

CLIMATE CHANGE ANALYSIS IN THE INVESTMENT PROCESS

EXECUTIVE SUMMARY

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Our planet is warming, primarily in response to increased levels of carbon dioxide (CO₂) and other greenhouse gases in our atmosphere, which change the climate in numerous ways. The physical and economic impacts of these changes are becoming clearer year by year. Global cost estimates reach into the tens of trillions of US dollars by the end of the century, with the potential to shave off 1/10th of US GDP by that time if no actions are taken to forestall climate change.

CFA Institute has decided to focus on this issue to better understand and lay out the financial industry's role in the efforts to mitigate climate change that have already begun and will only continue to grow. This report aims to help improve knowledge and understanding about how climate risk can be applied to financial analysis and portfolio management. It then informs practitioners how best to incorporate these analyses into their investment processes, based on case studies of firms that are currently integrating climate-related analysis into their investment models.

To inform our understanding about how climate change is included in or omitted from the investment process, CFA Institute surveyed its community on the topic. Currently, about 40% of all survey respondents incorporate climate change information into the investment process. A separate question to a select group of C-level executives found about 75% feel that climate change is an important issue. The gap between these percentages seems to come from a lack of data and disclosure on climate risks from issuers, which we hope that this report and other work in this area can ameliorate.

As the earth's atmosphere warms and the side effects of climate change become more prevalent, more pressure will be placed on everyone, including financial professionals, to take actions that address climate change. To do this important work, financial professionals need a few key tools.





A price on carbon

CFA Institute agrees that a price on carbon is an essential tool in combating climate change, supported by a transparent pricing mechanism that enables financial professionals to reliably incorporate carbon pricing into their analysis of investments' exposure to climate risk. CFA Institute believes that market-based mechanisms are the most effective way to develop and support carbon pricing. Accordingly, ***CFA Institute calls on policymakers to ensure that regulatory frameworks for carbon markets are designed to deliver transparency, liquidity, ease of access for global market participants, and similar standards across jurisdictions, in order to underpin robust and reliable carbon pricing.***



Carbon price expectations included in analyst reports

A realistic market price on carbon will send a price signal that analysts need in order to properly value the externalities that come with greenhouse gas emissions. ***CFA Institute recommends that investment professionals account for carbon prices and their expectations thereof in climate risk analysis.*** The externality of climate change has a cost, and that cost will be the future impact of climate change on our markets and society. Economists, investors, and policymakers who have studied the issue agree that a realistic price on carbon will allow markets to accurately price the impact of carbon on the world economy.



Increased transparency and disclosure on climate metrics

Investors should work with issuers to settle on the metrics that matter when assessing a company's climate change strategy. ***CFA Institute acknowledges that the investment industry is coalescing around the Sustainability Accounting Standards Board (SASB) and Task Force on Climate-related Financial Disclosures (TCFD) standards for climate-related disclosures, which are the most relevant and succinct climate-related disclosure standards for addressing the materiality of climate-related risks.***



Engagement with companies on physical and transition risks of climate change

Investors agree that climate change is an important issue, but lack of data and consistent disclosure around climate metrics are holding back climate-related analysis. ***We believe investors should engage with issuers to ensure that climate data, scenario analysis, and related disclosures are sufficiently thorough to support robust climate risk analysis in the investment process.***



Education within our profession

Investors need to continue to educate themselves about climate change in order to provide clients with the climate-related analysis they deserve.



Policy that complements our efforts

Investors need to continue to meet with policymakers in order to make sure that investors have the tools they need to do the work of finance—that is, the efficient allocation of capital that helps to tackle the existential threat of climate change.