Copenhagen: what should investors be demanding?

The outcome of the Copenhagen climate conference may have disappointed some business leaders and may not be the 'Global Deal' that many, including the UK's Carbon Trust, had been hoping for, but it is being touted as another small step forward in the long process towards reducing carbon emissions.

Although five countries, including the US and China, did reach an accord on carbon emissions and recognised the scientific case for keeping the rise in temperatures to two degrees centigrade, the Copenhagen talks failed to reach a legally-binding 'Global Deal' that would be a successor to the Kyoto Protocol which runs out in 2012. The Protocol set binding targets for 37 industrialised countries and the European community for reducing GHG emissions, amounting to an average of five per cent against 1990 levels over the five-year period 2008-2012.

For investors, a Global Deal could "fire the starting gun on the low-carbon race, showing that all countries are now properly pledged to move to a low-carbon economy," **Bruce Duguid**, head of investor engagement at UK's Carbon Trust, told INSEAD Knowledge ahead of the UN climate talks.

However, Duguid believes that investors will ultimately realise successful investments if they invest in activities that will do well. This requires an understanding of the environment they are operating in. "Most investors implicitly act as though the world is heading to a high carbon world of, say, 700 parts per million (ppm) carbon in the atmosphere and four to five degree centigrade temperature rises. Ideally we are aiming to reduce CO2 emissions to a maximum of 450 ppm and a two degree centigrade rise."

Risks and opportunities

With the economic downturn, there are risks associated with near-frozen capital markets, as well as certainty and opportunities linked to government stimulus packages focusing on energy efficiency, renewable energy, clean technologies, taxation and forest protection, says **Stephen Hine**, head of responsible investment development at Experts in Responsible Investment Solutions (EIRIS).

"The goal of achieving a low-carbon economy will favour low-carbon activities. At a time when global capital is in short supply, businesses which continue to pursue unmanaged high-carbon strategies will be risking their investments as well as the climate," he argues.

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Businesses will also need to work closely with governments to create effective and practical rules to push forward with low-carbon investments and guarantee sustainability.

"A number of improvements have been observed in the strategies that companies have put in place with regard to their climate change impact. A higher proportion of companies have policies and systems in place, while the number of companies that report on their performance has also increased," says Hine. "However, there are areas where further progress can be achieved, such as the involvement of the board in the company's climate change initiatives through linking remuneration to performance in this area."

The role of investors

Investors are in a key position in relation to climate change -- they have a motive and opportunity to tackle this problem, Hine told INSEAD Knowledge. "As the owners of companies, they are able to exert influence in order to encourage companies to improve their response to the challenges of climate change, reduce their overall emissions and begin the transformation of their business models to enable them to compete in an emerging post-carbon world."

EIRIS, a global provider of independent research into the social, environmental governance and ethical performance of companies, analysed the impact and response of some of the world's largest 300 companies on the basis of 24 climate change indicators covering governance, strategy, disclosure and performance elements. Comparing the data with the results of a report published in 2008, they found there is a high level of unmitigated risk among the top global companies.

In view of this, Hine says that asset owners should demand that their asset managers integrate climate change into their investment process and monitor their performance in this regard.

The report also shows that high-risk companies are improving with regard to how managers of companies are responding to climate change but there is still a long way to go. "There is an opportunity for investors to exercise their voting rights and to engage companies to minimise risk," he adds.

Investors, though, need to demand greater transparency from companies to evaluate their exposure and performance regarding climate change.

Protecting and enhancing investments

Hine says investors can take steps to protect and enhance their investments by identifying portfolio risks. Understanding the carbon profile or footprint is an important first step.

Another step is to 'factor in carbon'. This involves fully understanding carbon risks and opportunities within both the portfolio and the wider economy. "This isn't really about divesting from high-impact companies, and more about the investor engaging with companies to improve their response to climate change. Investors should factor in carbon when pricing high-impact companies," he says. "Another way is to focus on investing in climate change solutions companies, such as those focusing on renewable energy or energy efficiency."

Investors can further protect their investments by engaging with the company, focusing on specific climate change issues and the wider policy debate.

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