is a material issue for a company. In particular, USS uses carbon pricing models for sectors covered by the EU ETS and the utilities sector in the US, to integrate a price on carbon into their investment decisions.

USS has also participated in collaborative research projects, where they feel there has been a gap in the analysis of the investment implications of climate change. For example, USS collaborated with Insight Investment, Henderson Global Investors and RAILPEN Investments to identify how companies and their investors are likely to be affected by the physical impacts of climate change[8].

Where USS believes that climate change or climate policy may have a material impact on a company's share price in future (even if this is not the case now), USS has a shareholder engagement strategy which encourages environmentally responsible corporate behaviour and good standards of corporate governance.

In order to benefit from the opportunities arising from climate policy, USS has invested in renewable infrastructure, including, solar, wind farms and renewable energy funds. In 2008, USS also took a direct equity stake in Climate Change Capital, an investment manager and advisor focused on carbon funds.

USS is also active in improving the environmental performance of its property portfolio. The property team has led on the accumulation of baseline data at the majority of the fund's properties and in setting targets for the reduction in energy use and water consumption, amongst other key performance indicators (KPIs).

[8] Rory Sullivan, David Russell and Nick Robins (2008), *Managing the Unavoidable: Understanding the Investment Implications of Adapting to Climate Change* (Henderson Global Investors, USS, Insight Investment and Railpen, London). http://www.uss.co.uk/Documents/managing_the_unavoidable.pdf.

Case Study: F&C Management
The impact of climate policy on investment strategy

F&C's Governance and Sustainable Investment (GSI) Team includes climate change policy experts, who brief fund managers on climate policy developments such as allocation decisions under the EU emissions trading scheme and the emergence of US legislation. This helps fund managers to understand how climate change will impact the profitability of investments. Members of the GSI team also join fund managers' meetings with company management, where they probe companies about how their strategic approach to climate change may affect financial performance. For instance, they had discussions with a number of European utility and aviation companies about the impact of emissions trading on their business.

F&C also considers the investment opportunities arising from climate change, and in 2007 launched a fund investing specifically in companies providing climate change solutions. The focus is on companies expected to see a rise in the market for their goods and services due to the impact of climate change. Examples include companies in renewable energy, which have benefited from feed-in tariffs in the EU and State-level renewable portfolio standards in the US; and companies involved in "smart grid" technologies, following generous support for grid improvement in fiscal stimulus packages. F&C also looks at companies which may help society adapt to the changing climate, including those involved in the provision of clean water, as one of the most damaging impacts of climate change is likely to be an increase in drought in areas which are already water constrained.

However, despite actively seeking out opportunities, the investment case for companies providing climate solutions is often undermined by weak, inconsistent or non-existent policy. F&C therefore takes part in a number of initiatives to promote ambitious global climate change policy by governments, including the Corporate Leaders Group on Climate Change and ClimateWise, as well as the IIGCC.

Assessing the impact of climate change integration

Very few investors have begun to assess the impact of their climate change approach on the performance of their portfolio or portfolio risk. Only 2 out of 11 asset managers and 2 out of 8 asset owners have attempted to do this. This appears to be a particularly challenging area, primarily due to the lack of quantitative data to support this type of assessment.

Reporting

The vast majority of asset managers report on their climate change activities externally (9 out of 11). 3 out of 8 internal managers of asset owners report on their activities externally.

Overall, the results of the 2008 surveys and interviews show that investors are actively trying to understand the implications of climate change for their investments.

Broker reports continue to play an important role in informing investment decision-making. The number of internal managers of asset owners using broker reports on climate change has doubled. However, there are still varying degrees to which this research is distributed across investment teams.

All asset managers and three quarters of the internal asset managers of asset owners state that they consider climate change risk and opportunities in their investment analysis for listed equity. For asset owners, this is a substantial increase on 2007.

An increasing number of asset managers are also looking at climate change issues for other asset classes. Fixed income is the asset class for which the integration of climate change is seen as particularly difficult.

The most immediate reasons for integrating climate change into investment decision-making continue to be regulation (e.g. emissions trading schemes) and investment opportunities created by government incentives (e.g. in renewable energy), highlighting the importance of strong, credible public policy frameworks.

A large majority of asset managers cover climate-related activities in their external reporting but few have begun to assess the impact their climate change approach has had on the performance of their portfolio.

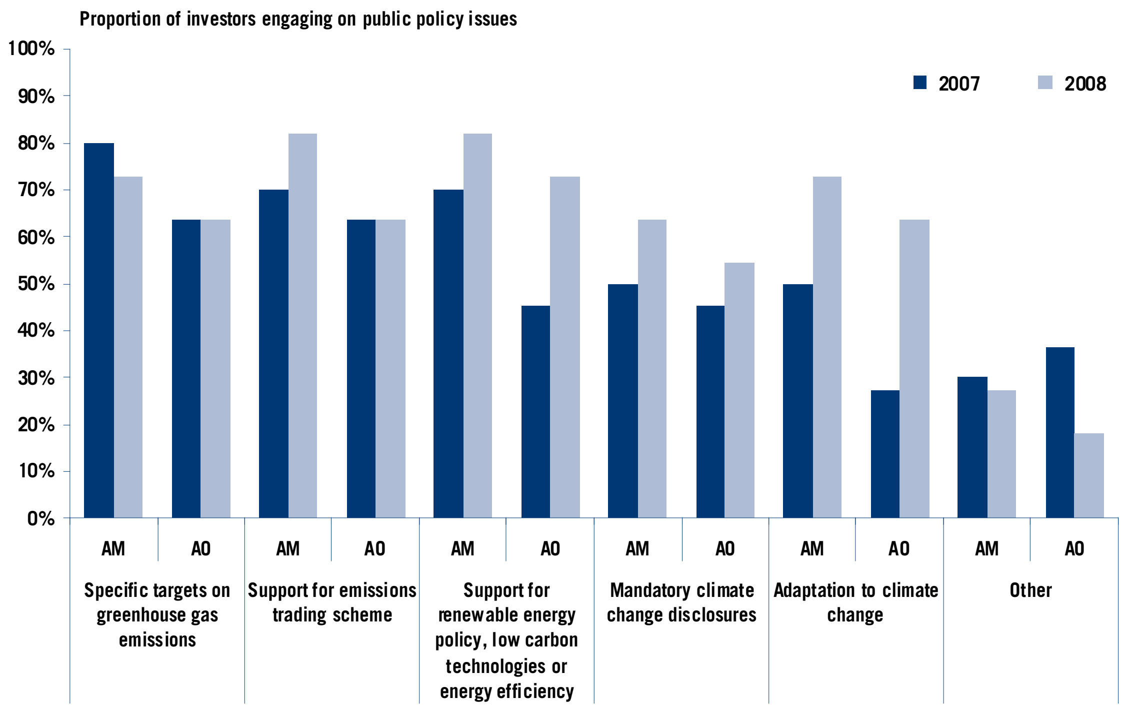
6 Public policy engagement

Investors have an interest in reducing the impacts of climate change on individual assets and overall portfolios and in exploiting opportunities from climate change. They therefore have a role to play in engaging in the policy process to ensure that policy measures are sufficiently strong, credible and long-term to provide them with the confidence to allocate capital towards low carbon solutions. This section considers how investors have engaged with policymakers and regulators on climate change issues.

The surveys suggest that investors have continued to engage in the policy process on a wide range of climate related issues, in particular on the importance of specific targets on greenhouse gas emission reductions, on the need for emissions trading schemes and in support of incentives for renewable energy. Adaptation to climate change received much more attention by both asset managers and asset owners in 2008 compared to 2007 and mandatory corporate climate disclosure has also moved up the agenda[9].

"Other" issues covered by investors in their dialogue with policymakers during 2008 include the UK Government's Sustainable Development Policy and Strategy and the reinforcement of UK policies on climate change.

Chart 11 Public policy engagement by issue



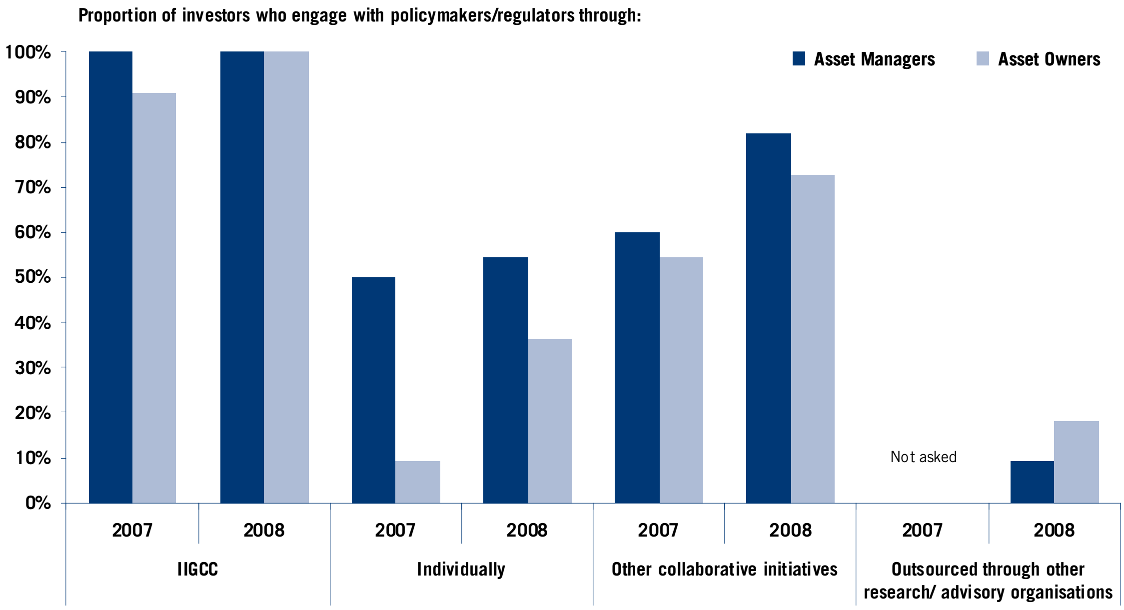
The IIGCC remains the focal point for European investors to carry out their collaborative policy engagement on climate change. Several respondents highlighted that they considered the policy initiatives organised by the IIGCC in 2008, in particular the Investor Statement on a Global Agreement on Climate Change[10] and the IIGCC investor delegation at the UN climate conference in Poznan, to have been very effective.

9 The drop in the number of investors engaging on specific emission reduction targets may reflect a change in the way the question was phrased in 2008 compared to 2007.

10 The IIGCC collaborated with US-based Investor Network on Climate Risk, INCR, and the Australia/New Zealand IGCC in 2008 to produce a Statement outlining how a new international treaty could support investment into a low carbon economy. The Statement was signed by some 150 investors with over $9 trillion in assets.

There has also been an increase in investors who engage with policymakers through other collaborative initiatives, for example LAPFF, and around half of asset managers also continue to engage with policymakers individually, as do a third of asset owners.

Chart 12 Engagement with policymakers and regulators



Case Study: Aviva Investors
Engaging with climate negotiators

Aviva's SRI team was part of the IIGCC delegation to the climate conference in Poznan during December, where they hosted a dinner for a number of diplomats, negotiators and investors – including Yvo de Boer, the Executive Secretary of the UN Framework Convention on Climate Change.

Following the conference, Aviva and the rest of the IIGCC delegation:

- **alerted members to the scale of the challenge of getting an agreement from a process involving over 1,000 diplomats, with 10,000 delegates and hundreds of non-governmental organisations seeking to influence the process;**
- **noted that the argument that investors shared their interests in the long term health of the economy as a whole – rather than one specific company or sector – and that investors are therefore useful allies in the discussions regarding the financial consequences of their actions was well received;**
- **reported that the ideas for creating funding mechanisms such as inter-governmental bonds for climate change mitigation and adaptation generated significant interest, as did criticisms of the current workings of the Clean Development Mechanism.**

The IIGCC's engagement at the Poznan conference helped the group to (a) understand where its efforts in relation to the negotiations on the Copenhagen agreement would be most useful and (b) to establish priorities for the policy workstream in the run-up to the Copenhagen climate conference.

Case Study: PGGM
Discussions with the European Parliament on a climate change resolution

As one of the over 150 signatories of the Global Investor Statement on a Global Agreement on Climate Change, PGGM decided to actively promote the Statement and start discussions with several Dutch Members of the European Parliament about the role that institutional investors could play in mitigating climate change.

The MEPs were all involved in the temporary committee on climate change and therefore responsible for drafting a resolution on an EU strategy for a comprehensive climate change agreement in Copenhagen and the adequate provision of financing for climate change policy. Through the discussions, PGGM was able to add an institutional investor-related point to the resolution, which made the European Parliament publicly acknowledge the role that investors could play under the right circumstances.

The wording was that the European Parliament *"underlines that binding targets would enable investors to better assess the risks and opportunities associated with climate change and would involve investors in projects that would meet mitigation as well as adaptation targets; underlines, moreover, the need for clarity regarding the role of private capital in the investment necessary in order to reach the targets".* The resolution was adopted by the European Parliament on 11 March 2009. It will serve as a guiding tool in future actions and decisions of the European Parliament.

The results from the 2008 survey as well as the interviews again highlight that investors are actively engaging with policymakers on a wide variety of climate change issues, including specific targets on greenhouse gas emissions, emissions trading schemes and renewable energy incentives. They have started to pay attention not just to mitigation issues, but are gradually considering policy on adaptation as well.

In order to leverage their influence, investors are conducting their policy work in collaboration with others and the IIGCC remains the focal point for this in Europe. Investors have been able to obtain greater access to policymakers and are receiving greater recognition that they have an important role to play in the climate change debate. However, there is still further progress to be made in this respect.

7 Climate change considerations in property investment

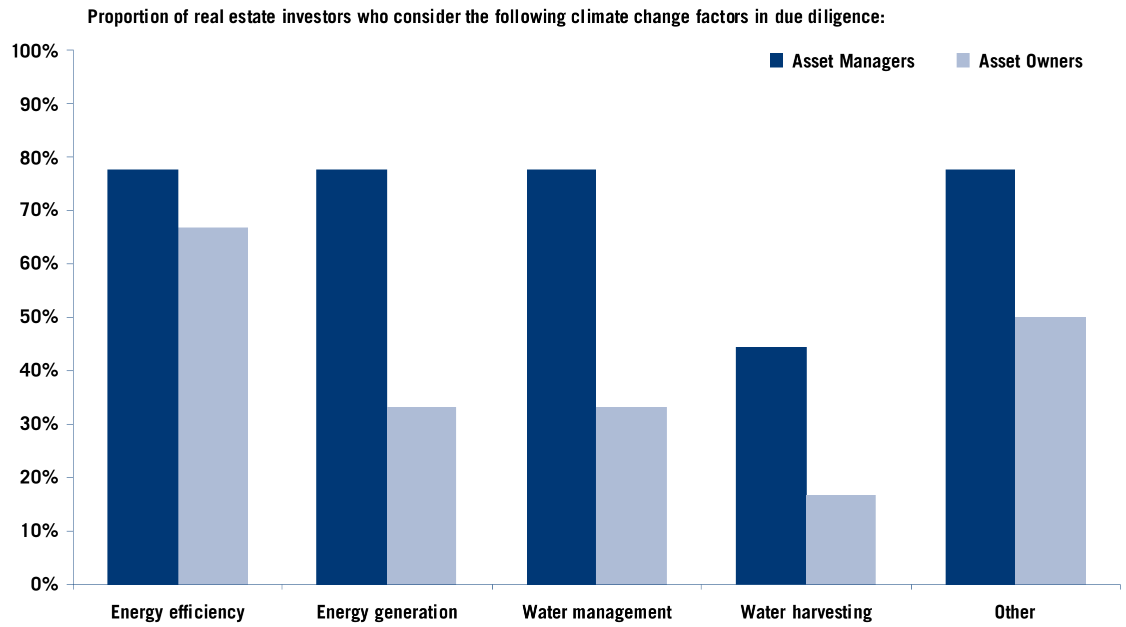
A large majority of signatories to the Statement (around 80%) invest in property and may therefore be affected by the impact of climate change or climate policy on these assets. Real estate also has the potential to play an important role for concerned investors wishing to reduce greenhouse gas emissions, as it accounts for around 30-40% of global carbon dioxide emissions[11 12].

This report therefore dedicates a new chapter to property investment and aims to assess how asset managers and asset owners integrate climate change into their investment analysis or due diligence processes[13].

Consideration of climate change in due diligence process

The majority of respondents (12 out of 15) consider climate change factors in their due diligence process for property opportunities. Most often they consider issues such as energy efficiency, energy generation, and water management, but a large number of investors also consider other factors such as dependency on vehicle use. Climate change is commonly considered in due diligence processes when investing or managing direct assets, rather than buying property funds.

Chart 13 Climate change factors considered in due diligence



[11] Price L., De la Rue du Can, S., Sinton, J. And Worrell, E. 2006. *Sectoral Trends in Global Energy Use & GHG Emissions.*

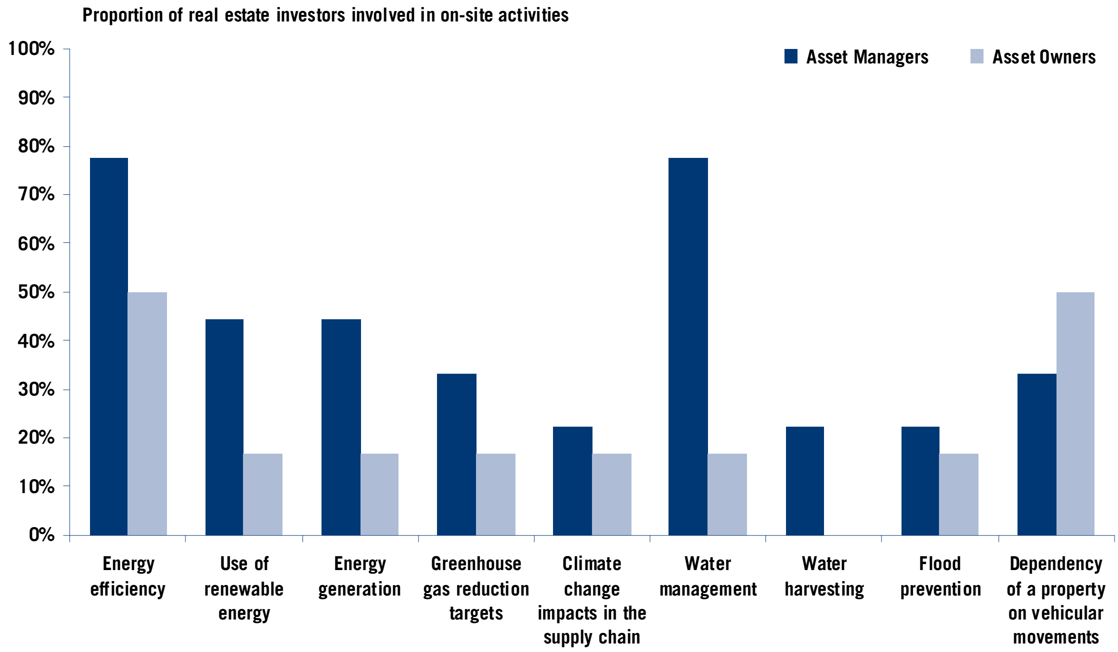
[12] UNEP SBCI (2006) *Sustainable Buildings and Construction Initiative*, SBCE Secretariat, Paris.

[13] This section includes 9 asset managers and 6 asset owners with internally managed assets.

On-site climate change activities

The majority of asset managers (7 out of 9) have been involved in on-site climate change activities for their property investments, particularly energy efficiency and water management. Only 3 out of 6 internal managers of asset owners report that they have been involved in such activities.

Chart 14 On-site environmental activities



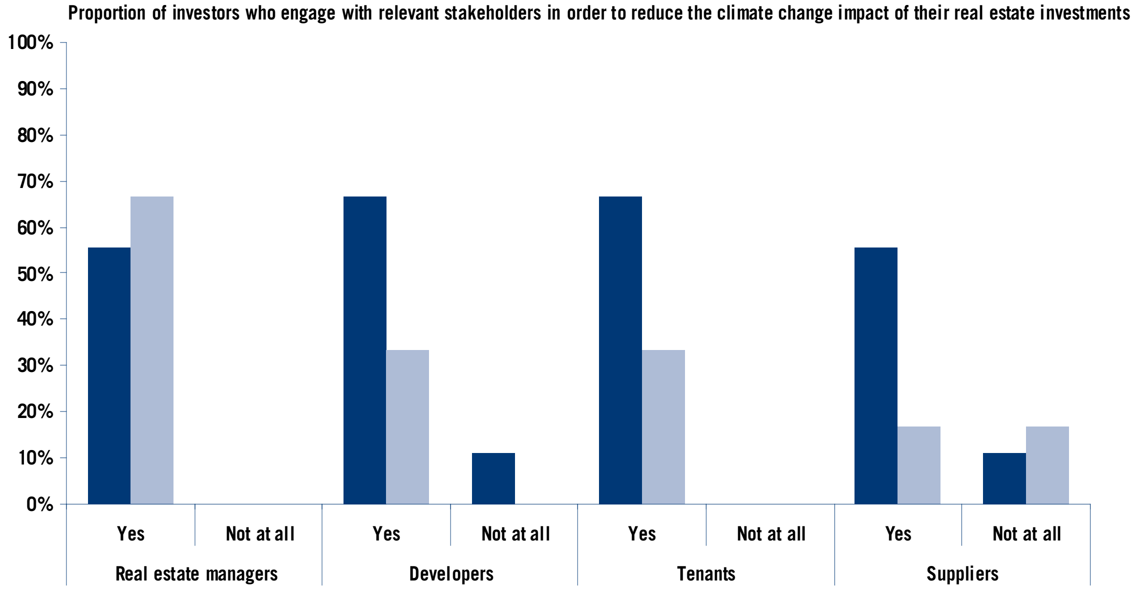
Compliance with specific building standards

A significant number of asset managers with property investments (7 out of 9) consider compliance with specific environmental building standards (primarily the UK BRE Environmental Assessment Method, BREEAM) in new or existing property investments. In addition, 2 out of 9 asset managers combine this benchmark with other standards and benchmarking services such as the Minergie Standard (Switzerland), Upstream Jones Lang LaSalle Third Dimension benchmark and the IPD IPF Sustainability benchmark. 3 out of 6 internal managers of asset owners consider compliance with environmental building standards.

Engaging with relevant stakeholders

The majority of asset managers state that they engage with stakeholders, such as real estate managers, developers and tenants and suppliers. The internal managers of asset owners primarily focus their engagement activities on real estate managers.

Chart 15 **Engaging with stakeholders**



Reporting

Reporting on climate change related engagement activities by asset managers is fairly evenly split between internal reporting, publicly disclosed reporting and external reporting to clients. Internal managers of asset owners report mainly internally.

Measuring the effectiveness of engagements

5 out of 9 asset managers, but no internal managers of asset owners, stated that they had seen some evidence of the effectiveness of their engagements with property stakeholders. A small number of managers noted positive outcomes such as energy and cost savings and an increase in responses to the Carbon Disclosure Project (CDP) post engagement.

Case Study: PRUPIM
PRUPIM's 'Improver Portfolio'

Given the chance to 'engage' with buildings, leases and tenants, the relationship an investor has with commercial property can be more 'hands on' than with equities and bonds in the pursuit of responsible investment aims.

However, as with any form of SRI, responsible property investment has to be justifiable in fiduciary as well as environmental and/or social terms. Sadly, despite evidence emerging to the contrary, many in the property industry still believe that the responsible management of property portfolios could harm performance and, thereby, breach fiduciary responsibilities.

Given this background, PRUPIM decided in 2007, amongst other initiatives, to establish a sub-portfolio of assets drawn from currently managed portfolios with the express intent of seeing how the environmental impacts of property assets could be reduced (and 'improved') through the implementation of low and no added cost initiatives which, by definition, should not threaten existing fiduciary responsibilities.

To this end, £500m of existing fund assets were selected that broadly represented the variety of asset types in the commercial property market. The selected assets were neither 'green' nor environmentally degraded; rather, the emphasis was on them being ordinary in order to better learn how investors could economically reduce the environmental impacts of their wider property portfolios.

The initiative was deliberately not confined to a small team but spread across a wide number – to increase staff involvement and learning. Base-line audits and expert consultants were commissioned to assess the initial environmental impacts of the assets and establish which low and no cost works might be initiated.

PRUPIM has learned some crucial lessons from the exercise. First, there are some assets, particularly large multi-let properties, where the landlord/investor can have material influence on environmental impacts at little or no cost. However, there are others, like single let shops, where influence is limited. Second, it is clear that tenant engagement is crucial to securing the wider aims of driving down the environmental impacts of most properties. Third, cooperation between landlord and tenant can be increased through developing the lease contract. Fourth, as in every area of responsible investment, the interest and take up of ideas varies across individuals, with some 'champions' pushing the boundaries and others requiring encouragement.

The Improver Portfolio exercise has taught PRUPIM many valuable lessons to help it refine its approach to the crucial area of responsibly managing property portfolios.

Overall, the surveys show that the majority of respondents consider climate change factors in their due diligence process for direct property investments as well as in their on-site climate activities. The issues most often considered are energy efficiency, energy generation and water management.

A significant number of asset managers with property investments consider compliance with specific environmental building standards and benchmarks.

Investors are also engaging with stakeholders, including real estate managers, developers and tenants, and a small majority of asset managers report some evidence of the effectiveness of their engagement.

8 Conclusions and looking forward

Investors have an important role to play in responding to the climate challenge. As providers of private capital, which is essential for the move to a low carbon economy, and as proxy owners of companies and other assets, investors have significant influence and leverage.

This report confirms that investors, both asset managers and asset owners, are increasingly paying attention to climate change as a financial issue and they are building their capacity to analyse the financial implications of new regulations. Asset managers are encouraged in these efforts by a growing number of asset owners who are trying to integrate the issue into their appointment and evaluation processes. The report confirms that the issue is receiving greater attention with respect to listed equities and property investments, but much less so in other asset classes.

Signatories to the Statement are making significant progress in their engagement with companies to manage the risks of potential future government regulation or physical impacts. They are doing this where they believe that future climate regulation will develop in a way that will constrain greenhouse gas emissions and that the physical impacts of climate change will have an impact on investor value over the longer term. The issue is also being addressed with real estate managers, developers and tenants.

The report, however, also suggests that whilst there is much greater activity on analysing the implications of climate change, the main areas of focus continue to be those where there are clear investment opportunities (e.g. where there are government incentives for renewable energy) or those sectors that are directly exposed to climate change regulation, i.e. those areas where policy makes the issue material. Another finding is that investors remain focused on companies' management practices and processes rather than on performance, i.e. delivering emissions reductions or directing capital to renewable resources.

The report therefore reinforces the view that strong public policy is critical for investors and companies to move capital towards a low carbon economy through sending the correct price signals. It also suggests that a credible and effective policy framework would help to reinforce the effectiveness of investor engagement because it would provide support to the argument that companies need to prepare themselves for further policy action over time.

Investors have shown increased willingness to engage in the policy process – particularly in collaboration through the IIGCC – and have indeed been able to obtain greater access to policymakers. They are also receiving greater recognition that they have an important role to play in the climate change debate. However, there is still much progress to be made in this respect. Investors should therefore redouble their efforts, not only with respect to their own processes, but also on policy engagement to ensure that policy measures send the appropriate signals both to companies and to the investment community in order to support the move towards a low carbon economy.

Appendix 1 IIGCC investor statement on climate change

Introduction

As institutional investors, cognisant of our roles as major shareholders and bondholders in many of the world's companies and as significant investors in other assets such as real estate, we accept the broad scientific consensus that greenhouse gas emissions from human activities are a critical contributor to changes in the world's climate. Further, we recognise that climate change is likely to result in profound negative consequences for human society, the global economy, and the world's natural systems. As such, climate change presents a series of material business risks and opportunities – for investors and companies – to which investors must respond.

We believe that it is essential to adopt a proactive approach to this issue and to take action now that will result in substantial reductions in global greenhouse gas emissions within a timeframe that minimises the risk of serious impact. In addition, we recognise that there is a need to assess the risks associated with changes already built into the climate system as a result of historic greenhouse gas emissions, and to adapt to these changes if necessary.

It is our view that governments should lead this response by creating a framework that provides incentives and investment certainty to companies and individuals. However, we recognise that investors have a critical role to play in addressing climate change. To be most effective, our response should be coordinated internationally and be collaborative. As investors, we are ready to work with international bodies, national governments, companies, non-governmental organisations and our clients to develop solutions appropriate to the environmental and economic challenges we jointly face.

This Statement sets out our views of the role that can be played by investors in responding to climate change. It is in line with the UN's Principles for Responsible Investment. We call on all institutional investors to support this Statement and to work together in its implementation.

1 The role of investors

We recognise that:

- Investment decisions taken now will have a major impact on current and future global greenhouse gas emissions and, hence, on the world's climate.
- The greenhouse gases already emitted into the atmosphere are predicted to cause environmental change and this will impact upon the companies and assets in which we invest.
- Current investment research, analysis and decision-making and shareholder ownership activities do not fully reflect the risks and opportunities presented by global climate change.
- It is not in the long-term interests of the ultimate beneficiaries of the assets we represent that climate change occurs.
- By working together, investors, their clients, their agents, regulatory authorities and companies can create an investment environment that contributes to a more orderly shift to a low carbon economy and so helps to ensure a more stable climate for current and future generations.

Therefore, as asset owners and asset managers, we will:

- Use our individual and collective influence to encourage governments to adopt policies that provide incentives to reduce greenhouse gas emissions and to encourage appropriate responses to the physical and societal impacts of climate change.
- Build our capacity to assess the investment implications of climate change.
- Work together on initiatives that will help reduce the threat and impacts of climate change.
- Promote information-sharing among the growing number of investors and organisations around the world concerned about climate change.
- Incentivise and/or support research on the risks and opportunities of climate change and climate policy that adds value to our investment decision-making processes.
- Seek to minimise the adverse impacts and maximise the positive impacts of investment decisions on the production of greenhouse gases.

As asset owners we will:

- Encourage our asset managers to integrate consideration of climate change risks and opportunities in their investment research, analysis and decision-making and shareholder ownership activities.
- Consider climate change in our processes for the appointment and evaluation of our asset managers.
- Instruct our advisors and consultants to consider the impacts and opportunities of climate change and climate policy in the advice that they provide to us, in particular to pro-actively consider the opportunities to invest in clean energy.

As asset managers we will:

- Explicitly consider climate change risks and opportunities in our investment analysis and, individually and collectively, develop the tools to assess the short-term and long-term risks and opportunities presented by climate change and climate-related policies.
- Engage with the companies in which we invest to ensure that they are minimising the risks and maximising the opportunities presented by climate change and climate policy. We will also encourage these companies to improve their governance and disclosure of climate risks and opportunities.

2 Working with others

We encourage companies to:

- Clearly define board and senior management responsibilities for climate change.
- Integrate climate change risks and opportunities into business strategy.
- Set high-level policy commitments in support of action on climate change, including commitments to greenhouse gas emissions reductions.
- Provide appropriate disclosures on climate change risks and opportunities that allow investors to assess the financial implications of these risks and opportunities for the company.
- Prepare and report comprehensive inventories of greenhouse gas emissions (both directly from operations and activities and indirectly from, for example, the use of the company's products). These inventories should allow historic performance to be assessed and should include projections of likely changes in future emissions.

- Integrate climate change into product design and operations. This should include setting targets and timelines for reducing greenhouse gas emissions and impacts along the value chain.
- Proactively engage with public policy makers and other stakeholders in support of policy measures to reduce greenhouse gas emissions, and not lobby to obstruct legitimate attempts to reduce greenhouse gas emissions or mitigate the effects of climate change.

We encourage governments to:

- Provide long-term guidance to investors and companies on the direction of public policy – at the national and international levels – on climate change.
- Establish a policy framework that sets clear and challenging yet achievable international targets for greenhouse gas emissions reductions for the short, medium and long-term that will enable atmospheric concentrations of greenhouse gases to be stabilised at a level that averts the most significant risks of climate change, and that provides the necessary mechanisms and institutions for the delivery of these targets.
- Enact national policies that align with international goals for emissions reductions, and that incentivise the development and adoption of low carbon technologies, energy efficiency and other forms of emissions reduction.
- Enact and support regulations that require companies to adequately report on the business risks and opportunities associated with climate change and climate policy.

3 Implementation and monitoring

- The IIGCC will publish an annual report detailing the actions that have been taken by the signatories towards achieving the goals in this Statement.

Appendix 2 List of signatories

Asset Managers	Asset Owners
Aviva Investors	BBC Pension Trust
BlackRock	Environment Agency Pension Fund
BNP Paribas Investment Partners	Ethos Foundation
Central Finance Board of the Methodist Church	Greater Manchester Pension Fund
Co-operative Asset Management	Joseph Rowntree Charitable Trust
F&C Management	London Borough of Hounslow Pension Fund
Generation Investment Management	London Pensions Fund Authority
Hermes	PGGM
Insight Investment	USS
PRUPIM	West Midlands Pension Fund
Schroders	West Yorkshire Pension Fund

IIGCC

Institutional Investors Group on Climate Change

www.iigcc.org

Design by Guy Batey | **Ragged Right**