

The carbon bubble: why investors can no longer ignore climate risks:

The financial risks posed by climate change and bad investments could make an ugly dent in your retirement savings, a new report warns



When Sandy Emerson sat down in her portfolio manager's office two years ago and announced she wanted to divest from fossil fuels, the latter furrowed her brow and said: "Why would you want to do that?" Emerson, a 68-year-old Berkeley, California resident, explained her unease about owning shares in companies that contribute to climate change and began selling her stock.

As a result, Emerson has been paying closer attention to the ups and downs in the oil industry and the growing public discussions about the future of fossil fuel use. "I've become aware of the financial implications it has for me," she says.

Emerson is among a growing number of investors who see global warming not only as a looming environmental problem but also an investment risk. Some fund managers are ringing alarm bells as well. BlackRock, the world's largest asset manager with almost \$5tn in assets, issued a report last month recommending investors include climate risks in their decisions.

"Investors can no longer ignore climate change. Some may question the science behind it, but all are faced with a swelling tide of climate-related regulations and technological disruption," the 16-page report said.

Even before BlackRock's report, evidence was mounting that investing in companies with a low carbon footprint pays off. The MSCI Low Carbon Target Index, for example, has modestly outperformed its traditional counterpart since 2010, data from the index provider shows. Earlier this year, Morningstar issued a rating system to help investors evaluate the environmental, social and governance factors of funds.

The bottom line: the financial risks posed by climate change could make an ugly dent in your retirement savings if you don't pay attention.

For middle-class investors, the office worker in Illinois with a company 401k or the teacher in Oklahoma with a state-sponsored pension, the risk could be particularly acute because they don't oversee their own investments. And attitudes and expertise regarding climate risk vary widely among those charged with investing average folks' money.

In a survey of portfolio managers and analysts done by the London-based CFA Institute last year, 73% said they consider environmental, social and governance (ESG) risk factors in their analysis – but only 40% of those regarded climate change as important. Moreover, only half of those who consider ESG risks said their firm provided training in this area, with most of that training done via miscellaneous sources such as research papers and conferences.

Efforts have begun to create industry-specific standards for companies to disclose climate change risks, most notably by the Sustainability Accounting Standards Board (SASB), a nonprofit group chaired by former New York Mayor Michael Bloomberg. The board estimates that significant climate risks – things like how severe weather events can impact businesses, regulations imposing a cost on carbon and economic development that is less reliant on fossil fuels – exist for most of the companies it tracks, which represent \$27.5tn, or 93%, of US stocks as measured by market value.

“Due to the ubiquity of climate risk, investors can't simply diversify away from it; instead they must focus on managing it – and on encouraging portfolio companies to manage it – in all its forms,” the SASB writes.

The future of fossil fuel companies is at risk as more investors move their money elsewhere. By some estimates, the industry could face a “carbon bubble” that will leave it stuck with trillions of dollars in stranded assets – unburnable oil, coal and gas reserves – as nations move to limit the planet's warming trend to 2C, the target of the Paris climate agreement, which takes effect 4 November.

But climate risk doesn't only affect the big oil. Industries ranging from automobiles to agriculture to steel to utilities could also face climate-related challenges such as sea level rise and drought, tightening emissions standards, changing consumer preferences and the growing divestment movement, the BlackRock report notes.

New technology that emerges as a response to climate change could also force changes within industries with a heavy carbon footprint, the report says. For example, advancements and falling prices in lithium batteries are poised to impact both the oil and gas and automotive industries because they are making electric vehicles and battery storage for solar or wind energy more practical and affordable. Earlier this year, Bloomberg New Energy Finance reported that battery prices have declined by 65% since 2010, with 35% of that in 2015. The market research firm projects another 35% decline for 2016, a spokeswoman says.

“You can lose a lot of money by having exposure to losing strategies, losses that could be hard to make up,” says Ewen Watt, senior director of the BlackRock Investment Institute. “If you're saving money for your long term future, the risk for you is there won't be enough money when you retire to meet your retirement needs.”

While the financial industry is recognizing climate risks, its actions sometimes don't reflect that. Banks have continued to fund the dirtiest fossil fuel projects and big fund managers have voted against shareholder proposals forcing companies to disclose their climate risks.

BlackRock, along with peers Invesco, BNY Mellon and Vanguard, voted against such shareholder proposals at Exxon Mobile and Chevron earlier this year. BlackRock argues that global warming has yet to harm these oil companies, so it prefers to continue putting money in them and pushing for change from within rather than getting involved in a confrontation. Sandy Emerson's wealth management firm also advocated this strategy.

The federal government has taken conflicting approaches to hold oil companies accountable for disclosing climate risks. Earlier this summer, the House of Representatives passed legislation that would block the Securities and Exchange Commission from implementing climate disclosure guidance. Proposed by Representative Bill Posey, a Republican from Florida, the measure now awaits a vote by the Senate.

Regular folks might end up being the biggest losers in this fight among regulators, fund managers and fossil fuel companies over their roles in addressing global warming. Consumers who depend on investment professionals to protect their retirement savings may not entrust their hard-earned money with the right people.

"If what you read about stranded assets is true, it's a potentially serious problem for regular, middle-class people who aren't necessarily paying attention," says Cari Rudd, a Washington DC-based communications consultant, who does social media work for Divest-Invest and sits on the board of As You Sow, an Oakland, California-based nonprofit that promotes environmental and social corporate responsibility through shareholder advocacy.

"Now that I have become involved, I'm much more concerned about Joe in Cleveland who has a little 401k and how he's already been screwed on a lot of fronts," Rudd says.

The emergence of divestment advocacy groups is providing more information to help individuals navigate what can be a daunting process of moving their investments to, say, environmentally friendly technology such as renewable energy. Some investment companies offer fossil-free mutual funds.

For example, As You Sow's Fossil Free Funds, which uses data from Morningstar, is a free online tool that allows investors to type in the name or ticker of a fund and see what percentage is invested in fossil fuels. Earlier this month, the organization expanded Fossil Free Funds to include a feature that shows each fund's carbon footprint and which companies are the main contributors. For 401k participants who don't have direct control of selecting the funds offered in their retirement plan, As You Sow also provides advice on how to speak to their employers about expanding their company's plan to include low-carbon options.

Looking ahead, Sandy Emerson says she's been impressed with the handful of largely European oil producers developing small renewable energy divisions.

"I'm watching the oil companies that are starting to make moves in renewables and I'm thinking that they're pretty smart," she says.

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