

Carbon: The new financial frontier





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It is often said that a business can only manage what it measures. Since 2000, the Carbon Disclosure Project (CDP)¹ has, on behalf of institutional investors, challenged the world's largest companies to measure and report their carbon emissions, integrating the long-term value and cost of climate change into their assessment of the financial health and future prospects of their business.

Corporations' ability and willingness to monitor and report these activities and issues reflects the inexorable rise of climate change from debate at the fringes of society to the boardroom agenda. The effects of climate change may include physical impacts on assets, changing market dynamics for goods and services, escalating regulation and greater scrutiny from an increasingly sophisticated range of stakeholders. Investors want to know how companies are futureproofing themselves against these issues, whilst maximising the opportunities they present.

CDP's sixth and most recent request for information (CDP6) was sent to more than 3,000 of the world's largest corporations requesting information on greenhouse gas emissions, the potential risks and opportunities climate change presents and strategies for managing those risks and opportunities. The request was backed by 385 leading

institutional investors representing more than US\$57 trillion of funds under management. The corporations' responses and reports assessing the results of these were published in more than 20 countries around the world during September/October 2008 and are freely available at www.cdproject.net.

The logic for CDP is simple: addressing the climate change challenge depends on a dialogue between shareholders and corporations, supported by high-quality information. Companies need to articulate their position in a coherent way to an increasingly sophisticated set of stakeholders.

PricewaterhouseCoopers (UK), CDP's global adviser, has analysed the responses from the 500 largest corporations in the FTSE Global Equity Index Series, the 'Global 500'. As of March 2008, the market capitalisation of these companies was US\$22 trillion. This article provides a brief overview of CDP's Global 500 Report, and focuses on the key findings pertaining to the financial services sector.

CDP Global 500: Consistent growth

CDP is the largest investor coalition in the world and remains the world's leading proponent of climate change awareness

and carbon disclosure. Since its inception, CDP has grown considerably, both in terms of the number of institutional investors which back the disclosure request (from 35 to 385) and the response rate of companies (from 44% to 77%).

As shown in Figure 1 overleaf, CDP6 achieved an impressive overall response rate of 77% – consistent with the record level achieved in CDP5, despite deteriorating economic conditions in many countries in the world and substantial changes in the composition of the Global 500. European and North American companies continue to set the pace, with Asian Global 500 companies lagging.

Key drivers for action

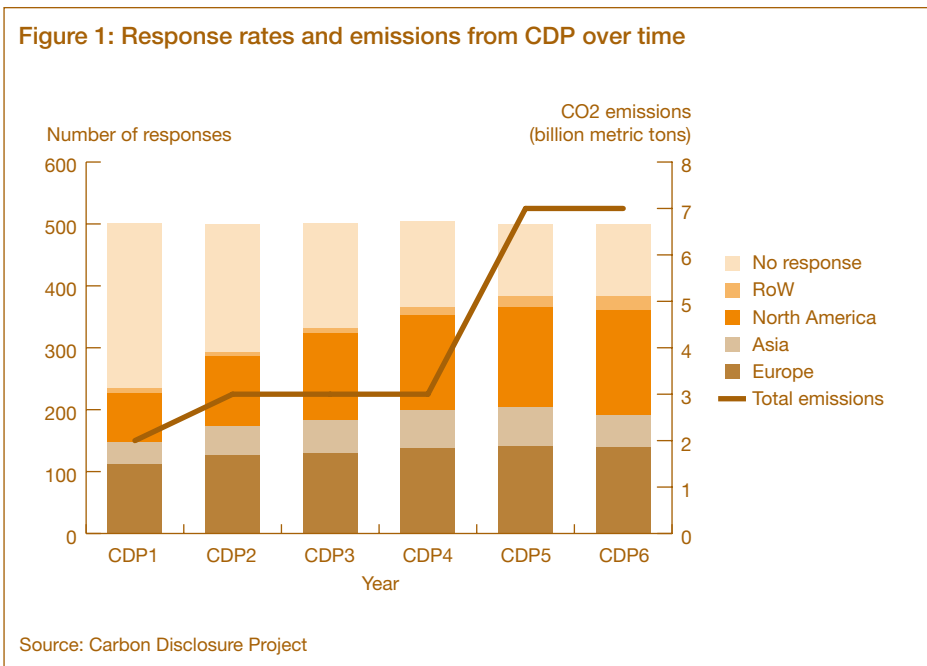
Our analysis has found that there are a number of key drivers for action which are raising the significance of carbon and the need for companies to consider carbon as a strategic issue:

- **The impact of uncertainty** – although there is now a broad consensus on climate science, the implications for corporate value are less certain. For some CDP6 respondents, this translates into a 'wait and see' strategy to see how peers are responding and how the regulatory environment is evolving. Others clearly feel that late starters risk missing out on opportunities.

¹ 'Carbon Disclosure Project' and 'CDP' refers to Carbon Disclosure Project, a United Kingdom company limited by guarantee, registered as a United Kingdom charity number 1122330.

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Figure 1: Response rates and emissions from CDP over time



Source: Carbon Disclosure Project

devoting significant resources to investigating supply chain emissions, possibly motivated as much by cost-savings and reputational benefits as by their wider environmental impact.

The financial services sector

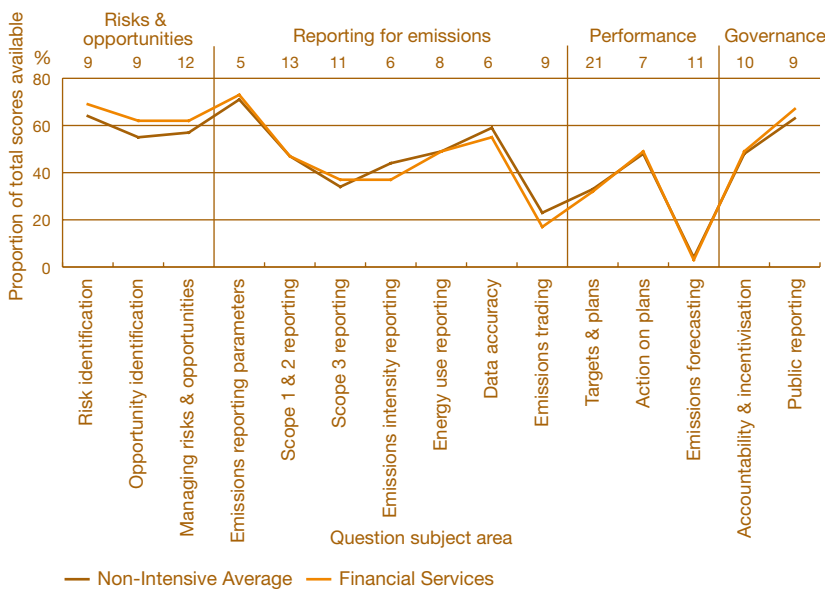
There are 121 financial services companies included in the Global 500, of which 95 responded to the information request. Relative to other sectors classified as ‘non-intensive’, the financial services sector achieved the joint highest scoring. The sector’s relatively strong performance is a reflection of (i) its large exposure to reputational risk, (ii) its long track record of sustainability reporting generally and (iii) its need to understand the risks and opportunities of the businesses in which it invests.

An analysis of results from companies in the financial services sector demonstrates that the sector is particularly strong in disclosing risks and opportunities, i.e. their identification, management and assessment of business impact. This is likely to be a result of the industry needing to integrate climate change risks and opportunities into its day-to-day investment, lending and contract decisions to run a successful and sustainable business (See Figure 2).

- **Regulation remains a key issue** – with more countries and regions now contemplating emissions trading schemes for carbon-intensive sectors, regulation featured frequently as a key risk factor. Companies are looking for greater visibility on climate policy and on carbon prices, and many also mentioned the lack of harmonisation on regulatory issues. A commitment to a long term, global, cap-and-trade scheme at the UN climate talks in Copenhagen next year would clearly help business to plan for the transition to a low-carbon economy.
- **Increasing consumer awareness** – consumer attitudes are featuring increasingly as a driver of risks and opportunities in the B2C sectors. However, carbon disclosure to customers is still very much in its infancy. Some corporations are exploring carbon labelling, but there is little clarity on what information is relevant or whether this actually impacts upon consumer choice.
- **More focus on the supply chain** – retailers such as Wal-Mart, Tesco and Carrefour noted that they were



Figure 2: Sector disclosure – financial services



Source: Carbon Disclosure Project 2008 – Global 500

their value in AXA's investments portfolios.¹² Mitigating these risks, for example by using positive selection criteria and exerting influence on the portfolio, could reduce its potential to negatively impact the investor's profitability.

The level of risk management undertaken in relation to climate change varies significantly throughout the sector. Some companies stated that they do not consider themselves to be exposed to regulatory, physical or general risks, e.g. Aegon and AFLAC, though they do appear to consider risks in relation to their product portfolios. Other companies have integrated climate change considerations into business continuity plans as well as forging links to scientific and academic institutions and introducing climate change investment and lending screening procedures (e.g. American Express, AXA and Canadian Imperial Bank of Commerce).

In addition to this a significant proportion of the sector now factors in carbon and climate change considerations into its investment decisions and financial decision making, as can be seen from ANZ Bank's response: 'Future carbon prices and potential carbon credits are factored into our financial decision-making processes where possible.'¹²

The financial services sector disclosures suggested that the three key risks for the sector at the time were:

- **Reputation** – as a result of growing consumer awareness;
- **Credit-worthiness** – of the businesses in its investment portfolio; and
- **Increased energy costs** – as a result of the increased cost of compliance of utilities companies.

Climate change impacts on the companies that constitute the sector's investment and loan portfolios, and the subsequent credit and other risks are a large and complex area for the sector to evaluate. This is captured in AXA's response: 'In terms of investment policy, companies which are ill-prepared for more stringent environmental regulation may face unexpected new expenses and a decreasing ability to sustain their returns and share price, thus decreasing

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Sir Tom McKillop, Chairman, Royal Bank of Scotland Group, commented: 'The specialist focus of the CDP provides a suitably rigorous structure for an overview of a company's response to climate change.'²

Each sub-sector is seeing opportunities arising from climate change which are specific to its area of business expertise. The insurance sector has seen opportunities in the areas of managing the risk of carbon credit projects and providing new products to insure against extreme weather events. The banking sector has seen opportunities arising from participation in the trading of carbon and renewables certificates and providing specialist 'green products' for responsible investors. The response from Allianz shows just how much potential there is for new product and service innovation in the change to a low-carbon economy: 'Regulatory changes to combat climate change are providing a huge portfolio of opportunities.'² Similarly, Merrill Lynch & Co commented: 'We believe that the market for alternative energy, clean technology and carbon trading will continue to grow exponentially.'²

Carbon disclosure leadership index

The Carbon Disclosure Leadership Index (CDLI) identifies the top scoring companies within each sector, and provides a valuable perspective on the range and quality of responses to CDP's questionnaire (the CDLI score is not a metric of a company's performance per se as it does not take into account emissions levels or reduction achievements).

Financial services companies have traditionally featured strongly in the CDLI, reflecting the commitment of the sector to carbon disclosure and the strategic importance of climate change to the sector, notwithstanding the relatively low level of its own direct emissions.

Conclusions

Given their level of exposure to the public and the general consumer most of the companies in the sector, in particular the banks, have taken great steps to ensure they are seen to be 'green'. These steps have to date included providing products for the environmentally conscious

Figure 3: Carbon disclosure leadership index – financial services sector

Company	CDLI Score
Barclays	98
Merrill Lynch & Co	98
Munich Re	98
National Australia Bank	98
Australia and New Zealand Banking Group	97
Citigroup	97
Lloyds TSB	97
Royal Bank of Canada	97
Wells Fargo	97
HBOS	95
Westpac	95
Royal Bank of Scotland Group	94
Standard Chartered	94
Credit Suisse	92
Allianz SE	91
HSBC Holdings	91
Bank of Montreal	90
Hartford Financial Services	90

Source: Carbon Disclosure Project 2008 – Global 500



consumer, reducing energy use and offsetting emissions. As well as saving energy costs, these schemes have been reported as providing the leading institutions with good reputations and hence potential customer appeal.

The disclosures from the financial services sector show that its greatest risk from climate change and its greatest opportunity to reduce the advance of global warming is through its investment and lending portfolios and other customer exposures. The deep and wide risks that a financial institution is exposed to through its portfolio must be increasingly understood and made transparent to assure investors that climate change poses a managed and controlled risk to their investment. In conjunction with this, financial institutions have the opportunity to influence their portfolio to reduce emissions, provide 'solution' products and adapt to the changing climate.

Financial services sector company highlights:*

- Top disclosers by CDLI score: ANZ Bank, Barclays, Merrill Lynch, Munich Re, National Australia Bank

Key sector metrics

- Number of companies in the Global 500 in sector: **121**
- Number of companies responding in sector#: **91** (75% – ranked =5th overall, =2nd out of non-carbon intensive)
- Number of companies disclosing publicly: **76** (83% of respondents)
- Sector average CDLI score: **70** (ranked =1st out of non-carbon intensive)
- Range of scores: **7** lowest – **98** highest
- Percentage of respondents disclosing emissions: Scope 1: **64%**, Scope 2: **65%**, Scope 3: **56%**
- Most common metric used for measuring emissions intensity – **per employee and per square metre**

* Companies listed include non-public responses. Names are listed alphabetically within categories.

The information in this box is based on the final number of respondents to CDP as of 31 July 2008. However, for time reasons the cut-off date for the responses received in the data and charts in the rest of the section was 1 July 2008, and hence these may differ slightly from this figure.