Investment Leaders Group

UNIVERSITY OF CAMBRIDGE
INSTITUTE FOR SUSTAINABILITY LEADERSHIP

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Investors Quantify "Winners" and "Losers" from Climate and Energy Regulation

Cambridge's Investment Leaders Group develops model for industry to get ahead with smart stock picking

CAMBRIDGE, UK (12 May 2016) – Anticipating a continued shift to a low carbon society, a global network of investors with over US $4 trillion under management, has developed a model that quantifies the impact of potential climate and energy regulation on company profitability. The findings are being presented today at a meeting held by the Swiss Ministry of Finance that will feed into the G20's Green Finance Study Group. The model goes beyond carbon footprinting by calculating the impact of regulation on companies' margins. Developed by the Investment Leaders Group (ILG), a network of 10 leading investment managers and asset owners, it has the ability to improve stock picking and empowers investors to engage with companies on actions they can take to make them 'future proof'.

The recent COP 21 climate agreement represents a global consensus on the need to take urgent action on climate change. Governments have already sent a clear signal that they intend to transition the world to a low-carbon society. Other examples of pertinent regulation include the EU's 2030 climate and energy targets, the introduction of a national carbon market in China, and the US Clean Power Plan. "Without giving analysts and portfolio managers effective tools to assess climate risk and its financial impacts we cannot expect portfolios to be positioned for a low-carbon future. This model form part of the groundwork that will allow investors to start making the necessary adjustments" said Urban Angehrn, Chief Investment Officer of Zurich Insurance Group.

The model integrates two regulatory scenarios for each of the countries it covers in this phase, the first (Transition Scenario) that is reflective of plausible changes to regulations that would come into effect by 2020 and the second (€45 Carbon Price Scenario), that adds a carbon price of €45/tonne of carbon dioxide (tCO_2), as a proxy for more aggressive policy action to curb emissions.

The illustrative results of the model on companies cover three high-risk sectors (electric utilities, oil refining and natural gas) in the UK, Spain, Germany, Canada (Alberta) and US (California). It draws several interesting conclusions, including:

- **Energy and carbon regulation can have a significant impact – both positive and negative.** While margins of utilities in Spain could increase by €2 cents per kilowatt hour (76 per cent) due to their high exposure to renewables, margins of utilities in the UK, with the current exposure, is at risk. Even in a Transition scenario, it could lose up to €3.5 cents per kilowatt hour. This would eliminate all the profit and result in the activity becoming a loss if fuel mix and technologies remains unchanged. The profitability of other sectors could also be at risk under a €45 Carbon Price scenario. Gas production in Alberta (Canada) and California (USA) and oil refineries in Spain and Germany could lose over 10 per cent of their margins if no action is taken.

Oil refinng	-1.1 EUR/bbl -12%	-1.2 EUR/bbl -15%

Gas production	-4.2 EUR/kqm gas -11%	-5.5 EUR/kqm gas -14%

- **Impact of regulation also depends on company-specific factors.** Differences in technology and efficiency can result in significant differences in how exposed companies are in comparison to their peers. The analysis for oil refineries shows that impact on margins can differ between refiners in the same country by up to 30 per cent due to refinery configuration.
- **Companies can mitigate the risk.** Investors can protect their investments by engaging with companies on mitigating the risks. For example, mitigation activities for electric utilities were shown to be able to increase margins by more than 50 per cent in the UK and Spain.

"This research underlines the financial risk of not addressing climate change in investment analysis", says Bozena Jankowska, Global Co-Head of ESG at Allianz Global Investors, who is presenting the findings in Switzerland today. She continued, "Investors can begin anticipating this financial impact and make investment decisions that are consistent with the expected future direction of climate policy".

This work is launched at a time when government authorities around the world are visibly stepping up their focus on environmental risks. Under the Chinese Presidency, the G20 Green Finance Study Group is analysing how to enhance the ability of the financial system to mobilise capital for green investment. Environmental risk analysis is a key cross-cutting issue. "The work of the Investment Leaders Group could not be more timely given the attention G20 governments are giving to how environmental risks are handled in the financial system this year," said Andrew Voysey, Director of Finance Sector Platforms at the University of Cambridge Institute for Sustainability Leadership (CISL), which as well as convening the ILG is a Lead Knowledge Partner for the G20 Green Finance Study Group. "G20 Ministries of Finance and Central Banks are increasingly aware of the challenges posed by environmental risks and – whether physical events or risks from the transition to a zero carbon economy. They want to understand what tools and techniques financial institutions are developing and what challenges they are facing implementing them. The ILG's experience is extremely relevant."

Data availability continues to remain challenging and is reflected not only in the accuracy of results of this model, but as a barrier for the industry and financial authorities to improve their understanding of the risk. "As we gain access to more data, this work has the potential to help translate companies' alignment with the transition to a low carbon economy into investment decisions," says the CIO of Standard Life Investments, Rod Paris. "Quantifying the financial impacts of changing energy policy will allow investors and the companies they invest in to mitigate risks and identify new investment opportunities". Further research could also include modelling to cover the full operational footprint of the companies analysed or even be expanded to other high-risk sectors, such as chemicals and transportation.

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About the report

***Feeling the heat: An investors' guide to measuring business risk from carbon and energy regulation* -** This report develops the methodology for a financial model that assesses the impact of future carbon-related regulation on the most sensitive industries and geographies. The first phase of the project covers three high-risk sectors (electric utilities, oil refining and natural gas) in five key geographies (UK, Spain, Germany, Canada's Alberta province and the US State of California). With the help of an analytical tool, investors can begin anticipating the financial impact of future climate-related policy within their models and investment decisions.

- Read the full report

About the Investment Leaders Group

The Investment Leaders Group (ILG) is a global network of 10 leading investment firms, with approximately US $4 trillion under management, convened by the University of Cambridge Institute for Sustainability Leadership. ILG members are: Allianz Global Investors, First State Investments, Loomis, Sayles & Company, Natixis Asset Management, Nordea Life & Pensions, Old Mutual Group, PensionDanmark, Standard Life Investments, TIAA Asset Management and Zurich Insurance Group. The ILG's mission is to shift the investment chain towards responsible and long-term value creation, so that economic, social and environmental sustainability are delivered as an outcome of the investment management process as investors go about generating robust, long-term returns.

About the Cambridge Institute for Sustainability Leadership

The University of Cambridge Institute for Sustainability Leadership (CISL) brings together business, government and academia to find solutions to critical sustainability challenges. Capitalising on the world-class, multidisciplinary strengths of the University of Cambridge, we deepen leaders' insight and understanding through our executive programmes; build deep, strategic engagement with leadership companies; and creates opportunities for collaborative enquiry and action through its business platforms. CISL's latest initiative – Rewiring the Economy, was launched by The Prince of Wales in July 2015.

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