Preparing for the storm?

UK fund managers and the risks & opportunities of climate change

October 2009

FairPensions™
The campaign for responsible investment

FairPensions is a registered charity that campaigns to see UK pension funds and fund managers adopt an effective responsible investment capability – to monitor and manage environmental, social and governance issues that have the potential to significantly affect investment returns. FairPensions believes that responsible investment practices help to safeguard investments, as well as securing environmental and social benefits.

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FairPensions™
The campaign for **responsible** investment

Disclaimer: This publication should not be taken as financial advice or seen as an endorsement of any particular company. Whilst every effort has been made to ensure the information contained herein is correct, FairPensions cannot guarantee accuracy. The research was carried out between May and August 2009.

During the period of the analysis, those entities surveyed were given the opportunity to review their submissions and consent for full disclosure of their responses was sought. Some requested that their responses be kept anonymous. All surveys published are with consent.

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"our actions over the coming few decades could create risks of major disruption to economic and social activity… similar to those associated with the great wars and the economic depression of the first half of the 20th century."[1]

1. The Stern Review, Executive Summary (page ii), published 30 October 2006.

Endorsing organisations

We wish to recognise the following asset owners for their endorsement of this research:

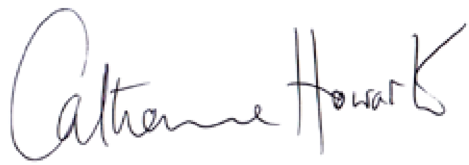
- Church Investors Group
- Environment Agency Active Pension Fund
- Esmée Fairbairn Foundation
- Friends Provident Foundation
- Joseph Rowntree Foundation
- Local Authority Pension Fund Forum (representing 49 pension funds)
- Oxfam GB
- Polden Puckham Foundation
- Strathclyde Pension Fund
- WWF UK

A key vulnerability in asset owners' responsible investment effectiveness relates to their dependency on external managers to implement their investment principles. It is therefore critical for pension funds and other asset owners to have a grasp on how fund managers approach risk-management of ESG (environmental, social and governance) issues, company research and analysis, and the degree of resource devoted to engagement with companies on behalf of clients to challenge identified risks.

Prior to sending our climate change survey to 100 fund managers (full list on page 24), FairPensions contacted the pension funds, charitable foundations and church investors listed to secure their endorsement for the research. A key objective of securing support from these varied asset owners was to ensure a high level of survey participation by fund managers, and in turn the highest possible quality of data at the end of the project. At 39% participation, robust data analysis of survey responses has been possible. Nevertheless, we consider it a worrying sign that even with the explicit endorsement of the asset owners listed above (their names were on the covering letter which went out with the survey to fund managers) more than half the managers who received a survey failed to complete and return it.

Those fund managers who participated have, almost overwhelmingly, agreed to have their survey responses published at fairpensions.org.uk. This allows clients and potential clients to see what is being done by these fund managers to assess and manage climate change risks and opportunities. We applaud these managers for their open approach. We would strongly encourage asset owners who use any of the 61 fund managers who did not participate to encourage them to complete the questionnaire and make the data available in future.

FairPensions' work over the last few years has demonstrated that clear and consistent client demand for responsible investment plus external scrutiny does make a substantive impact on fund manager policy and practice. We hope very much that this piece of research will have a similar positive catalytic effect upon investor behaviour.



Catherine Howarth
Chief Executive, FairPensions

"the greatest economic opportunity we've had since we mobilized for World War Two" [2]

2. Bill Clinton, Speech to US Conference of Mayors' Climate Protection Summit, Quoted by Reuters 1 November 2007.

Introduction

For financial services companies to regain the trust of investors, policymakers and the public, they need to show themselves capable of identifying and managing not only those issues which precipitated the current financial crisis, but also those which could reasonably be expected to cause the next one.

Climate change is an obvious potential cause of a future financial crisis that could dwarf current problems: there are now few serious commentators who do not expect climate change to create serious physical and regulatory impacts on businesses, but it will also create political, social, technological and market challenges which will affect companies and their investors. These changes may be difficult to quantify, but their potential significance means that they should nevertheless be actively anticipated.

The consequences of climate change will increasingly be felt in the short term: the UN climate change conference in December 2009 is expected to produce new initiatives to reduce emissions with impacts upon companies and their investors. However, investors (especially those with longer-term investment objectives, such as pension funds) need to take action now to ensure that assets are "future-proofed": companies that convert to lower emissions models in a proactive, timely and planned manner will find the transition easier and more cost-efficient than those who are forced to change hurriedly and reactively.

This report looks at fund management companies partly due to the public interest in a sector that manages the assets of pension schemes, charitable foundations and individuals. Fund management companies are also of interest because as huge shareholders they are in a position to either promote timely corporate anticipation of the risks and opportunities arising from climate change or to delay progress by encouraging a corporate culture that is focused on short-term returns at the expense of longer-term financial sustainability.

This report is intended to inform investors and policymakers, by identifying the attitudes, actions and reporting of fund managers (as a group and individually) on the risks and opportunities of climate change. It is anticipated that our findings will add value to research published by others showing the exposure of companies and investors to climate change risks[3].

We hope that the research will also be of use to fund managers themselves, who, as the financial effects of climate change become increasingly apparent, can expect increased demand from clients for relevant action and reporting. Fund managers could also view the management of climate change proactively, as a means of rebuilding client and public confidence in their ability to assess and manage risks.

This report focuses more on engagement with investee companies than on buy-sell tactics (although there is also a case for the latter). Most fund managers who participated in this research have altered investment allocations in at least some companies due to climate change considerations, but this is a partial solution: excluding the sectors most obviously impacted by climate change, such as oil & gas and transport would unacceptably reduce portfolio diversification, and the consequences of climate change will flow through supplier and client chains to impact the entire economy. Engagement with companies also puts investors in a position to detect risks and opportunities early, as some participating fund managers have pointed out.

Research was carried out between May and July 2009, based on survey responses from 39 fund management companies.

3. Examples include Mercer & Trucost "Carbon Risks in UK Equity Funds" 2009; EIRiS "Climate Change Compass: The road to Copenhagen", 2009 and the work of the Carbon Disclosure Project (cdproject.net)

Executive Summary

The importance of climate change is recognised…

An overwhelming majority (89%) of participating fund managers recognise that climate change is an “important” or “very important” investment issue, and a large majority (66%) state that it has become more important in the last two years.

…but action is suppressed by short-termism and lack of client demand.

63% of fund managers surveyed said that the low current carbon price was the most significant barrier to the incorporation of climate change risks and opportunities into investment analysis and decision making. This creates, in the words of one surveyee, an “imbalance between the relatively short term horizons of mainstream investment analysis and the relatively long term nature of the material business impacts of climate change”[4]. Our findings also suggest that fund managers feel under little pressure from clients to temper short-termism (including those such as pension funds which have longer-term investment objectives): 56% of respondents cited “lack of demand from clients” as a barrier to managing climate change risks and opportunities.

Leaders and laggards

Despite the near-universal recognition of the importance of climate change, there are significant differences in the extent to which fund managers are taking action to anticipate climate change. For example, 29% of our surveyees make use of climate change data in their analysis of “all companies where data is available”, but some (6%) use such data “in no companies” (although it is worth noting that the fund managers who responded to our survey are self-selected and therefore likely to reflect the more engaged section of the investment community). Among participants who undertake engagement, 81% ask companies for an action plan to reduce emissions (though clients and other interested parties may ask why the other 19% do not).

Differing views on which sectors require action to manage climate change

Fund managers surveyed fell into two main camps, those who take the view that “all sectors of the economy will be affected”[5] (and act accordingly) versus those who think that “carbon emissions are material and relevant for some sectors […] but not for others”[6] (and therefore take more limited action): 39% request climate change data from companies in “all sectors” and a similar proportion (36%) request such data from companies in “a minority of sectors”.

Strong fund manager support for mandatory emissions reporting and reduction

There is a powerful consensus amongst participating fund managers on the need for greater regulation: 86% stated that they would welcome requirements on companies to report greenhouse gas emissions and 78% would welcome stock exchange listing rules requiring companies to disclose climate related risks.

4. Henderson Global Investors
5. F&C Asset Management plc
6. AllianceBernstein LP

In addition to support for reporting requirements, 72% would also welcome regulatory requirements on companies to reduce emissions. These results suggest that current Whitehall preferences for voluntary reporting (as discussed in our "conclusions and recommendations") is out of step with the needs of a key part of the business community.

Reporting by fund managers: the transparent, the opaque, and an argument for mandation.

Despite the strength of support among participating fund managers for mandatory emissions reporting by investee companies, fund managers' reporting on their own management of climate change risks and opportunities is disappointing, and suggests that they do not see this as 'key data': 15% do not report on the issue at all, and almost half (44%) report only to "clients who request it". Given that climate change is an important investment issue and that fund managers are not uniformly good at addressing it, there is a strong argument that clients should request such information to ensure that their interests are being promoted.

We also suggest that the mandatory reporting requirements which fund managers are keen to apply to companies should also apply to the emissions exposure of their own portfolios, due to the clear public interest in knowing whether the financial services sector is behaving in a manner both financially and environmentally sustainable.

The submissions of participating fund managers are available online, at fairpensions.org.uk

List of participating fund management companies

The following companies' survey responses were used to prepare this report, and their survey responses are available online:

Aberdeen Asset Managers Ltd.
AEGON Asset Management UK
AllianceBernstein LP
Aviva Investors
AXA Investment Managers
Baillie Gifford & Co.
Barclays Global Investors Ltd.
BlackRock
CCLA Investment Management Ltd.
The Co-operative Asset Management
Credit Agricole Asset Management
Credit Suisse Asset Management
Doughty Hanson & Co.
Ecclesiastical Investment Management
F & C Asset Management plc
Gartmore Investment Management Ltd.
Goldman Sachs Asset Management
Henderson Global Investors
Hermes Equity Ownership Services Ltd.
JP Morgan Asset Management
Jupiter Asset Management
Legal & General Investment Management Ltd.
Martin Currie Investment Management Ltd.
MFS International (UK) Ltd.
Morgan Stanley Investment Management Ltd.
Newton Investment Management Ltd.
RCM (Allianz Global Investors)
Royal London Asset Management Ltd. (RLAM)
Sarasin & Partners LLP
Schroder Investment Management Ltd.
Standard Life Investments Ltd.
State Street Global Advisors
T Bailey Asset Management Ltd.
T Rowe Price
Threadneedle Asset Management Ltd.
UBS Global Asset Management Ltd.

The following companies also participated in the research, but preferred that their survey responses were not published:

Friends Provident plc
Impax Group plc
Insight Investment

A full list of fund management companies invited to participate appears on page 24.

Main Report – Results in detail

Section A – Assessment of climate change as an investment issue

Recognition of climate change as an investment issue

As figure 1 illustrates, a large majority (89%) of responding fund managers stated that climate change was either 'important' or 'very important' as a factor in investment research, decision making and engagement actvities.

Figure 1

Section A Q1. In your business, how important is climate change as a factor in investment research, decision making and engagement activities with companies?

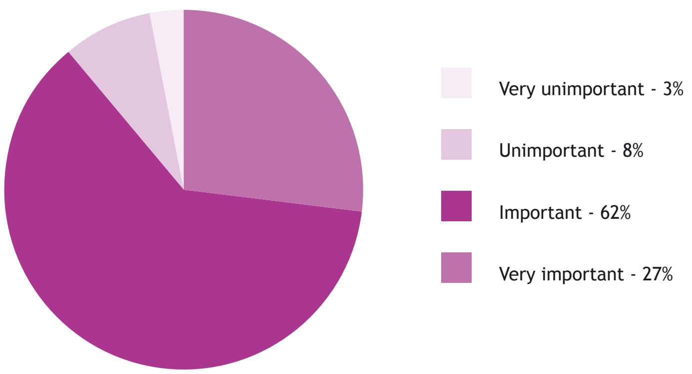
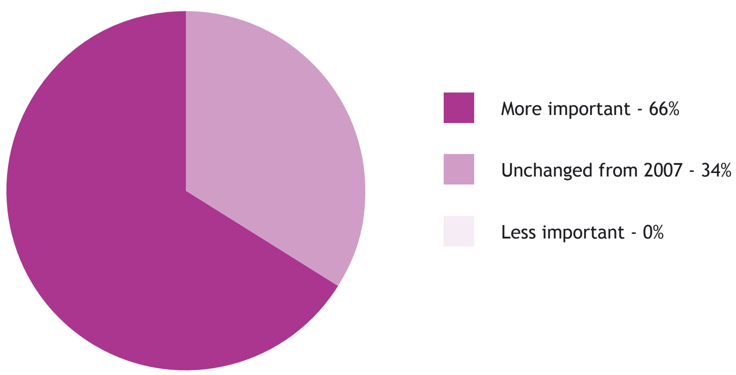


Figure 2

Section A Q2. With regard to question 1, and compared to 2007, has climate change become:



66% of respondents also stated that climate change had become more important since 2007 (figure 2), indicating substantially increased awareness – no responding fund managers said that climate change had become less important.

Barriers to the incorporation of climate change into investment analysis and decision making

Although there is a strong consensus that climate change is an important investment issue, fund managers identified a number of factors that prevent them from incorporating climate change into investment analysis and decision making in practice.

The most commonly cited barrier was the current low carbon price and the difficulty in determining the material financial impact of climate change on companies: 83% of respondents cited this as a factor, with 53% rating it as their most important factor (figure 3).

Comments made by fund managers in response to this question indicate that the current low carbon price is an issue owing to pressure on fund managers to generate short-term returns preventing them from putting time and effort into anticipating the longer-term impacts and costs of climate change.

For example, one fund manager commented that "the most significant barrier is the imbalance between the relatively short term horizons of mainstream investment analysis and the relatively long term nature of the material business impacts of climate change"[7].

Lack of demand from clients also appears to be a very significant factor in holding fund managers back from properly managing the investment risks and opportunities associated with climate change. This issue was rated as the second "most

7. Henderson Global Investors

significant barrier", and was cited by 56% of respondents. Fund managers commented that "while climate change is of great interest to a small proportion of our clients, for the majority, it is perceived as secondary to the objectives of maximising economic returns"[8]. Although one fund manager thought that "we are now seeing this trend reverse"[9], our findings suggest that most fund managers' clients are not effectively asserting their requirements for investment strategies that will deliver results beyond those "short term horizons".

A lack of regulatory requirements on investee companies was cited as a barrier by 64% of respondents. Uncertainty regarding regulation was raised by a number of respondents as a disincentive to the full integration of climate change into investment analysis and decision making: one fund manager stated that "the weakness of the regulatory framework – and especially the absence of confidence of what will happen post 2012 – is the over-riding obstacle"[10]. Other fund managers expressed doubts about the existence of the necessary political will to deal with climate change.

One sector that most fund managers surveyed do think is adequately regulated is their own: a minority of respondents rated "lack of regulatory requirements for investors" as a barrier to action for their industry.

Investor demand for climate change regulation of investee companies

As figure 4 shows, an overwhelming majority (86%) of respondents would welcome regulatory requirements on investee companies to report greenhouse gas emissions.

Perhaps surprisingly, it appears that the preferred form of regulation goes beyond mere reporting requirements with 72% of respondents believing that, in addition to mandatory reporting, regulation should be implemented to require investee companies to reduce their greenhouse gas emissions (figure 5). These results suggest a clear platform of support within the investment community for increased regulation with respect to both the reporting and reduction of greenhouse gas emissions.

8. JP Morgan Asset Management
9. Impax Group plc
10. AXA Investment Management

"the most significant barrier is the imbalance between the relatively short term horizons of mainstream investment analysis and the relatively long term nature of the material business impacts of climate change"[7]

Figure 3

Section A Q3. As a fund manager, which of these factors do you see as a barrier to incorporation of climate change risks/opportunities into investment analysis and decision making?

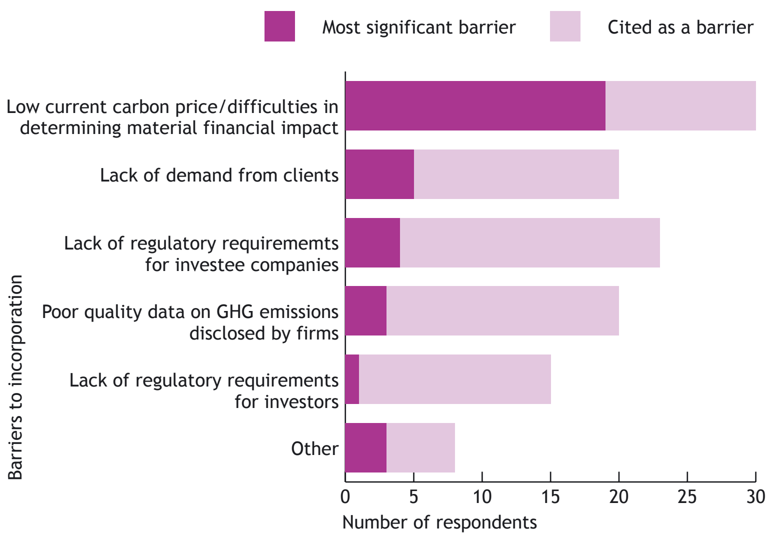
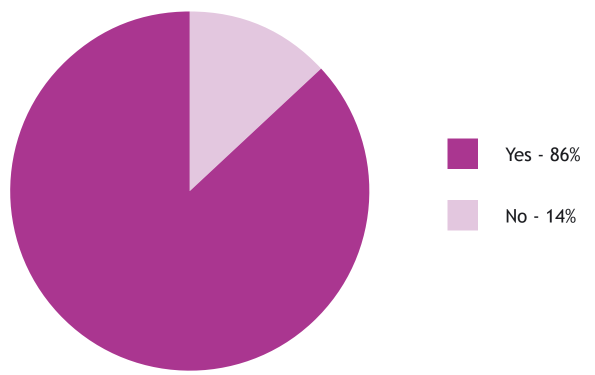


Figure 4

Section A Q4. As a business, would you welcome regulatory requirements on investee companies to report GHG emissions?



An overwhelming majority of respondents would welcome regulatory requirements on investee companies to report greenhouse gas emissions.

Figure 5

Section A Q5. As a business, would you welcome regulatory requirements on investee companies to reduce GHG emissions?

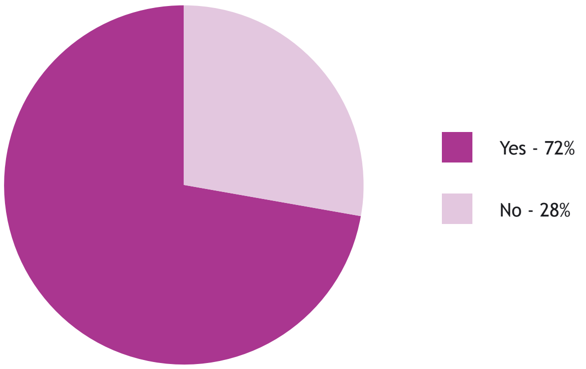


Figure 6

Section A Q6. Do you (directly or through any collaborative initiatives) engage with government regarding regulation for companies and investors concerning GHG emission measurement, reporting and reduction responsibilities?

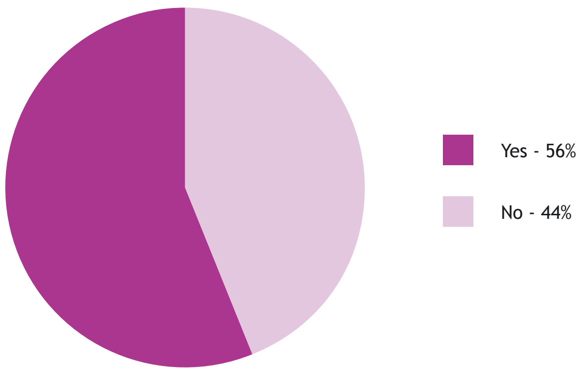
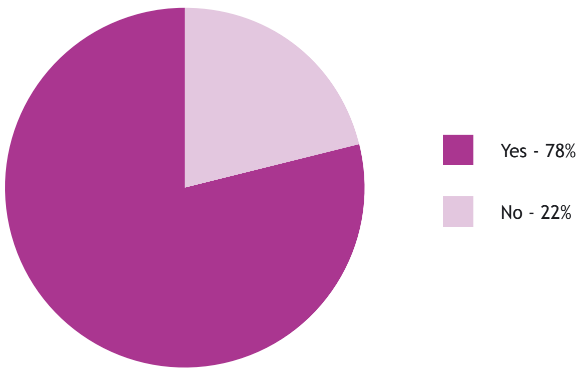


Figure 7

Section A Q7. As a business, would you welcome stock exchange listing rules which require companies to disclose on a comparable basis climate change related risks?



Fund managers' engagement with government on emissions

As figure 6 shows, over half of respondents – 56% – asserted that they have some level of engagement with government, either directly or through collaborative initiatives, regarding regulations on greenhouse gas emission measurement, reporting and reduction.

Amongst collaborative initiatives mentioned, 9 fund managers cited membership of the Institutional Investors Group on Climate Change (IIGCC), 5 cited the Carbon Disclosure Project (CDP) and 3 cited the United Nations Principles of Responsible Investment (UNPRI).

Other initiatives mentioned included the Investor Network on Climate Risk (INCR), the Poznan Letter, the Association of British Insurers (ABI), UK Sustainable Investment and Finance (UKSIF), the Carbon Reporting Working Group of the CBI, the Department for Environment Food and Rural Affairs (DEFRA), Climate Wise, the Prince of Wales communiqué on Bali and the Carbon Reduction Commitment (CRC).

Strong support for stock exchange listing rules on climate risks

78% of respondents favour the introduction of stock exchange listing rules requiring companies to disclose, on a comparable basis, climate-related risks (figure 7). One fund manager noted that "this will improve transparency which enables analysts and investors to compare companies and define the opportunities and risks in their decision making process"[11].

Some fund managers expressed concern about the potentially anti-competitive impact of introducing mandatory listing rules in some stock exchanges but not others, and the need for consistent standards and simultaneity with other markets. One fund manager commented on a need "for consistent disclosure across all major stock markets"[12]. However, it was also noted that in the context of the recent financial crisis greater disclosure and transparency were essential to improving risk management: another fund manager told us that "we are aware that exchanges may be wary of introducing new requirements because of the fear of losing listing business to rivals. However, the credit crunch has been a timely reminder that poor disclosure can lead to bad risk management, which ultimately can undermine markets"[13].

11. AXA Investment Managers
12. Martin Currie Investment Management Ltd.
13. F & C Asset Management plc

Section B - Use of climate change data

Findings in this section reveal significant differences in the extent to which fund managers are taking action to anticipate the risks and opportunities associated with climate change,
as well as different approaches being followed.

Different approaches - do fund managers tackle climate change in all sectors?

Fund managers appear to fall into two main camps: those who state that they take steps to anticipate the effects of climate change in all sectors of the economy and those whose efforts are restricted to certain sectors.

Over half – 56% – of respondents request climate change related data from "a majority" or "all" sectors they invest in (figure 8). However, a big constituency are highly selective, requesting data only from companies they see as being particularly exposed to climate change risks. A minority (8%) of respondents never ask companies for climate change data (although it is possible that this figure would be higher among those fund managers who did not participate).

It should be noted, however, that a number of fund managers who said they asked for information from "all sectors" added "where relevant". The full responses (available at fairpensions.org.uk) may be helpful in allowing readers to assess this issue for specific respondents.

As figure 9 shows, a similar proportion (60%) to those who request climate change data from a "majority" or "all" sectors are making use of such data in their investment decision making for a "majority" or "all" sectors. This still leaves large numbers of fund managers who are not making use of climate change data nor factoring climate change related risks and opportunities into analysis and investment decisions for the majority of companies in which they invest.

When the focus is switched from proportion of sectors to proportion of companies, there remain significant variations between fund managers: most (57%) respondents only make use of climate change data for "a minority" of companies, but a significant minority (29%) of respondents use climate change data in their analysis of all companies in which they invest (figure 10).

Figure 8

Section B Q1. Does your firm request climate change related information (including data on emissions) from investee companies?

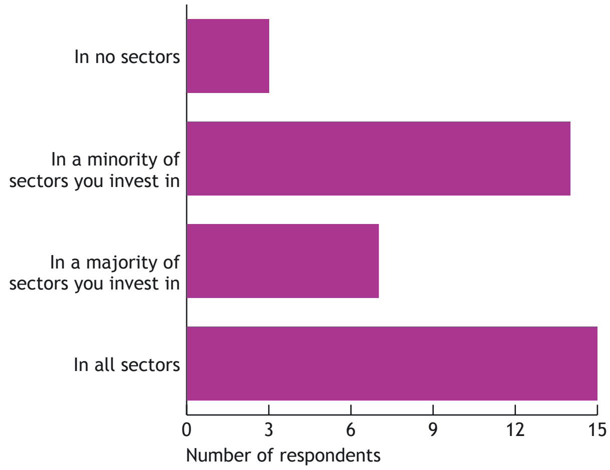
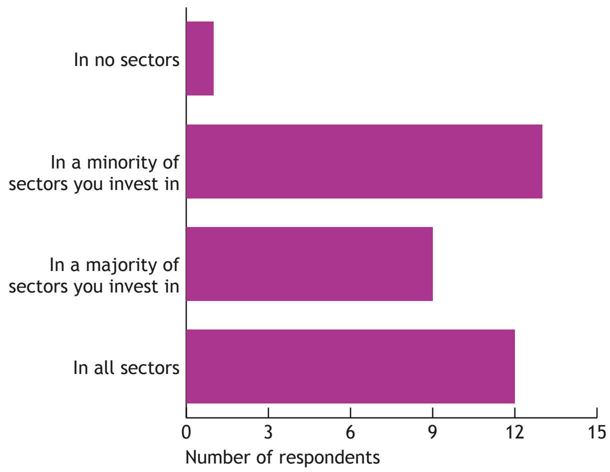


Figure 9

Section B Q2. As a business, do you factor climate change related risks and opportunities into analysis and investment decisions?



"as regulation tightens and the physical impacts of climate change become more apparent, all sectors of the economy will be affected"

A number of fund managers told us that "as regulation tightens and the physical impacts of climate change become more apparent, all sectors of the economy will be affected"[14] and that "the global context for business is changing – there is now wide acceptance that dealing with, for example, climate change is about economic self-interest at every level. We are convinced that the transition from a high-carbon to low-carbon economy will be one of the primary drivers of industrial and economic development for the coming decades"[15].

On the other hand, a significant proportion of the fund managers who commented upon these questions stated that they focused mainly or exclusively on high intensity sectors such as utilities, transport and energy, and a number of fund managers said that climate change was only relevant to certain sectors: "carbon emissions are material and relevant for some sectors (e.g. energy, materials, transportation and utilities) but not for others (e.g. financials or pharmaceuticals). The key issue is materiality"[16]. This point was echoed by another fund manager stating that "climate change is not yet a material consideration for all the companies producing data on their emissions. Where we believe that the impact may be material, then we will reflect this in our investment decisions and our voting activity"[17].

Figure 10

Section B Q3. Are you currently making use of climate change related data provided by companies (including data on emissions) in investment decision making?

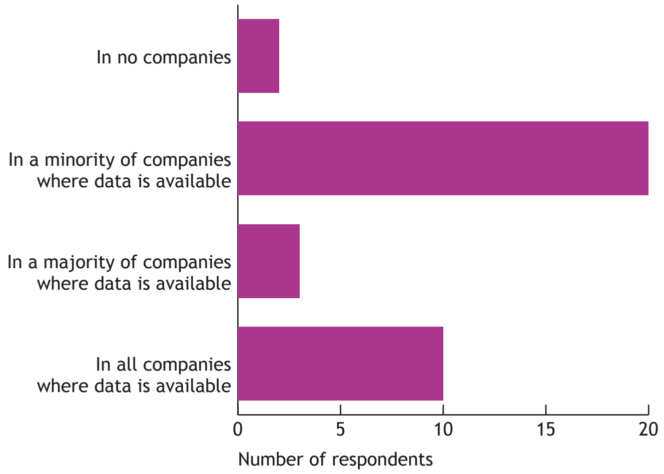
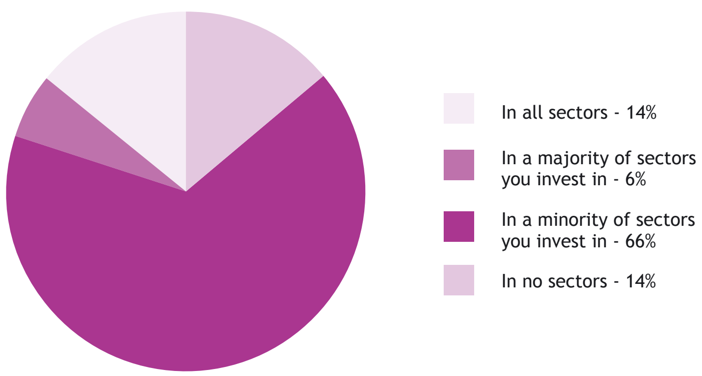


Figure 11

Section B Q4.In the last 2 years, have climate change related factors affected investment allocations at your firm (n.b. excluding specialist SRI / Environmentally focused funds)?



Impact of climate change data on specific investment allocations

When asked whether climate change data had actually affected investment allocations (outside "socially responsible" funds) 66% of respondents stated that in the last 2 years climate change considerations had affected investment allocations in a minority of sectors, versus 14% who said that climate change had not affected allocations in any sectors at all (figure 11).

The fact that most responding fund managers have altered investment allocations in at least some companies owing to climate change indicates that investors are starting to favour companies taking steps to anticipate climate change – something that investee companies should be aware of.

14. F&C Asset Management plc
15. Jupiter Asset Management
16. AllianceBernstein LP
17. AVIVA Investors

Section C – Engagement with investee companies on climate change issues

Degree of engagement

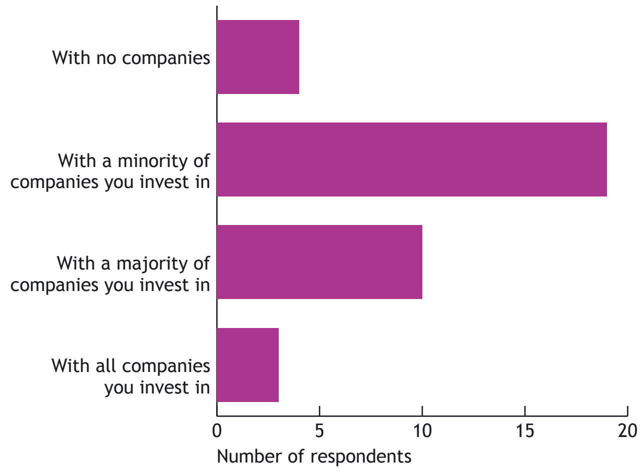
Our survey findings show that the degree of investor engagement with companies on climate change risks and opportunities varies greatly between fund managers, as does the range of objectives for any engagement that does occur.

Although the majority (89%) of responding fund managers undertake at least some engagement with investee companies, there is still a significant minority (11%) who do not engage with any companies at all about the risks and opportunities of climate change (figure 12).

Among those that do engage on this issue, some fund managers prioritise it more than others, with 28% engaging with a majority of their investees and 8% engaging with all investees.

Figure 12

Section C Q1. As a business, do you engage (via written or face-to-face communication) with investee companies to ensure that they address climate change related risks and opportunities effectively?



Focus of engagement

When asked to comment on the purpose of engagement, almost all fund managers highlighted its benefits, with comments including "We believe that engagement with companies we invest in is an important part of our fiduciary duties and responsible ownership, and climate change remains a key focus of our discussions. Not only is it good for the planet, but is good for the long term sustainability of investment performance"[18].

However, the term "engagement" appears to be understood in two quite different ways: some of our respondents' comments on engagement referred exclusively to a process of proactive questioning of investees (which may have some indirect influence on company behaviour if it leads to investment or divestment), while others clearly referred to direct requests for change.

Among our respondents, engagement is widely valued as a fact-finding tool, in order to make a better assessment of a company's risks and long-term value: as one fund manager told us "engagement on climate change helps to better understand how to estimate a company's future earnings"[19]. In particular, fund managers commented upon the importance of engagement as a means of assessing whether an investee company is addressing the implications of current or future regulation. A number of fund managers highlighted this theme, with one stating that the purpose of engagement is "to ensure the company has considered the issues, is managing the associated risks and taking advantage of the opportunities, and is well positioned to respond to future regulatory changes"[20].

18. Jupiter Investment Management Limited.
19. RCM (Allianz Global Investors)
20. Baillie Gifford & Co.

Figure 13
Named board member/senior executive responsible for addressing climate change risks/opportunities

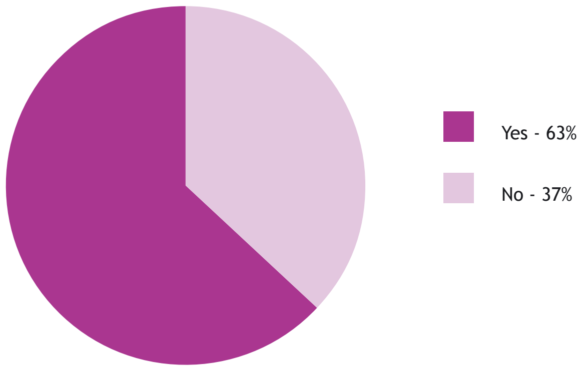


Figure 14
Company measures its GHG emissions and discloses to shareholders

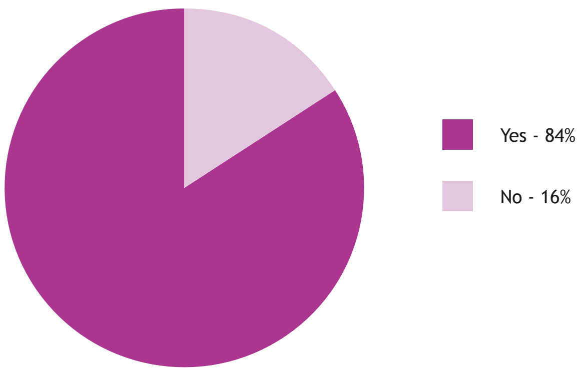
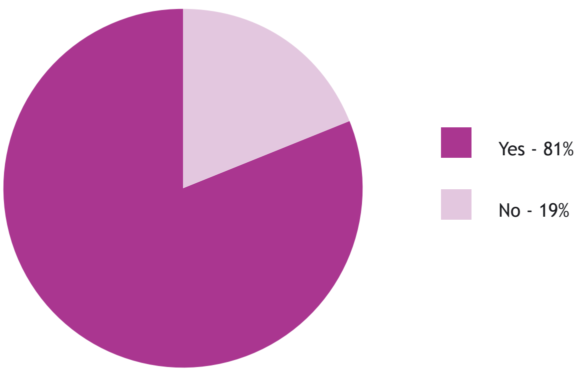


Figure 15
Company has an action plan with targets to reduce GHG emissions over a specified timetable



Some fund managers who commented on their engagement with companies stated that they did this purely as a matter of information gathering, while most fund managers did not make clear whether their engagement efforts sought to change or merely to understand investee behaviour.

There is at least a minority of fund managers who indicated that they are using their position as shareholders to promote improvement in the companies they invest in. This is in line with the IIGCC Investor Statement which invites investors to "engage with the companies in which we invest to ensure that they are minimising the risks and maximising the opportunities presented by climate change and climate policy. We will also encourage these companies to improve their governance and disclosure of climate risks and opportunities"[21]. A question which was not addressed in this research (but which fund managers' clients may wish to pursue) is to what extent engagement has been successful in producing change.

"We believe that engagement with companies we invest in is an important part of our fiduciary duties and responsible ownership"

21. IIGCC: "Investor statement on climate change" 2006

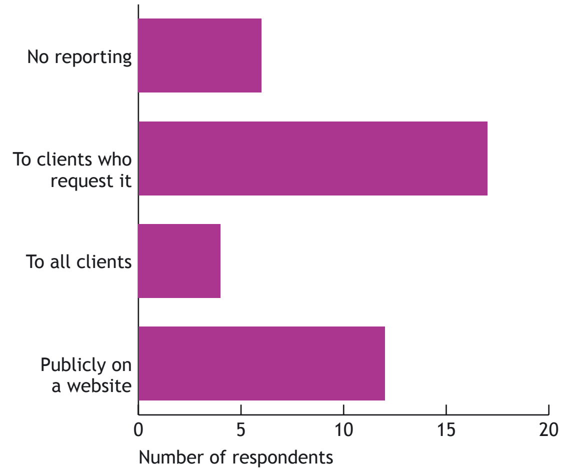
Section D – Reporting on climate change issues

31% of respondents report publicly on climate change-related issues (figure 16). Almost half – 44% – of responding fund managers stated that they report on action taken on climate change only to "clients who request it". This finding is disappointing and strongly reinforces that it is important for clients to scrutinise the actions being taken on their behalf and to demand reporting on this key area, especially as clients cannot be confident of consistent performance in tackling climate change related risks and opportunities across the fund management sector, as we have seen earlier in this report.

Our findings show that 15% do not report at all on action taken to reduce portfolio risks and enhance opportunities arising from climate change, including to clients.

Figure 16

Section D Q1. As a business, do you report on action taken (including engagement with companies) to reduce portfolio risks and enhance opportunities arising from climate change?



Conclusions and recommendations

This report has identified some important issues, including that short-term financial issues and lack of client demand may be suppressing fund managers' action to manage the impact of climate change; that there is investor appetite for mandatory reporting and reduction of greenhouse gas emissions and that there are significant differences in the strength and type of action undertaken by different fund managers on climate change.

This report is intended as a tool to facilitate the management of the risks and opportunities of climate change by fund managers, their clients, investees and those who regulate and advise them. We have therefore summarised here the most important conclusions of this research for those audiences.

Fund managers' clients

Climate change will increasingly impact upon investment returns, in the short term and more obviously in the longer-term. This is an issue that cannot wait until the effects become material: as Nicholas Stern and others have shown, delay could be very costly, so investors need to work with investees now to future-proof profits / returns before it is too late to do so while remaining competitive. This is also an issue which cannot be anticipated just by buying or selling assets (because although some sectors will be more affected than others, all sectors will be impacted) and which therefore requires engagement with companies not only to encourage future-proofing but also to identify problems quickly. Fund managers' clients should be aware of which fund managers are best placed to manage the risks and opportunities presented by climate change.

A primary purpose of this research is to allow fund managers' clients to assess and compare the performance of companies which currently or potentially manage assets on their behalf. To this end the full submissions of participating fund managers are available online, at fairpensions.org.uk.

One of the key messages arising from our research is that fund managers need clear signals from asset owners: lack of client demand is identified in this report as one of the key barriers to fund managers taking action on climate change. In the absence of any immediate pricing imperative to take climate change into account, clients should send clear instructions that the longer-term risks and opportunities associated with climate change should be given appropriate weight.

Given that almost half of fund managers surveyed report on management of climate change risks and opportunities to clients only upon request, it is important that clients do request regular reports on this area, especially as – as we have seen – performance is not uniformly good.

Asset owners should also encourage their advisors and those who research fund managers on their behalf to assess and report on fund managers' ability to manage the risks and opportunities associated with "extra-financial" issues such as climate change.

Policymakers and regulators

The fund management industry has significant power to encourage or discourage corporate efforts to ready themselves for the effects of climate change. It is inappropriate to assume that the sector will police itself and suffer any consequences of failure: the consequences of failure to effectively identify and manage climate change risks will impact most heavily on others.

This research also suggests a need for smart regulation to ensure public reporting on portfolios' exposure to climate change risks, and action taken to manage risks and opportunities (as forthcoming guidance from the government will encourage investee companies to do[22]).

Our data reveals a clear appetite from investors for clarity about the government's intended policy on climate change, and for a stronger regulatory framework (including mandatory reporting and reduction requirements for companies, and stock exchange listing rules requiring disclosure of climate change related risks). Politicians and policymakers should note this appetite for regulation, as those government departments presently considering corporate emissions reporting guidelines regard mandatory reporting as "not the preferred option"[23]).

The fact that fund managers regard the low carbon price as the most important barrier to managing climate change suggests that unless global climate negotiations produce higher carbon prices then investor pressure to reduce emissions will continue to be suppressed.

Those policymakers who are committed to the creation of an (environmentally and financially) sustainable economy may wish to make use of fund manager appetites for progressive change that are demonstrated by the findings of this research, particularly because those fund management companies which are international (in terms of their investments and clients) can be part of global efforts to promote a low-emissions regulatory framework while retaining a level playing field.

Fund managers

This report has identified some clear examples of good practice among fund managers in managing the risks and opportunities of climate change. This includes the use of climate change data from all sectors of the economy (while focusing first on the most relevant), engaging with investee companies to secure reporting and reduction of greenhouse gas emissions, and public reporting of action taken.

As the effects of climate change and measures taken to mitigate or adapt to it become increasingly apparent, fund managers can expect demand from clients for action and reporting on climate change to increase. Fund managers should therefore take steps to analyse and manage longer term trends (such as expected future carbon prices) in anticipation of clients becoming increasingly aware of and assertive about their longer-term interests. Asset owners who are already taking steps to engage with fund managers on this issue are among the "endorsing organisations" listed on page 2 of this report.

In addition to anticipating client demand, fund managers could also view climate change proactively, as a means of rebuilding client and public confidence in themselves and the financial services sector, as part of a positive response to current discourse about how the sector manages the risks presented by longer-term "extra-financial" issues.

More specifically, fund managers should analyse climate change as an issue with

22. http://www.defra.gov.uk/corporate/consult/greenhouse-gas/index.htm
23. DEFRA "Impact Assessment of guidance on measurement and reporting" 2009, page 5 (http://www.defra.gov.uk/corporate/consult/greenhouse-gas/impact-assessment.pdf)

effects which will not be limited to physical and regulatory impacts, but which will also involve political, social, technological and market changes; with consequences that will affect some sectors more than others but which will flow through supplier and client chains to impact the entire economy. It will therefore become increasingly necessary to analyse relevant information from all sectors and make use of it in engaging with investees.

Our findings suggest that most fund managers need to improve reporting. This has benefits for clients, the wider public (who, as the financial crisis illustrates, are significantly affected by the actions or inactions of the financial services sector) and the fund managers themselves – because disclosure encourages the discloser to examine their own performance and thereby prompts improvements.

Investee companies

It is in companies' own interest to work with their investors to ensure that company profits (and therefore investment returns) will continue to be healthy when subjected to the risks and opportunities of climate change.

Some fund managers are already using climate change criteria in stock selection decisions. This trend can reasonably be expected to increase, and suggests that companies should view their policies and actions in anticipation of the financial impacts of climate change as a key factor in attracting or deterring investors.

Appendices

Copy of questionnaire as sent to participants

FairPensions' Climate Change Questionnaire 2009:

Name of Firm: ....

Assets Under Management:...

Position of person completing questionnaire: ....

Contact details: ....

Section A: Assessment of climate change as an investment issue:

1. In your business, how important is climate change as a factor in investment research, decision making and engagement activities with companies?

- a) Very unimportant ☐
- b) Unimportant ☐
- c) Important ☐
- d) Very important ☐

2. With regard to question 1, and compared to 2007, has climate change become:

- a) Less important ☐
- b) Unchanged from 2007 ☐
- c) More important ☐

3. As a fund manager, which of these factors do you see as a barrier to incorporation of climate change risks/ opportunities into investment analysis and decision making?
(please mark any that apply in priority order with 1 as the most significant barrier)

- a) lack of demand from clients ☐
- b) low current carbon price/difficulties in determining material financial impact ☐
- c) lack of regulatory requirements for investee companies ☐
- d) poor quality data on GHG emissions disclosed by firms ☐
- e) lack of regulatory requirements for investors ☐
- f) other – please specify

Please comment on barriers to integrating climate change into investment analysis and decision making:

4. As a business, would you welcome regulatory requirements on investee companies to report GHG emissions?

- a)Yes ☐
- b)No ☐

5. As a business, would you welcome regulatory requirements on investee companies to reduce GHG emissions?

- a)Yes ☐
- b)No ☐

6. Do you (directly or through any collaborative initiatives) engage with government regarding regulation for companies and investors concerning GHG emission measurement, reporting and reduction responsibilities?

a)Yes ☐

Please specify if via membership of any collaborative initiatives:

b)No ☐

Please comment on your firm's stance on the regulatory framework for companies:

7. As a business, would you welcome stock exchange listing rules which require companies to disclose on a comparable basis climate change related risks?

a)Yes ☐
b)No ☐

Please comment on the relevance of listing requirements to achieving useful disclosure?

Section B: Use of climate change data

1. Does your firm request climate change related information (including data on emissions) from investee companies?

a) In no sectors ☐
b) In a minority of sectors you invest in ☐
c) In a majority of sectors you invest in ☐
d) In all sectors ☐

Please comment on which sectors and why:

2. As a business, do you factor climate change related risks and opportunities into analysis and investment decisions?

a) In no sectors ☐
b) In a minority of sectors you invest in ☐
c) In a majority of sectors you invest in ☐
d) In all sectors ☐

Please comment on which sectors and why:

3. Are you currently making use of climate change related data provided by companies (including data on emissions) in investment decision making?

a) In no companies ☐
b) In a minority of companies where data is available ☐
c) In a majority of companies where data is available ☐
d) In all companies where data is available ☐

Please comment on your use of climate change information from investee companies:

4.In the last 2 years, have climate change related factors affected investment allocations at your firm (n.b. excluding specialist SRI / Environmentally focused funds)?

a) In no sectors ☐
b) In a minority of sectors you invest in ☐
c) In a majority of sectors you invest in ☐
d) In all sectors ☐

Please comment on why climate change does or does not affect investment allocations:

Section C: Engagement on climate change issues

1. As a business, do you engage (via written or face-to-face communication) with investee companies to ensure that they address climate change related risks and opportunities effectively?

a) with no companies ☐
b) with a minority of companies you invest in ☐
c) with a majority of companies you invest in ☐
d) with all companies you invest in ☐

Please comment on why you engage or do not engage with companies to address climate change related risks/ opportunities, and if relevant how you undertake engagement:

2. Where engagement occurs, which of the following do you seek to have in place at investee companies?
i) Named board member / senior executive responsible for addressing climate change risks/opportunities

a) Yes ☐
b) No ☐

ii) Company measures its GHG emissions and discloses to shareholders

a) Yes ☐
b) No ☐

iii) Company has an action plan with targets to reduce GHG emissions over a specified timetable

a) Yes ☐
b) No ☐

iv) Other – Please specify

Please comment on the purpose of climate change related engagement with companies:

Section D: Reporting

1. As a business, do you report on action taken (including engagement with companies) to reduce portfolio risks and enhance opportunities arising from climate change?

a) no reporting ☐
b) to clients who request it ☐
c) to all clients ☐
d) publicly on a website ☐

Please comment on your policy for reporting action to reduce climate change risk and enhance opportunity:

Statistical results

The full responses as given by each participating fund management company are available online at **fairpensions.org.uk**

Section A: Assessment of climate change as an investment issue:

1. In your business, how important is climate change as a factor in investment research, decision making and engagement activities with companies?

Very unimportant	1
Unimportant	3
Important	23
Very important	10
Total	37

2. With regard to question 1, and compared to 2007, has climate change become:

Less important	0
Unchanged from 2007	13
More important	25
Total	38

3. As a fund manager, which of these factors do you see as a barrier to incorporation of climate change risks/ opportunities into investment analysis and decision making?
(please mark any that apply in priority order with 1 as the most significant barrier)

Priority Ranking:	1	2	3	4	5	6	Total who view this factor as a barrier
Lack of demand from clients	5	7	5	0	2	1	**20**
Low current carbon price/difficulties in determining material financial impact	19	5	4	1	1	0	**30**
Lack of regulatory requirements for investee companies	4	13	2	3	1	0	**23**
Poor quality data on GHG emissions disclosed by firms	3	3	6	5	3	0	**20**
Lack of regulatory requirements for investors	1	0	1	8	5	0	**15**
Other	3	3	0	0	2	1	**9**

Total number of respondents to question 36

4. As a business, would you welcome regulatory requirements on investee companies to report GHG emissions?

Yes	31
No	5
Total	36

5. As a business, would you welcome regulatory requirements on investee companies to reduce GHG emissions?

Yes	23
No	9
Total	32

6. Do you (directly or through any collaborative initiatives) engage with government regarding regulation for companies and investors concerning GHG emission measurement, reporting and reduction responsibilities?

Yes	22
No	17
Total	39

7. As a business, would you welcome stock exchange listing rules which require companies to disclose on a comparable basis climate change related risks?

Yes	25
No	7
Total	32

Section B: Use of climate change data

1. Does your firm request climate change related information (including data on emissions) from investee companies?

In no sectors	3
In a minority of sectors you invest in	14
In a majority of sectors you invest in	7
In all sectors	15
Total	39

2. As a business, do you factor climate change related risks and opportunities into analysis and investment decisions?

In no sectors	1
In a minority of sectors you invest in	13
In a majority of sectors you invest in	9
In all sectors	12
Total	35

3. Are you currently making use of climate change related data provided by companies (including data on emissions) in investment decision making?

In no companies	2
In a minority of companies where data is available	20
In a majority of companies where data is available	3
In all companies where data is available	10
Total	35

4.In the last 2 years, have climate change related factors affected investment allocations at your firm (n.b. excluding specialist SRI / Environmentally focused funds)?

In no sectors	5
In a minority of sectors you invest in	23
In a majority of sectors you invest in	2
In all sectors	5
Total	35

Section C: Engagement on climate change issues

1. As a business, do you engage (via written or face-to-face communication) with investee companies to ensure that they address climate change related risks and opportunities effectively?

With no companies	4
With a minority of companies you invest in	19
With a majority of companies you invest in	10
With all companies you invest in	3
Total	36

2. Where engagement occurs, which of the following do you seek to have in place at investee companies?

	Yes	No	Total
Named board member/senior executive responsible for addressing climate change risks/opportunities	19	11	30
Company measures its GHG emissions and discloses to shareholders	26	5	31
Company has an action plan with targets to reduce GHG emissions over a specified timetable	25	6	31

Section D: Reporting

1. As a business, do you report on action taken (including engagement with companies) to reduce portfolio risks and enhance opportunities arising from climate change?

No reporting	6
To clients who request it	17
To all clients	4
Publically on a website	12
Total	39

Methodology

The survey was sent to 100 fund management companies. The majority of these were selected on the basis of membership of the Investment Management Association but we also specifically aimed to include a number of other fund managers with substantial UK pension fund business.

In mid-May 2009 FairPensions sent the survey to identified contacts at these 100 fund managers via email and post. An online survey was also set up, a link to which was sent to all these contacts. Every reasonable effort was made to secure appropriate contacts. Where it was impossible to find an exact contact, the survey was sent to the central address and email. We asked fund managers to complete the survey within four weeks, to which we later added a two week extension. 39 fund managers submitted completed questionnaires.
All participants were given an opportunity to review their submissions, make any amendments, and were asked permission for full public disclosure of their submitted surveys. Three participants opted to keep their submissions private, although their results are included in the general statistics.

This climate change survey differed from previous fund manager surveys conducted by FairPensions, in that instead of scoring or ranking participants, this exercise was designed to gather information about the attitudes towards, and action on, climate change within the investment community.

The submitted questionnaires serve as a self-analysis by our participating fund managers. In conducting our analysis we did not query fund managers' interpretation of our questions.
The main body of the report (analysis of data pages 21 to 22) presents statistics based upon the responses from all participating fund managers. However whilst we did not wish to rank the participants, we were keen to present a comparable set of information for pension funds, enabling them and other asset owners to compare. The completed surveys can be viewed in full online at fairpensions.org.uk where responses from individual fund managers are available.

It is worth noting that the 39 fund managers who responded to our survey are self-selected and therefore likely to reflect the more engaged section of the investment community.

Full list of fund management companies invited to participate

Aberdeen Asset Managers Ltd.*
AEGON Asset Management UK*
Alliance Trust Asset Management
AllianceBernstein LP*
Artemis Investment Management Ltd.
Atlantis Investment Management Ltd.
Aviva Investors*
AXA Investment Managers*
Baillie Gifford & Co.*
Barclays Global Investors Ltd.*
Baring Asset Management Ltd.
Belgrave Capital Management
BlackRock*
BNP Paribas Investment Partners
BNY Mellon Asset Management International Ltd.
Brewin Dolphin Securities Asset Management
Canada Life Asset Management Ltd.
Capita Financial Group
Capital International Ltd.
Cazenove Capital Management Ltd.
CCLA Investment Management Ltd.*
City of London Investment Management Co. Ltd.
Clerical Medical Investment Group Ltd.
Close Investments Ltd.
The Co-operative Asset Management*
Credit Agricole Asset Management*
Credit Suisse Asset Management*
Daiwa SB Investments (UK) Ltd.
Doughty Hanson & Co.*
Ecclesiastical Investment Management*
Edinburgh Partners
F & C Asset Management plc*
Fidelity International
First State Investments
Fortis Investment Management (UK) Ltd.
Franklin Templeton Investments
Friends Provident plc*
GAM
Gartmore Investment Management Ltd.*
Generation Investment Management LLP
Genesis Investment Management LLP
GLG Partners LP
GMO UK Ltd.
Goldman Sachs Asset Management*
Henderson Global Investors*
Hermes Equity Ownership Services Ltd.*
HSBC Global Asset Management (UK) Ltd.
Ignis Asset Management (Resolution Asset Management)
Impax Group plc*
Insight Investment*
Invesco Perpetual
Investec Asset Management
Janus Capital International Ltd.
J. O. Hambro Investment Management
JP Morgan Asset Management*
Jupiter Asset Management*
Lazard Asset Management Ltd.
Legal & General Investment Management Ltd.*
Legg Mason Investments
Lincoln Financial Group
Liontrust Asset Management plc
Liverpool Victoria Asset Management
Majedie Asset Management Ltd.
Marathon Asset Management LLP
Marks & Spencer Unit Trust Management Ltd.
Martin Currie Investment Management Ltd.*
MFS International (UK) Ltd.*
M & G Investments
Morgan Stanley Investment Management Ltd.*
Neptune Investment Management Ltd.
Newton Investment Management Ltd.*
NFU Mutual
Nikko Asset Management Europe Ltd.
Nomura Asset Management UK Ltd.
Northern Trust Global Investments
Old Mutual Asset Managers (UK) Ltd.
Payden & Rygel Global Ltd.
PI Investment Management Ltd.
Pictet Asset Management Ltd.
Principal Global Investors (Europe) Ltd.
Putnam Investments Ltd.
Rathbone Unit Trust Management Ltd.
Royal Liver Asset Managers
RCM (Allianz Global Investors)*
Royal London Asset Management Ltd. (RLAM)*
Sarasin & Partners LLP*
Schroder Investment Management Ltd.*
Scottish Widows Investment Partnership Ltd.
SG Asset Management UK Ltd.
Skandia Investment Management Ltd.
Standard Life Investments Ltd.*
State Street Global Advisors*
T Bailey Asset Management Ltd.*
Tilney Investments Management
T Rowe Price Global Investment Services Ltd.*
Threadneedle Asset Management Ltd.*
UBS Global Asset Management Ltd.*
Wachovia Global Asset Management
Wellington Management International Ltd.
Wesleyan Unit Trust Managers Ltd.

*Asterisks denote fund management companies that participated in this research

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