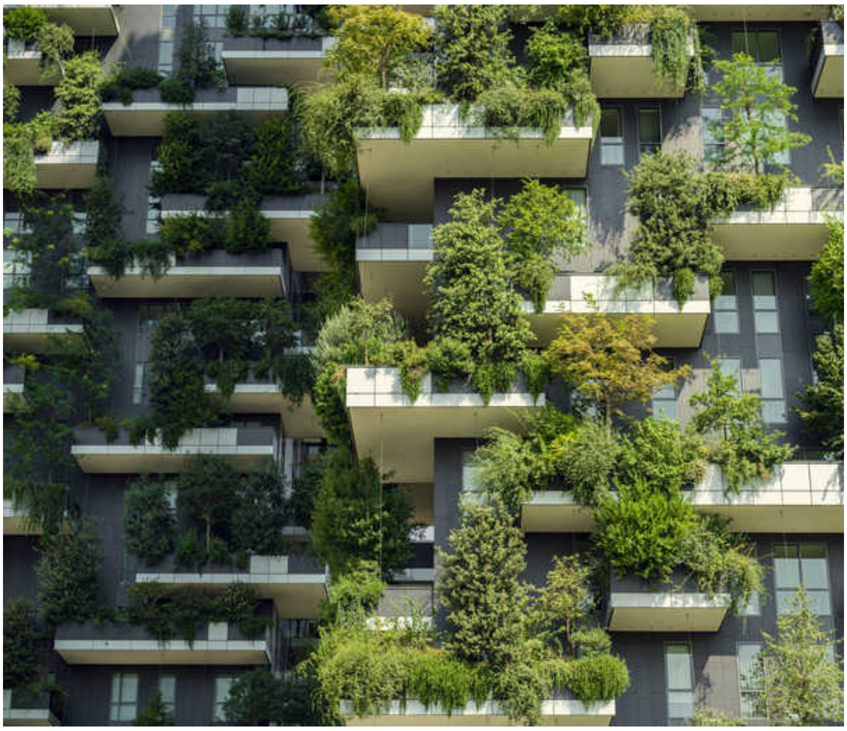
Solving the environmental crisis with public and private finance

By **RICHARD BURRETT, CSO, EARTH CAPITAL** • Jan 02, 2020, 9:00AM



We all know we are running out of time to address climate change. Based on existing climate policies and forecasts of future emissions, we have a slim chance of keeping global temperature rises below 2°C – levels at which the consequences remain manageable, but perilously so. According to the International Monetary Fund (IMF), world economies are facing growing indebtedness and unsustainable asset prices as we enter an unsettling geopolitical reality, where nationalism and populism are creating do-it-alone state mentalities leading to rising military, economic and commercial tensions. At the same time, failure to mitigate climate change and growing cybersecurity breaches continue to grow as threats to global stability.

So, what'll it be? Bite the bullet and get ahead of the problem the Bank of England Governor Mark Carney calls the 'tragedy of the horizon' before it becomes unmanageable, or not? We either work together, both public and private markets, a) acting now to avoid a negative outcome, or b) take a more expensive action later to deal with a worse outcome and risk an ultra-expensive catastrophic outcome.

The encouraging news (from the Carbon disclosure Project) is that many of the world's largest firms are increasingly aware of the risk that climate change poses to their business models. Bloomberg reports that of 25 company reports it reviewed, 21 identified "inherent climate-related risks" with potentially substantial financial or strategic impacts. The penny may be dropping, but momentum must continue.

Transitioning to a low carbon economy means dealing with growing physical risks such as extreme weather events and investing today to avoid future worsening risk scenarios developing. Public policy will be essential to set targets, standards and incentives to facilitate this. It is a step in the right direction to see all the major political parties include policies around combating climate change and protecting the environment in their latest general election manifestos.

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The incoming government from the election has an opportunity to accelerate the shift to a low carbon economy. What is also clear is that public and private sector entities must work together to achieve the net zero target: private commerce shouldn't be left to its own devices. It is the government's role to put the guide rails in place for the private sector to act. This includes enhanced measurement and disclosure. We estimate that about 70-80% of the cost of achieving the net zero target must come from the private sector. It is a big spend, but also a big opportunity. Contributing to a low-carbon sustainable future will provide a greater pay-off to investors over the long-term.

The investment sector is beginning to get to grips with this need for change and the power of this capital is critical to that transition. The financial rationale for doing it is clear too. Many recent academic studies including those from Harvard Business School have demonstrated the positive relationship between high performance on relevant ESG issues and superior financial performance. The mounting evidence is being reflected in the take up of sustainability focussed practices. For instance, here in the UK, pension scheme trustees must now set out the extent to which they take account of members' views on non-financial matters in the development of their investment strategy under proposals put forward by the UK government today. Non-financial matters would include, but not be limited to, matters of ethics, social impact and "present and future quality of life".

Better practices around disclosure will help to identify the precise exposure of companies to climate risks and their impact on the environment – a key issue that both investors and regulators face. Without them, investors cannot make decisions to rebalance their portfolios, and regulators cannot design optimal policies.

While we are currently falling behind in our efforts to beat climate change, it is still within our power to avoid the most damaging outcomes. A financial services industry that understands the risks of inaction and redirects its capital towards a low-carbon sustainable economy of the future can address the challenge.

Policymakers need to play their role too, creating the conditions under which the green transition can happen. Inaction is our biggest threat. Collaboration between the key stakeholders here, business, policy and finance, can save our futures.