

## **Global Private Investments and Climate Change**

**9 June 2008, Trusteeship Council Chamber**

UNHQ, New York City

### ***Purpose of the meeting***

*In a very dense 2008 climate calendar, the objective of this specialized follow up meeting to the 2008 General Assembly thematic debate on climate change is to provide Member States with a debate on the intense reciprocal relationship between private investments and climate change. On the one hand, the meeting will focus on the major impacts private investment choices have on current and upcoming CO2 emissions, and, on the other hand, it will highlight the impacts that the current and upcoming climate regime will have on investment choices by region, by sector and by asset class.*

*Extensive research has already been done on how public funding may promote climate-proof and sustainable development, especially in developing countries. Climate risks and opportunities linked to private investments have been made an issue of salience to both companies and investors. However, the links between public decision-making and private investment flows and their implications for global warming need to be further addressed.*

*Given the magnitude of the issues at stake (both in terms of capital to be invested and CO2 to be emitted), this meeting should provide Member States negotiating the future climate regime, with investors' perspective on the options ahead - be it in their national regulatory capacity or in their international negotiating capacity. Indeed, when making their investment choices, business and investors are concerned with constraints and possibilities, but also with predictability, linked to the climate regime.<sup>1</sup>*

*To this effect, the President of the General Assembly is inviting a select group of senior financial service executives from different topical and geographical backgrounds. The speakers will provide various perspectives on climate change from the standpoint of analysts, banks, insurers, pension funds and hedge funds. The presentations and discussions will highlight the crucial importance, for investors, of decisions made by Member States on climate change. Member States, in return, will be given an overview, by various types of investors particularly involved in climate issues, of the constraints and potentials they face.*

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<sup>1</sup> In line with paragraph 11 of the Bali Action Plan which "agrees that the process shall be informed by, inter alia, the best available scientific information, experience in implementation of the Convention and its Kyoto Protocol, and processes there-under, outputs from other relevant intergovernmental processes and insights from the business and research communities and civil society", this meeting aims at supporting and facilitating ongoing and future consultations and negotiations.

## A growing interest in climate change from various private financial actors

Financial institutions shape our economies in many and varied ways and are also having major yet differentiated impacts on climate change, in particular as they have increasing influence on corporate behaviour through their investment choices. In order to understand these impacts, one must understand the complexity of the finance industry. It is composed of very different actors operating according to different rationales and different time frames, which are crucial to grasping the vast array of their links to climate change. **Banks – both generalist and investment banks** – are the world’s major capital providers while **insurers** are the global economy’s risk experts, as well as, being major investors in their own right. Institutional investors such as **pension funds**, which are concerned with long-term risks, are exerting increased influence on companies through their investment decisions. **Hedge-funds** are also to be considered in this context, as they have the ability to invest major sums on a very short term basis. Their collective potential impact on the economy is massive, as numbers show: major institutional investors such as pension funds, holding 20% or USD 12.5 trillion of the capital in the USD 54<sup>2</sup> trillion global equity markets, as well as more specialized actors such as private equity houses and hedge funds, are dominant on the investment front.

Financial institutions are also at a crossroad on climate change. The evidence of the economic and financial impacts of global warming are hardening and a select group of banks, insurers and investment institutions, are taking a high profile stance on climate issues. This is in part due to the new evidence spread by the **analysis** emerging from the intergovernmental and public-policy community, detailing the likely economic impacts of climate change, as well as the increasing estimated costs of addressing the threats. Three main sources contributed to this raising awareness:

- A report<sup>3</sup> by UK economist Lord Nicolas Stern highlighted that with a 5-6 degree centigrade warming a real possibility for the next century models were estimating an average 5-10% loss in global GDP with poorer countries suffering costs in excess of 10% GDP. Equally, the Stern Review suggested that early action with strong mitigation policies could yield net benefits of USD 2.5 trillion. A recent report<sup>4</sup> by Stern shows that the risks seem even greater than anticipated in the original Stern Review. Nevertheless, even if one goes for parameter values implying less weight on richer generations than associated with the base case of the Stern Review, then the costs of no or delayed action can be much higher than those of timely action, particularly when the greater risks which we now see are taken into account.
- In 2007 a report<sup>5</sup> for the United Nations Framework Convention on Climate Change (UNFCCC) stated that in 2030 additional global investment and financial flows of USD200-210bn would be necessary just to return emissions to current levels. It was estimated that this would equate to 0.3-0.5% of estimated global GDP and 1.1-1.7% of global investment in 2030.

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<sup>2</sup> McKinsey Global Institute (January 2008) *Mapping Global Capital Markets: Fourth Annual Report*, downloaded from [http://www.mckinsey.com/mgi/reports/pdfs/Mapping\\_Global/MGI\\_Mapping\\_Global\\_full\\_Report.pdf](http://www.mckinsey.com/mgi/reports/pdfs/Mapping_Global/MGI_Mapping_Global_full_Report.pdf) 29.5.2008.

<sup>3</sup> Stern, Nicholas (2006) *The Stern Review: The Economics of Climate Change*, HM Treasury, United Kingdom.

<sup>4</sup> Stern, Nicholas (April 2008) *Key Elements of a Global Deal on Climate Change*, The London School of Economics and Political Science, downloaded from [www.lse.ac.uk/collections/climateNetwork/publications/KeyElementsOfAGlobalDeal\\_30Apr08.pdf](http://www.lse.ac.uk/collections/climateNetwork/publications/KeyElementsOfAGlobalDeal_30Apr08.pdf) 29.5.2008.

<sup>5</sup> United Nations Framework Convention on Climate Change (UNFCCC) (October 2007) *Investment and Financial Flows to Address Climate Change*, downloaded from [http://unfccc.int/resource/docs/publications/financial\\_flows.pdf](http://unfccc.int/resource/docs/publications/financial_flows.pdf) 29.5.2008.

- Also, in 2007 the Intergovernmental Panel on Climate Change (IPCC) presented its Fourth Assessment Report<sup>6</sup> which warned that continued greenhouse gas emissions at or above current rates would accelerate warming and induce many changes in the global climate system during the 21st century that would very likely be larger than those observed during the 20th century.

The arrival of these three reports, coming within a relatively short period of time, resonated strongly with leading private financial service institutions and accelerated their already mounting concerns over the potential economic and financial liabilities associated with climate change. In a summary report<sup>7</sup> presented by a group of financial institutions to the UN climate negotiations in Bali, Indonesia, in December 2007, a group of banks, insurers and asset managers noted that: *“All three – Stern, the IPCC and the UNFCCC – lead to the conclusion that strong and early action to reduce emissions is critical and can dramatically limit the costs of addressing the problem. It is very likely that the benefits of strong and early action far outweigh the economic costs of not acting. Furthermore, not only mitigation, but also adaptation is essential as climate change is already happening and developing countries will be worst affected.”*

### **Responding to the challenges of climate change**

Financial institutions and other investors are vital to foster vibrant, long-term, liquid carbon markets and to further stimulate investment in climate-friendly technology. In order to be able to perform these functions, financial institutions have consistently called for reduced policy uncertainty around the evolution of the international climate regime that can act to mobilize greater volumes of private capital and deepen the nascent carbon markets.

Integration of climate factors into all lending, insurance and investment decisions is far from guaranteed. Engagement of the broader financial services sector is crucial to help provide the finance and investment flows needed to embed climate-friendly technologies in the global market. However, several recent studies conclude that, in general, financial sector engagement is still weak and the quality of their management of climate change risks and opportunities below average. One explanation advanced for the hitherto rather limited engagement of financial sector institutions relates to the uncertainty and slow pace of development of the climate policy framework that forms the basis for carbon markets. As a result, a survey of business leaders recently found that nearly two thirds agreed that “uncertainty over government policy is making it difficult to plan strategies for corporate sustainability.”<sup>8</sup>

### **The crucial impact of private investments on climate change**

Climate change has moved to the top of the public policy agenda, both internationally and in national capitals. It has become a major financial issue for Member States, but also for other stakeholders.

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<sup>6</sup> Intergovernmental Panel on Climate Change (IPCC) *4th Assessment Report (4AR)*, downloaded from <http://www.ipcc.ch/ipccreports/ar4-syr.htm> 29.5.2008.

<sup>7</sup> United Nations Environment Programme Finance Initiative (December 2007) *Carbon Crunch: Meeting the Cost*, downloaded from [http://www.unepfi.org/fileadmin/documents/CEObriefing\\_carbon\\_crunch.pdf](http://www.unepfi.org/fileadmin/documents/CEObriefing_carbon_crunch.pdf) 29.5.2008.

<sup>8</sup> The Economist Intelligence Unit (Feb 2008) *Doing good: Business and the sustainability challenge*, downloaded from [http://a330.g.akamai.net/7/330/25828/20080208191823/graphics.eiu.com/upload/Sustainability\\_allsporsors.pdf](http://a330.g.akamai.net/7/330/25828/20080208191823/graphics.eiu.com/upload/Sustainability_allsporsors.pdf) 29.5.2008.

In particular, the private sector has become a major actor of the climate change debate, as it is at the core of the problem as much as it can also provide solutions. Both for the challenges it poses and the opportunities it provides, key industries (such as energy, transportation, construction, etc.) are addressing climate change in their business strategy and activity. They have thus quickly been recognized by public decision makers as one major set of actors in the climate discussions. However, the private sector is broad and there are other, less visible actors. One such group are private investors, principally because they could provide the major source of finance needed to address climate change.

According to a recent UNFCCC report, the vast majority – up to **86 per cent** – of the global finance flows needed to respond to climate change will indeed come, not from bilateral donors or multilateral organizations, but from private investment sources.<sup>9</sup> In particular due to their increasing influence on corporate behaviour, financial institutions, as the world's major capital providers, as well as, insurers and institutional investors, hold a pivotal position in this context.

The fact that total investment in new physical assets is projected to triple between 2000 and 2030 provides a window of opportunity today to direct finance and investment flows into new facilities that are more climate friendly and resilient.<sup>10</sup> A large share of these investment and financial flows will be in developing countries. The UNFCCC report concludes that the investment decisions that are taken today will affect the world's emission profile in the future. Private investors will therefore play a key role in shaping the transition to a low-carbon economy worldwide.

Serving as a follow-up conference to the General Assembly Thematic Debate on *Addressing Climate Change: The United Nations and the World at Work* (Feb. 11- 13), and drawing on conclusions derived from the Investors Summit held at the UN Headquarters the following day (Feb 14<sup>th</sup>), the purpose of this specialized meeting is to foster dialogue between private investors and public decision makers. In particular, it is aimed at considering how financial institutions react to and are being impacted by the current and forthcoming climate regimes. Accordingly, the meeting should provide information on and promote awareness about how financial institutions integrate climate change related risks and opportunities in their operations and investment decisions. This in turn should stimulate open discussions between Member States and private investors on their respective roles in promoting innovation, investment in clean technologies, technology diffusion and transfer, among other areas.

### **The various impacts of investment choices on climate change**

Financial institutions and other investors have a vital role and growing self-interest in securing timely, practical and cost-effective solutions to mitigate climate change, to promote early responses to the economic and investment aspects of adaptation and to transform the global financial architecture to one that supports a low carbon economy.

Pension funds are developing an interest in incorporating climate related assessments of their portfolios, as their long-term perspective makes them both more susceptible to risks and opportunities. Accordingly, several pension funds are at the forefront calling for

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<sup>9</sup> United Nations Framework Convention on Climate Change (UNFCCC) (October 2007) *Investment and Financial Flows to Address Climate Change*, downloaded from [http://unfccc.int/resource/docs/publications/financial\\_flows.pdf](http://unfccc.int/resource/docs/publications/financial_flows.pdf) 29.5.2008.

<sup>10</sup> United Nations Framework Convention on Climate Change (UNFCCC) (October 2007) *Investment and Financial Flows to Address Climate Change*, downloaded from [http://unfccc.int/resource/docs/publications/financial\\_flows.pdf](http://unfccc.int/resource/docs/publications/financial_flows.pdf) 29.5.2008..

environmental impacts to be made an investment parameter in its own right. By focusing on environmental, as well as, financial returns they employ an innovative investment strategy. Recent reports have shown that such a strategy may not be at odds with profit maximisation.<sup>11</sup> Consequently, a sustainable approach to investment, also known as ‘green investing’, could also be used by hedge fund and other investors with a shorter investment perspective. Indeed, the strong and growing investor appetite for green investments in recent statistics reveal that the proportion of net inflows into equity funds that was directed to ecological or environment products across Europe grew from 2.6 per cent in 2006 to 15.2 per cent in 2007.<sup>12</sup>

The reasons for incorporating climate change into investment choices are obvious in a few key sectors, such as the **energy sector**. To meet upcoming estimated needs, new global energy supply is expected to require more than USD 20 trillion of capital investment over the next 25 years. Choices made by investors are thus critical as they will directly influence the quantity of greenhouse gases to be released into the atmosphere. In this respect, investment trends in renewable energy are indicative. In 2006, between USD110-125 billion was invested in 120 gigawatts (GW) of new power generation globally. Approximately a quarter of this investment, USD30.8 billion was in renewable energy excluding large hydropower. In terms of new generating capacity, renewable energy provided 14-15 per cent of total power sector investment, with wind alone accounting for the largest share of it. Financial institutions are thus very much involved in the process that is currently shifting investment patterns from business-as-usual onto a path leading to a low-carbon economy.

### **The impact of climate change on investment choices**

For global financial services and the investment community, climate change presents both major **risks** and potentially lucrative **opportunities**. Each public and private financial institution has its own investment criteria, procedures and guidelines that determine how and where it makes investments for the benefit of its stakeholders. The financial industry has a two-fold obligation. On the one hand, it needs to prepare itself for the negative effects that climate change may have on its business and on its customers. On the other hand, it can significantly help mitigate the economic risks and enter the low-carbon economy by providing appropriate products and services.<sup>13</sup>

The financial sector is making a push to reduce its own direct impact through, for example, carbon neutral initiatives. However, many question the fact that the financial sector’s role should end there. Some suggest that it should go further and attempt to influence the greenhouse gas emissions of key stakeholders, such as their clients. Actions by financial institutions that attempt to influence the emissions behaviour of their clients include carbon disclosure and mitigation actions as part of the client review process; measurement of the collective GHG emissions intensity of a portfolio; full disclosure of financial risks from climate change for publicly traded companies; favourable financing solutions to fund development of relatively lower emitting technologies; and, investments in low-emissions housing.

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<sup>11</sup> United Nations Environment Programme Finance Initiative and Mercer (2007) *Demystifying Responsible Investment Performance. A review of key academic and broker research on ESG factors*, downloaded from [http://www.unepfi.org/fileadmin/documents/Demystifying\\_Responsible\\_Investment\\_Performance\\_01.pdf](http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf) 29.5.2008.

<sup>12</sup> Thomas, Farley (27 March 2008) *Different shades of green*, Financial Adviser.

<sup>13</sup> WWF and Allianz (June 2005), *Climate Change & the Financial Sector: An Agenda for Action*, downloaded from [http://www.wwf.org.uk/filelibrary/pdf/allianz\\_rep\\_0605.pdf](http://www.wwf.org.uk/filelibrary/pdf/allianz_rep_0605.pdf) 29.5.2008.

As far as **risks** are concerned, global annual economic losses resulting from extreme weather events and natural disasters have been predicted by a group of financial institutions in 2002 to approach USD150 billion per year by 2012. As a result insurers, re-insurers and banks could be put at risk of insolvency. The estimated figure was surpassed in the year 2005 and more recent scenarios estimate an economic loss of up to USD1 trillion in a given year stemming from climate related disasters by 2040. In addition, to this financial risk derived from natural hazards reinforced by climate change, national and international policy frameworks for climate mitigation are increasingly bearing on investment choices. Moreover, over the long-term climate change impacts pose a real business risk, which can be expected to influence investment decisions with respect to sectors and asset classes. Uncertainty, too, is an issue. Reducing uncertainty, the institutions stress, will act to mobilize greater volumes of private capital. The tone of the finance sectors call for action from the political and policy communities has intensified in the past 12 months as witnessed by a declaration made ahead of the G8 meeting in Germany in June 2007 when a group of finance sector CEOs stated: “there has been a seismic shift in how climate change is perceived, and is widely considered to be the greatest market failure ever. This is in part due to the fact that many of the effects of climate change are beginning to manifest, and that the threats posed by continued warming will affect—and even possibly disrupt—the operation of markets, societies, ecosystems and cultures.”<sup>14</sup>

At the same time, climate change creates **opportunities** for new industrial sectors, trading in carbon markets, and risk mitigation instruments. Climate-related risks and rewards are increasingly seen by some financial institutions as part of a global financial future. An increasing number of financial institutions are hence investing in new products and services to serve growing client demands associated with carbon markets, renewable energy and clean energy technologies, as well as, addressing their own climate-related risk management needs.

One of the most obvious opportunities lies with channelling investments to renewable **energy**, cleaner energy and adaptation technologies and energy efficiency projects. By 2007, the renewable energy sector had doubled its electricity generating capacity since 2004, and saw the sector’s annual investment figure reach nearly USD 150 billion for the first time.<sup>15</sup> In the same year, according to a new finding by the World Bank, global carbon markets had reached USD 64 billion<sup>16</sup> and these nascent markets have been predicted to increase exponentially if they are underpinned by the evolution of a market supporting policy framework.

These investments together with the multitude of different policy initiatives and responses to climate change will each have employment consequences. In addition, the pace of **job creation** in lower-carbon sectors (“green jobs”) is likely to accelerate in the years ahead. According to a recent study by the United Nations Environment Programme (UNEP) globally around 300,000 workers are employed in wind power and more than 100,000 in solar photovoltaics (PV). By 2007, the renewable energy sector globally accounted for 2.4 million jobs<sup>17</sup>. In China, the USA and Europe more than 600,000 people are employed in the solar thermal industry – by far most of them in China. Almost 1.2 million workers are estimated to be employed in biomass in Brazil, the USA, Germany and China. Overall, the number of people employed in the renewable energy sector is presently around 2.3 million. There is also

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<sup>14</sup> United Nations Environment Programme Finance Initiative and 23 CEOs of financial institutions (June 2007) *Declaration on Climate Change by the Financial Services Sector*, downloaded from [www.unepfi.org/fileadmin/statements/cc\\_statement\\_jun2007.pdf](http://www.unepfi.org/fileadmin/statements/cc_statement_jun2007.pdf) 29.5.2008

<sup>15</sup> The Economist 2 May, 2008.

<sup>16</sup> United Nations Framework Convention on Climate Change (UNFCCC) (October 2007) *Investment and Financial Flows to Address Climate Change*, downloaded from [http://unfccc.int/resource/docs/publications/financial\\_flows.pdf](http://unfccc.int/resource/docs/publications/financial_flows.pdf) 29.5.2008.

<sup>17</sup> REN21 (February 2008) *Renewables 2007 Global Status Report*, downloaded from [http://www.ren21.net/pdf/RE2007\\_Global\\_Status\\_Report.pdf](http://www.ren21.net/pdf/RE2007_Global_Status_Report.pdf) 29.5.2008.

significant job creation potential in energy efficiency projects, including in construction and retrofitting of energy efficient buildings, as well as in sustainable transport.

Moreover, a significant number of financial institutions are mobilizing investments and directing financial flows into **carbon funds**. The global carbon market has been dominated by the sale and re-sale of European Union Allowances under the EU Emission Trading Scheme (ETS) at a value of USD 50 billion. Project-based activities through the Clean Development Mechanism (CDM) stand at a value of USD12.8 billion. Both markets grew sharply since 2004. Increasing numbers of private and public financial institutions also provide investment money for carbon funds that invest in emission reduction credits. More money is also flowing into the process of developing and commercializing CDM projects. Developing countries may not have benefited equally from the services financial institutions offer to address climate change, including insurance services. There also is a general lack of climate change capacity and knowledge within financial institutions, which is especially felt in developing countries.

To summarize, if financial institutions make the investment decisions, it is national governments that set the rules for the markets in which they invest and operate. Hence, Member States must be aware of their role in the multifaceted and complex relationship between global private investments and global climate change./.