THE GLOBAL PEREGRINE

Opinion

A Climate of Change:

The Financial World is Waking up to the Economic Consequences of Climate Change

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Climate change is the greatest challenge that humanity has faced in the many thousands of years that have elapsed since the agricultural and urban revolution. It may have been edged out of the public consciousness by the Covid-19 pandemic; yet it presents an existential threat which no vaccine will solve. Many scientists have warned that if climate change caused by the release of greenhouse gases is left unchecked humanity faces an unprecedented cataclysm due to spiralling global temperatures. Writers like Mark Lynas, in his work entitled *Six Degrees,* have indeed pointed out that if mean global temperatures rise above 4°C or 5°C humanity will face an extinction level event.

Few people can be unaware of the increase in severe weather events around the world in recent years. As David Wallace-Wells put it in what has been described as his "epoch-defining" 2019 book, *The Uninhabitable Earth*:

"It is worse, much worse, than you think. The slowness of climate change is a fairy tale, perhaps as pernicious as the one that says it isn't happening at all, and comes to us bundled with several others in an anthology of comforting delusions: that global warming is an Arctic saga, unfolding remotely; that it is strictly a matter of sea level and coastlines, not an enveloping crisis sparing no place and leaving no life undeformed; that it is a crisis of the "natural" world, not the human one; that those two are distinct, and that we live today somehow outside or beyond or at the very least defended against nature."[1]

This is not an article about the science of global warming since that is for climate scientists; it is about the way corporate and financial markets are responding to the threat of climate change.

Despite the clear urgency of this crisis, it might appear that for the world of capitalism and international financial markets it is business as usual for the moment. The underlying principle of capitalism relying, as it does, on ever increasing growth, fuelled by consumption, may seem irreconcilable with environmental protection. We need not agree with Yannis Varoufakis, the former Greek Finance Minister, that "Climate change is capitalism's Waterloo"[1] yet, those who support capitalism as a means of improving the lot of the poorest people and poorest countries need to address the issue of climate change. The global financial markets are by no means oblivious to the threat of climate change.

While, many signatories of the Paris Climate Accord are unlikely to meet their targets, some unlikely champions have appeared on the field, in the form of the world's securities market regulators and significant numbers of global investment institutions and it is on this development that this article is focused.

One of the principles which must be observed when a corporation wants people to subscribe to its securities is to alert them to the risks of their their investment. These risks must also be updated and reported on annually. However, historically, climate change has received relatively little attention in the risk disclosures of publicly traded companies, unless a major asset faced a specific issue (such as a mine affected by increasingly severe seasonal flooding).

Investors were finding that companies were not releasing enough forward-looking information about the possible effects of climate change of their businesses. For example, how might the increased instance of localised flooding impact the value of a developer's land bank? Did the threat of more frequent forest fires make the location of some corporate facilities untenable?

In response to this investor pressure, the UK's Financial Stability Board established a task force (the "Task Force on Climate Related Financial Disclosure" or "TCFD")[3] to devise a common approach to the disclosure of climate change related risks in companies' financial reports to allow market participants and policymakers to understand and better manage those risks. This initiative had the support of the G20 Finance Ministers and Central Bank Governors.

In 2017, the TCFD issued its *Final Report* setting out the issues companies should think about and the information they should disclose about the actual and prospective impact of climate change on their businesses and what they were doing about it. Nothing much happened in response to this Final Report. Compliance was voluntary and take-up of the recommendations by the corporate world was patchy.

In 2019 the EU published climate reporting guidelines based on the TCFD recommendations but, like the original recommendations, compliance was voluntary. (In the same year co-incidentally, the Norwegian Sovereign Wealth Fund announced that it would drop fossil fuel companies from its portfolio). 2019 also saw the publication by Australia's securities regulator of new TCFD based guidance and a reminder that climate related risks may be material risks which companies have a legal obligation to disclose. Then in September 2020, New Zealand made climate change reporting compulsory for large financial institutions.

In December 2020, the UK's securities regulatory introduced tough new reporting standards for UK listed companies, with effect from January 2021. These introduce specific obligations for UK company boards to consider and disclose how climate change may impact their businesses and the steps they are taking to address it. UK listed companies will also be required to engage in scenario planning, to anticipate the impact of different potential climate change outcomes (such as a global increase in temperature of 2 degrees centigrade) or some larger increase. It is also consulting on extending the rules to non-listed companies and other large entities.[4]

On 24 February 2021 the Securities & Exchange Commission (SEC) announced that it would be placing an enhanced focus on climate related risk reporting by US reporting companies. The European Central Bank has, in the meantime, identified climate change as a “major source of systemic risk” to the global financial system[5].

Equally investor pressure is growing on the international bond markets to heed the threat of climate change and one response to this has been the growth of the “Green bond” market and the “Blue bond market” which is drawing international investors to investments for ecologically desirable projects.

In short, investor groups and regulators around the world have woken up to the fact that climate change is not the sole domain of Polar bear hugging hippies. It has real, hard and imminent implications for the corporate sector, for which it has been an “inconvenient truth” for too long.

Forcing companies to examine the implications of climate change closely and to report on them publicly is designed to protect investors and market stability, not the planet. However, as investors vote with their feet, the burgeoning wave of mandatory reporting may just push the corporate world into thinking and acting in an environmentally responsible manner, even if they are driven there at least partially by the profit motive.

[1] Wallace-Wells, David. *The Uninhabitable Earth: Life After Warming*. Reprint edition, Tim Duggan Books, 2020.
[2] https://www.irishexaminer.com/opinion/commentanalysis/arid-30978758.html
[3] https://www.fsb-tcfd.org
[4] https://www.gov.uk/government/consultations/mandatory-climate-related-financial-disclosures-by-publicly-quoted-companies-large-private-companies-and-llps
[5]Shining a light on climate risks: the ECB’s economy-wide climate stress test https://www.ecb.europa.eu/press/blog/date/2021/html/ecb.blog210318~3bbc68ffc5.en.html