Managing Climate Change Risk
and
Investor Confidence in the Short Term

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Savvy investment fund managers must have a firm grasp of the risks that climate change and the transition to a low carbon economy will have on their current portfolios. They need to ensure the companies they invest in have plans to mitigate those risks. The good news is that by asking the right questions, investors can account for climate change risks to their portfolios and help drive companies forward on the path to both economic and climate sustainability.

Investors have two options related to climate change to consider.

1. Invest in companies that offer solutions to climate change such as renewable energy, batteries, and electric vehicles. But even these companies generate carbon emissions and carry risk.
2. Consider the climate change risk that all investments - both green and traditional - face as the global economy moves towards net zero future. This paper deals with the latter – reducing the risk and costs to corporations of the transition to the low carbon economy, no matter what you invest in. It is about knowing what data to analyze and what questions to ask.

The overwhelming majority of scientific opinion considers climate change an existential threat to the life we lead. Governments and companies worldwide are making commitments to reduce carbon emissions, often to reach "net zero." In simple terms, net zero occurs when we stop adding carbon dioxide to the atmosphere by a combination of reducing emissions and removing carbon dioxide. We *reduce* emissions when we use less energy or switch to no- or low-carbon energy. We *remove* emissions through nature-based solutions (e.g., forests) or technology (CO2 capture and storage.) But what strategies are best for a specific company? Investors need to hold businesses accountable for answering this question.

It does not take much analysis to realize that virtually every company currently in business will be impacted by climate change in the near future and over the long term. Recognizing this impact and risk prompted the Financial Stability Board to establish a Taskforce on Climate-related Financial Disclosure – referred to as TCFD. Its remit is to specify how the financial sector can take account for and publicly disclose climate related risks and plans. The outcome of this work was the development of a climate-related financial disclosure process. This disclosure process is voluntary, but wise investors will employ it now understand material risks. By now, any investable company should have undertaken a climate change risk assessment. When investors review a portfolio, the absence of climate-related risk disclosure should wave a red flag.

Alarmingly, many companies do not have the necessary skills or competence to undertake this disclosure. An initial question for any investor must be, who in the C-suite has the responsibility and competency to lead such a review? Further, if a review has been done, many investment houses are unable to understand or evaluate the disclosures made. An organization may declare they “will be net zero by 2035”, but it may lack a coherent strategy to achieve its targets. Some organizations are using “net zero” terminology as a smoke and mirror distraction to avoid undertaking a comprehensive strategic energy and carbon analysis. An investor needs to confirm the businesses in their portfolio have a solid understanding of their energy and carbon usage, have determined what is both achievable and sustainable by way of mitigation, and have the muscle to drive the necessary changes.

Climate change risk is flipping the script on risk. Typically, we associate longer-established companies with a portfolio’s lower-risk area. However, if these older companies fail to address climate change, their risk level moves in the wrong direction, increasing significantly over time. Investors can play a pivotal role to ensure their stable of companies address climate change with a well-thought-out strategy to identify all risks, develop mitigating measures, as well as assessing all climate change opportunities. The outcome will be a more profitable (or survivable) company and, as a co-benefit, a better long-term investment. Investors need to start asking the right questions.

Here are some questions to stay more infomed.

- What is your energy strategy?
- What is your carbon strategy?
- Who drives these strategies - lower-level managers or, hopefully, your C Suite?
- What analysis have you undertaken?
- How do you maintain momentum in times of stress, such as during a pandemic or periods of leadership turnover?

In both operational and investment terms, the net-zero or low carbon economy needs to be addressed today. The pace of change is quickening. The costs associated with doing little or nothing will escalate significantly.

Can investors manage climate change risk in a portfolio? The answer is **yes**.

- Investment houses need to be fully aware of what climate change risk is and factor it into their decision-making.
- Investment houses can work with companies that they already invest in to help them meet the challenges of the low-carbon economy and in so doing so lower the risk of their investment.
- TCFD provides a useful tool for investors and companies – but it needs to be understood and implemented in the right way.

At 360 Energy, our energy and carbon management expertise and services will help both investors and companies understand and address many of the risks and opportunities that climate change and the transition to a low carbon economy present.