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COLUMN

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How can finance do its part to combat climate change?

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

Unfortunately, inertia is one of the most powerful forces in the universe. We usually don't change until we have to. Well, we are at that point. The European Union's taxonomy for sustainable financial activities is a step in the right direction, a step that policy makers from Canada to India are also beginning to take. To better understand the current gap between desired outcomes around climate change and processes in the investment business, the CFA Institute surveyed its members concerning climate change for its 'Climate Change Analysis In The Investment Process Report'.

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

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

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

- Reliable carbon markets and the inclusion of carbon price expectations in analyst reports: we recommend that investment professionals account for carbon prices and their expectations thereof in climate risk analysis.

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

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

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

- Policymakers need to craft regulations to ensure that investors have the tools they need.

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