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Climate Change: Impact for Pensions Actuaries

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28 June 2018

Agenda

- Drivers behind increasing focus
- What should we be doing?
- Scenario testing

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Drivers behind increasing focus

Increasing focus on climate change and governance

Since 2016 climate related risks have featured prominently in the top global risks identified by the **World Economic Forum**.

The **Task Force on Climate related Financial Disclosures (TCFD)** (launched by Mark Carney and chaired by Michael Bloomberg) published its report in June 2017. Among other things, this report recommended that asset holders such as pension funds took account of the impacts of climate-change when considering strategy and risk management.

In its 2017 investment guidance, **the Pensions Regulator** raises environmental, social and governance issues for DB stating that it expects trustees “to assess the financial materiality of these factors and to allow for them accordingly in the development and implementation of your investment strategy.”

The **Environmental Audit Committee** made recommendations to House of Commons in May 2018 following a survey to the top 25 pension funds in the UK asking them to respond publicly to questions on how they manage risk posed by climate change.

DWP launched a consultation in June 2018 on clarifying and strengthening trustees’ investment duties in relation to ESG issues specifically highlighting climate change.

IORP II requires pension schemes to have a risk management function which shall be structured to "identify, measure, monitor, manage and report" regularly on environmental, social and governance risks relating to the investment portfolio.

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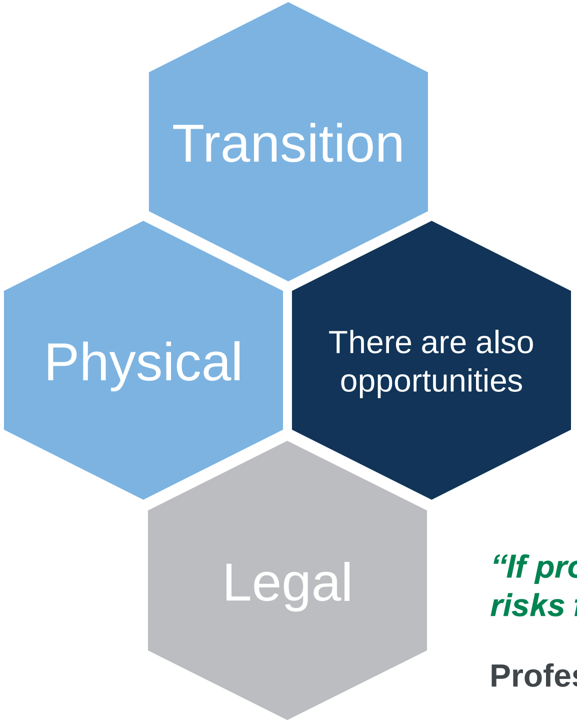
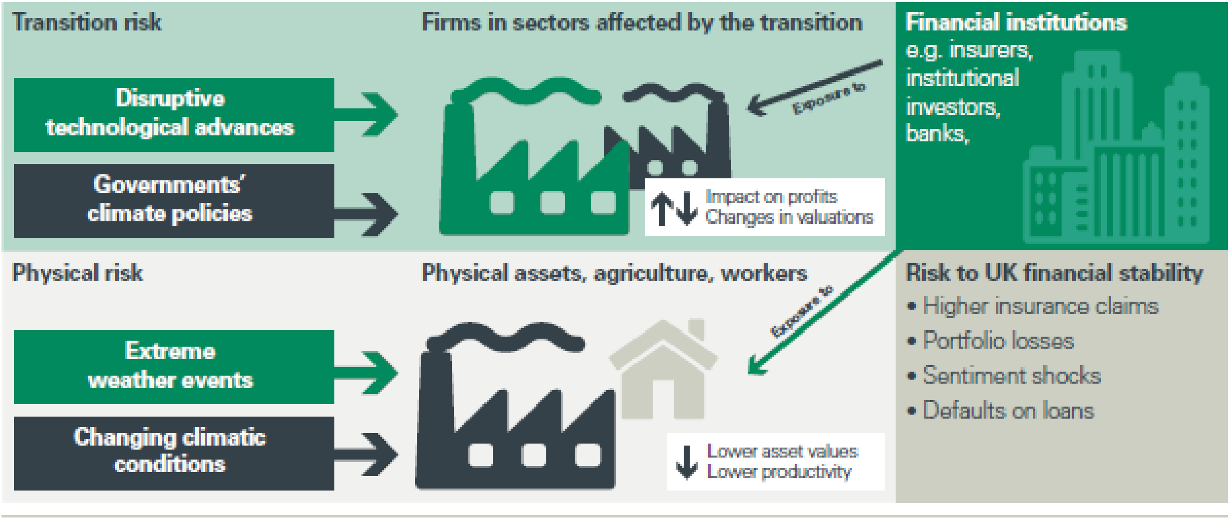
Risks from climate change





Source: Bank of England (2017)

"If progress continues at the same pace as the last 10 years then the transition risks for companies and investors could well crystallise within the next 10 years."

Professor Lord Stern, May 2017

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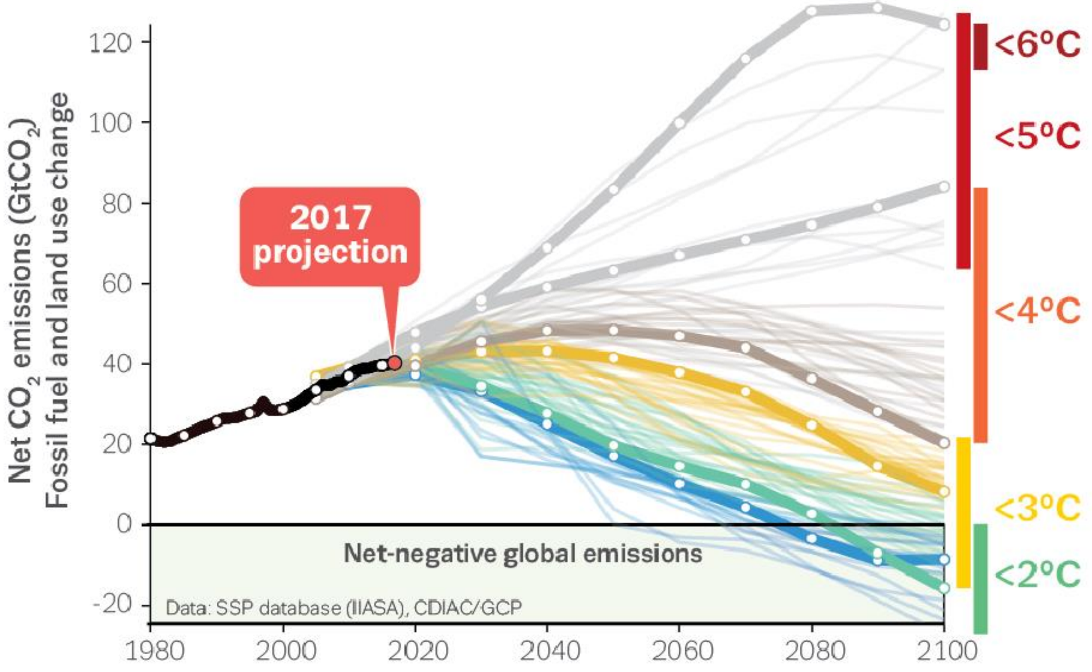
The 2ºC Goal



No Mitigation Scenario

Green Scenarios

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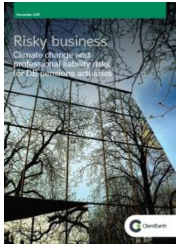

What is the legal/regulatory position?

"If the risks associated with climate change are financially material to a particular investment decision then it is clear, we think, beyond reasonable argument that the law permits and requires the trustees to take those risks into account when making that investment decision."

Keith Bryant QC and James Rickards (2016)

"Most investments in pension schemes are exposed to long-term financial risks, which may include risks around long-term sustainability. These can relate to factors such as **climate change**, responsible business practices and corporate governance."

"We expect you to assess the financial materiality of these factors and to allow for them accordingly in the development and implementation of your investment strategy."

The Pensions Regulator

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Risk Alert: Climate-Related Risks, 12 May 2017

Risk Alert:

Climate-Related Risks

Key message:

Actuaries should ensure that they understand, and are clear in communicating, the extent to which they have taken account of climate-related risks in any relevant decisions, calculations or advice.

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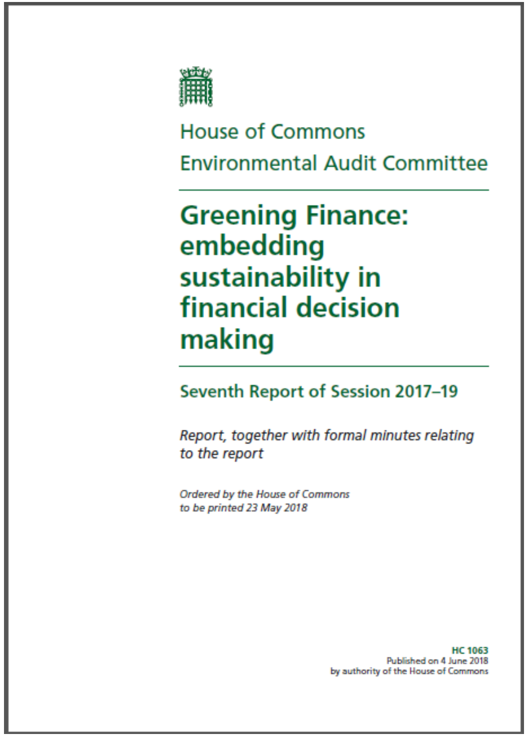
What should we be doing?

Climate risk disclosure initiatives recognise the importance of risk management…

- The TCFD puts risk at the core of managing climate risk disclosure

Report from Environmental Audit Committee



House of Commons
Environmental Audit Committee

Greening Finance: embedding sustainability in financial decision making

Seventh Report of Session 2017–19

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 23 May 2018

HC 1063
Published on 4 June 2018
by authority of the House of Commons

“The Government should clarify that pension schemes and company directors have a fiduciary duty to protect long-term value and should be considering environmental risks in light of this.”

“The Government should require fiduciaries to actively seek the views of their beneficiaries when producing SIPs.”

“It is important to ensure that climate risk reporting applies equally to asset owners (such as pension funds) and their investment managers.”

“The Government should make reporting mandatory on a ‘comply or explain’ basis by 2022.”

“There is a compelling case for other regulators to use the current round of adaption reporting required by the Climate Change Act 2008 to integrate climate change risk management into their work.”

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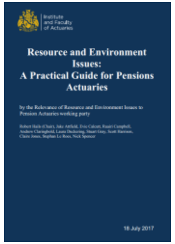
What can we do about it?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Resource and Environment Issues: A Practical Guide for Pensions Actuaries

by the Relevance of Resource and Environment Issues to Pensions Actuaries working party

18 July 2017

Investment

- Review Responsible Investment beliefs and policies
- Assess long-term risks in portfolio and effectiveness of managers

Covenant

- Consider exposure of covenant to long-term risks

Scenario Analysis

- Project funding (and consider covenant) on different climate change scenarios

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Scenario Analysis

Scenario analysis

What-if type questions?

- Stress test and consider outcomes
- Detailed explanation of how the story unfolds, and describes how economic and financial factors evolve over the projection period

Time horizon

- Next 5 years
- Long-term (eg 30 years)

So what?

- Risk mitigation
- Investment opportunities / risks across asset classes, sectors, geography etc.
- Consider impact on funding and covenant

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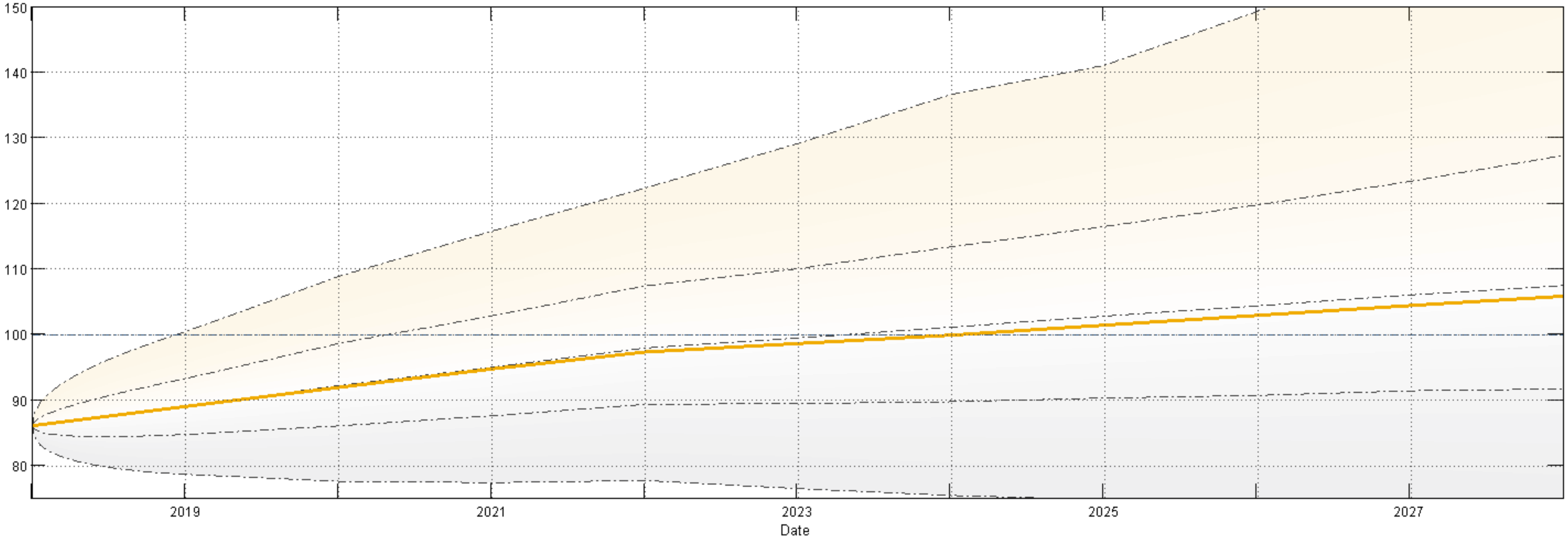
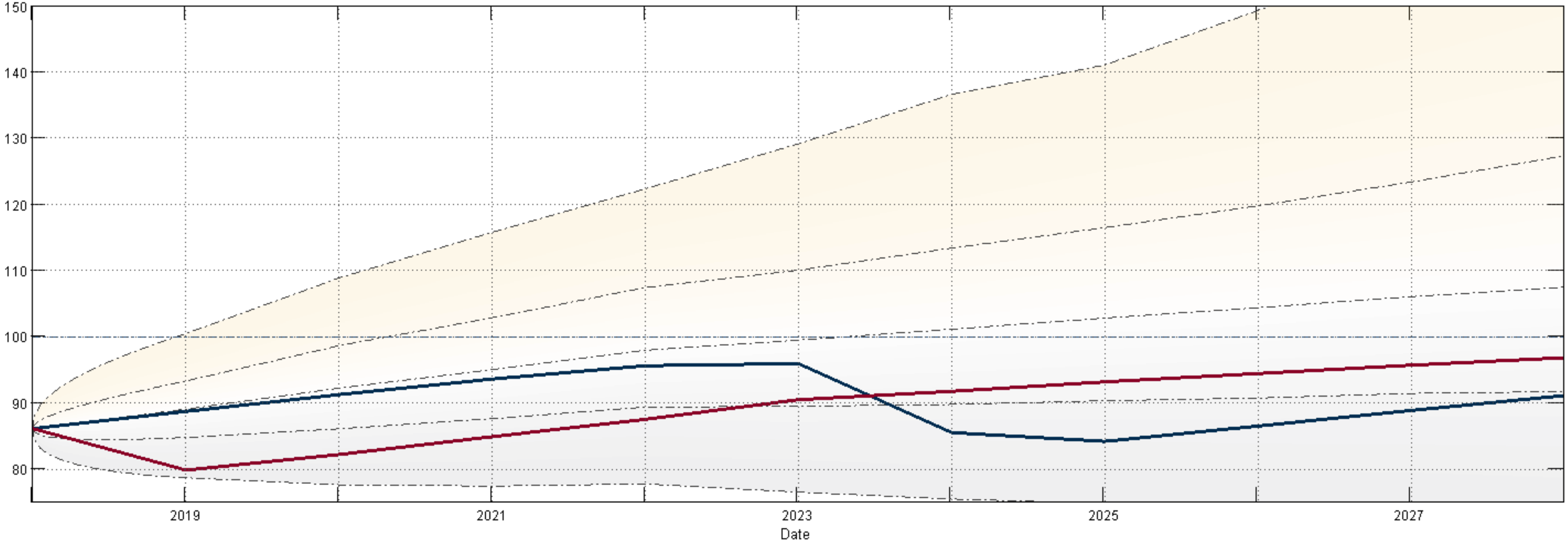
Funding implications for the Scheme under the scenarios – Business as Usual?



Source: Aon

Funding implications for the Scheme under the scenarios – Climate Change Risks



Source: Aon

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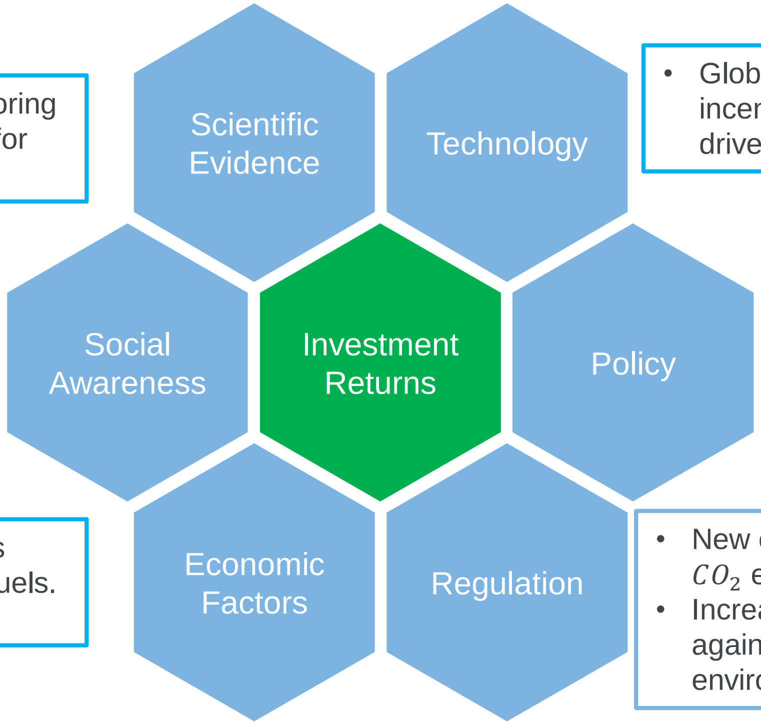
Climate Change Scenarios – Immediate Action

- Increased accuracy in the monitoring and measurement of emissions for attribution.

- Increased awareness of the risks GHG emissions pose.
- Increased pressure from shareholders, employees and activists to reduce emissions.

- Renewable technology becomes price competitive against fossil fuels.
- Stranded fossil fuel assets.



- Global government policy action and the incentivised shift away from fossil fuels drives the adoption of green technologies.

- Global agreement to limit GHGs with a tax and cap.
- Renewed political will progresses climate change mitigation.
- Commitment to stop the implicit subsidy of fossil fuels.

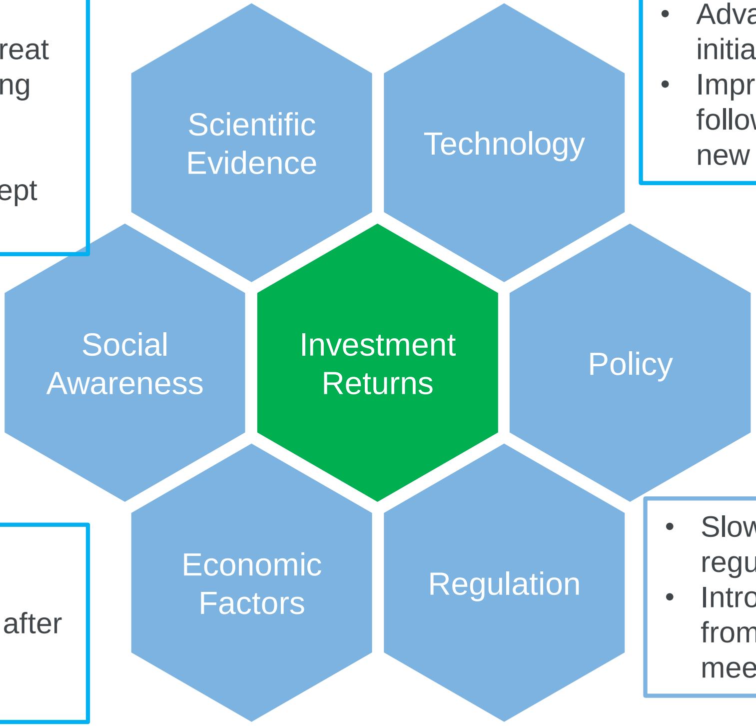
- New case law on the legality of emitting CO_2 emissions.
- Increase in lawsuits and liabilities placed against companies that disregard the environment.

Climate Change Scenarios – Delayed Action

- Growing scientific evidence and improved analysis suggest the threat from climate change is accelerating
- Scientists become more vocal convincing governments to act aggressively. Temperature rise kept below +2C by 2100

- Increased awareness of the threat from climate change
- Increased pressure from shareholders, employees and activists galvanise governments to act

- Regulation drives take-up of renewable technologies
- Carbon assets become stranded after 2023 as a result of policy and changes in market demand



- Advancement of green technologies is initially limited due to a lack of investment
- Improved adoption of green technologies follows global government policy action and new legislation

- Extreme climate events during 2018-2023 convince governments to address GHG emissions at a global level.
- High carbon taxes and a cap brought in 2024

- Slow progress on new environmental regulation over 2018-2023.
- Introduction of regulation in 2024 and threat from litigation incentivises companies to meet environmental responsibilities in 2024

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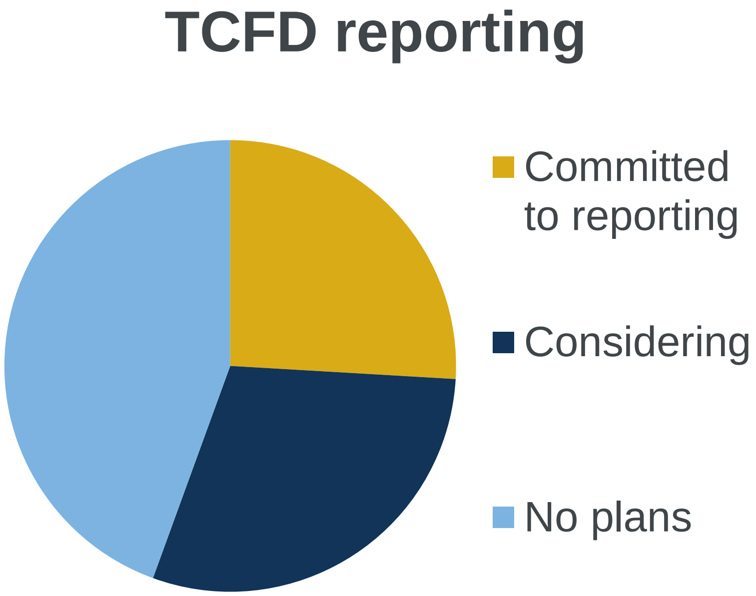
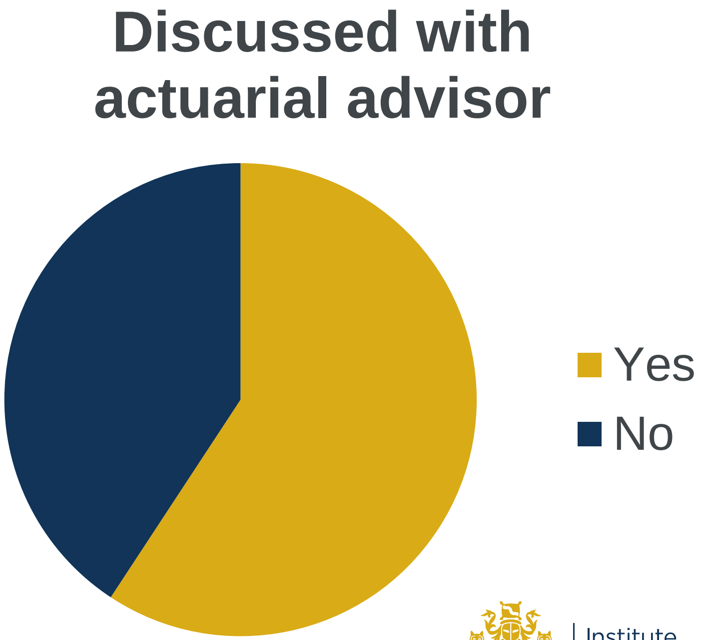
What are schemes doing?

What are schemes doing? – EAC Survey





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What are schemes doing? – Aon Survey

68% consider RI* at least somewhat important

Top concerns

Carbon footprint

Climate change

80%
UK

76%
Europe

Concerned about climate change

67%
Canada

48%
US

* Responsible Investment

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Next Steps

- Results of scenario analysis
- What can you do?
  - Learn more about climate risks so can discuss with clients
  - Encourage trustees to raise R&E issues with covenant adviser
  - Find out how clients are addressing R&E risks in investment processes
  - Review whether your models and documentation incorporate R&E risks adequately
  - Use scenario analysis to explore uncertainty
  - Help trustees include R&E risks in their IRM approach
- Opportunities in tcfd, alignment of investments with beliefs/member preferences and wider risk management?

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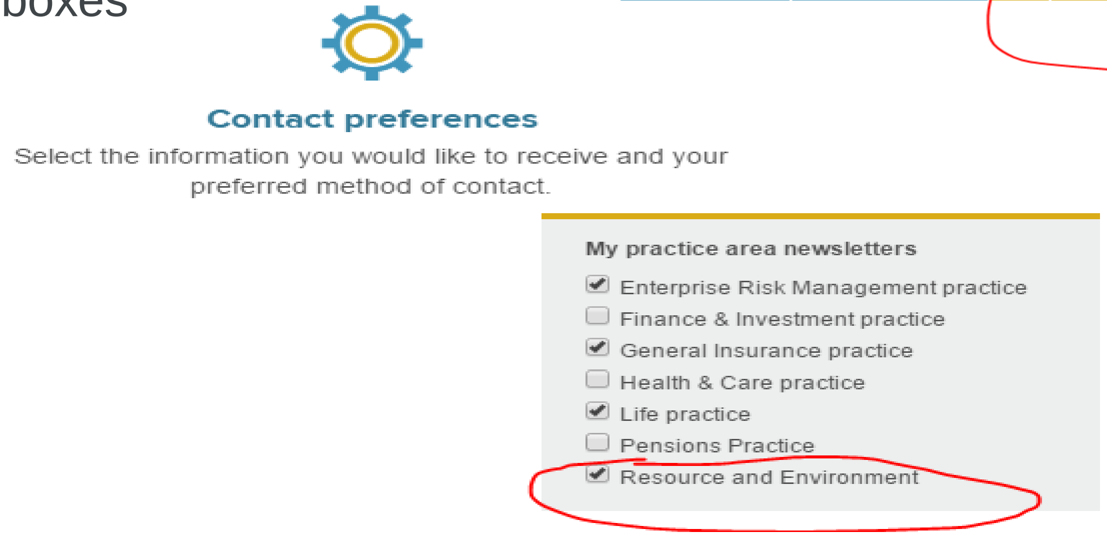
Signing up to the R&E Newsletter

- 1 – My Account
- 2 – Contact Preferences
- 3 – Tick R&E boxes



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Questions

Comments

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