

# Aviva Investors Viewpoint

## Climate change and the role of investors

June 2009



### **With the election of President Obama in the United States, the political debate on climate change has escalated to the point where the policies on what action to take are now changing almost as fast as the weather.**

By appointing climate scientists to key posts in his administration, President Obama has demonstrated that he is serious about the climate change commitments he made during the run up to his election. He has committed to a number of renewable energy plans, including having 10% of US electricity being generated by renewable sources by 2012 and has given his support to a US cap-and-trade program to reduce emissions by 80% by 2050. We believe that his leadership on the international stage is crucial to securing a successful global deal on a successor to the Kyoto protocol at or near to the next big conference on climate change in Copenhagen in December 2009.

However, what exactly are scientists saying about the environmental consequences of climate change, what impact do economists think it will have on development and – particularly important from Aviva Investors perspective – how could this affect our clients' portfolios? And as a responsible institutional investor, how should we respond?

The pre-eminent scientific authority on climate change is the Intergovernmental Panel on Climate Change (IPCC), established in 1988 by the United Nations. The IPCC published its Fourth Assessment Report in 2007 (the first being in 1990). Part of this report covered "the physical science basis" for climate change. This concludes that the 2005 levels of atmospheric carbon dioxide exceeded by far the natural range of the last 650,000 years, and that the primary source of this increase is fossil fuel use. The report concludes that warming of the climate system is unequivocally taking place and that the IPCC are more than 95% certain that most of the increase in globally averaged temperatures since the mid-20th century is due to the increase in anthropogenic greenhouse gas concentrations.

In terms of the environmental consequences of this change, the United Nations Environment Programme Global Environmental Outlook Report concluded in October 2007 that: "There has been a remarkable lack of urgency in tackling green house gas emissions... Climate change is a major global challenge. Impacts are already evident and changes in water availability, food security, and sea level rise are projected to dramatically affect many millions of people... To prevent future severe impacts from climate change, drastic steps are necessary to reduce emissions from energy, transport, forest, and agricultural sectors" (UNEP 2007).

Similarly, the UNDP Human Development Report for 2007/2008 emphasised that these environmental changes will also have an impact on society: "Climate change is the defining human development issue of our generation . . . Climate change threatens



to erode human freedoms and limit choice. It calls into question the Enlightenment principle that human progress will make the future look better than the past . . . Across developing countries, millions of the world's poorest people are already being forced to cope with the impacts of climate change. . . The world lacks neither the financial resources nor the technological capabilities to act. If we fail to prevent climate change it will be because we were unable to foster the political will to cooperate. Such an outcome would represent not just a failure of political imagination and leadership, but a moral failure on a scale unparalleled in history" (UNDP 2007).

So, if the environmental and social impacts from climate change are so significant, what impact do economists believe it will have on our economic development? There have been a number of attempts to answer this question but the most authoritative remains The Stern Review on the Economics of Climate Change (October 2006), which was commissioned by Gordon Brown as the UK's Chancellor. The Review considers the economic impacts from, for example, increased extreme weather events, rising sea levels and a changing global pattern of precipitation. This report makes it clear that climate change could represent a significant cost to the global economy. Its main conclusions are that one percent of global GDP is required to be invested a year in order to mitigate the effects of climate change, and that failure to do so could risk global GDP being up to twenty percent lower than it otherwise might be. The Review also proposes a range of possible responses such as taxation, subsidies and carbon trading.

The unprecedented scale of global government action that the Stern Review calls for would provide both significant costs and significant opportunities for companies. It is these costs and opportunities that hint at the primary role of institutional investors that are seeking to maximise the value of clients' investment portfolios.

For example, renewable power generation such as wind, solar, geothermal and waste to energy companies could benefit from greater government support. Conversely, those energy-intensive companies that are unable to reduce their emissions could incur increased future costs. Many of the best performing stocks we've picked have come directly from our research into how climate change impacts on investment portfolios. For example, Eaga,

which produces energy efficient insulation for buildings, has seen a steep change in the prospects for its product as a result of energy efficiency regulations on climate change.

While our primary role is to ensure that our clients' portfolios benefit from the financial opportunities and avoid, as far as possible, the financial risks, we also recognise that as a large institutional investor we have an ability to directly influence corporate performance in this area, as well as help shape the policy debate. We accept that with influence comes responsibility, and we seek to use this influence carefully and strategically in our engagement with companies and policy makers.

Our company engagement in this area focusses on improving disclosure of greenhouse gas emissions data and promoting increased efficiency measures. Part of this is conducted in collaboration with the Carbon Disclosure Project (CDP) – a project Aviva Investors helped found – which promotes disclosure of corporate risks and opportunities associated with climate change from over 2000 companies. As a practical example of how Aviva Investors applies this, we use our voting policy to promote improved disclosure of greenhouse gas emissions. We target companies based on the potential impact of climate change on their business, as well as the potential for their business to impact on climate change. We highlight that if the companies do not respond to the CDP, then Aviva Investors may withhold support for the Report and Accounts at future AGMs. The CDP has said that it believes our action has a positive impact on the response rate.

Most of our engagement with policy makers is conducted in collaboration with other responsible financial organisations. For example, Aviva Investors is an active member of the Institutional Investors Group on Climate Change (IIGCC), which we helped to found. Towards the end of 2008 we collectively issued a public statement, signed by 152 global investors collectively worth over \$9 trillion. This statement called on world leaders to negotiate a strong and binding successor to the Kyoto Protocol in order to ensure that investors receive the market signals critical to funding the transition to a low carbon economy.

Aviva Investors SRI team was also part of a small delegation to the climate conference in Poznan during December 2008, where we hosted a dinner for a small number of diplomats, negotiators and investors - including Yvo de Boer, the Executive Secretary of the UN Framework convention on Climate Change. The Poznan experience highlighted the scale of the challenge of getting an agreement at Copenhagen: the conference will involve over 1,000 negotiators, hundreds of non governmental organisations, and over 10,000 delegates - all seeking to influence the two week process that itself brings together hundreds of previous meetings around the world on the agreement.

While there are a significant number of political and economic risks to the process, on balance, Obama's election has led us to be more confident of a strong post Kyoto deal on climate change being signed near to the Copenhagen conference. Without question, the Copenhagen debate in December 2009 will provide the litmus test of whether President Obama will be able to put the US in the leadership position that he has indicated he intends to take.

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