



Report from the Expert Workshop  
**Climate Change and the Financial Sector**  
**Cologne, November 28, 2002**

Organizers: Germanwatch in cooperation with Gerling Group

***Background***

The consequences of climate change are continually stronger felt, and the sum of each single event (the flood of the Elbe river, Storm Lothar, Storm Wiebke, ....) make it obvious to the national and global economies that global climate change is becoming evermore relevant. Moreover most of the victims of climate change are not in the industrial countries, but rather in the rural areas of developing countries.

Those in the insurance business were the first in the financial sector to feel the consequences. Germanwatch already offered an expert workshop to address this issue on September 16, 2002, at which climate-insurance solutions for the "insurable" in developing countries was a topic, among other things. (see [www.germanwatch.org/klak/ws02vers.htm](http://www.germanwatch.org/klak/ws02vers.htm)).

However, more actors in other areas of the financial sector are making their voices heard, especially those who demand a stronger consideration for the risks that climate change brings. It is about developing appropriate risk management plans for the direct risks, such as flood and storms, as well as for the indirect climate risks, for example the regulation of greenhouse gases. The workshop, "Climate Change and the Financial Sector" dealt with these questions.

***Participants***

The 40 participants (see attached participant list) came from Germany, Great Britain and Switzerland and represented non-governmental organizations (NGOs), international organizations, banks, fund managers and corporations in the political, economical and insurance fields.

The variety of backgrounds and therefore, the different approaches of the participants was enriching: lawyers, climate experts, financial experts, insurance specialists and representatives of the civilian community discussed with each other in a mutually respectful and productive manner.



## ***Program***

Opening and welcome by **Klaus Milke**, member of the Germanwatch executive board and of Stiftung Zukunftsfähigkeit.

Opening speech by **Joachim Ganse**, Director of Environmental Affairs at Gerling Group.

### **Impulse Reports:**

**Dirk Kohler**, Gerling GSDP: "Implementing Kyoto Mechanisms, contributions by Financial Institutions"

Short reply from **Peter Roderick**, lawyer, Friends of the Earth International

**Nick Robins**, Henderson Global Investors: "Henderson and the Carbon Disclosure Project"

Short reply from **Niki Rosinski**, SAM Sustainable Asset Management

**Mark Mansley**, Claros Consulting: "10 Action points: Institutional Investors and Climate Change"

Short reply from **Scott Flemming**, UNEP Finance Initiatives

**Aled Jones**, Innovest Group: "Environmental Behavior and Company Performance"

### **Working Groups:**

What should short- and mid-term action plans look like and which actors need to be involved?

How should carbon risks be managed in the carbon intensive industry?

Discussion, analysis and strategical deliberations

Summary and conclusion, **Christoph Bals**, Germanwatch

## **Themes and Discussion Course**

### ***Reasons of the Status Quo***

Many are waiting to join the discussion about climate change until there is absolute security in the experts' discussion. Reactions will only follow when experts rate the certainty of a scientific result to be 100%.

Idleness and being uninformed are the causes for the deficiency in motivation towards more climate (and therefore, investment) protection from the financial sector.

The exponential dynamic and the problem of possible irreversible damages are not easy to understand. Course of action – not only in the financial sector – depends at least in part on past experience. Humanity, however, cannot expect to be able to rely upon past experiences when it comes to climate change and other global environmental changes. In the last 10,000 years, since humanity's high culture, there has been no environmental change of this expected magnitude. Cognitive barriers must be broken through with didactic instruments. The necessary behavior patterns needed to mitigate the consequences of climate change and the adjustment to the changes that are a result of climate change cannot be found in any history book. There has never been a "controlled" technical revolution, as is now, out of absolute necessity, needed.



## ***The Importance of Climate Change for the Financial Sector***

**Direct effects** of climate change: The financial sector is directly affected by the direct consequences of climate change (flooding, storms, droughts....). Further risks threaten through the regulative risks of climate change. Other possibilities or even probable consequences are mentioned in the IPCC Third Assessment Report (see table under [www.grida.no/climate/ipcc\\_tar/wg2/326.htm](http://www.grida.no/climate/ipcc_tar/wg2/326.htm)).

**Legal Liabilities and Risks:** Two lines of argumentation run together here. To the first belongs the duty of institutional investors to avert damages for the investors. Ignoring the risks of climate change or even the absence of a management strategy plan for climate risks could lead to loss and eventually lawsuits from investors. This hazard is still too unknown and not thoroughly researched.

Risks for investors threaten over a different path as well: Some of the victims of climate change are currently looking into lawsuit possibilities against some of the bigger greenhouse gas emitters. The time is coming soon for states and corporations, who fall into this category of large greenhouse gas emitters, when they will have to change their damaging behavior. The commitment to compensate damages, which has already been developed (and which, because of the idleness of the climate regime, is still being developed), could also be sued.

Several lawsuit options are being discussed on the Internet site:  
[www.climatelawsuit.org](http://www.climatelawsuit.org)

## ***Suggestions for Standards in the Financial Sector***

### **Climate Criteria in Fund Management**

In order to assimilate sustainable, especially climate, factors into the conventional selection process in fund management, it is necessary to have concise indicators and predictions to reveal how strongly weighted these indicators should be. To be more exact, it must be discovered where exactly the "missing links" are, so that managers, especially fund managers, can integrate carbon risks into their strategies.

### **Coverage of Greenhouse Gas Risks by Corporations**

Corporations who do not tend to climate questions could receive a worse rating, especially when high carbon (or greenhouse gas) risks are associated with the corporations themselves. For this to happen, further transparency agreements (required reports) are necessary. These transparency forms could be legally binding, demanded from individual business commitments or from the repetitive requests of private and/or institutional investors. How open a business is with their environmental information should be a quality criteria, one that should be connected to ratings.

The adaptation of the business to the current and coming consequences of climate change should be reported and analyzed within a rating framework. Only in this way can proactive activities from corporations start paying off now – the success of the



"late-bloomer" corporations is also bound to occur in the middle to long term, but this cannot be immediately figured into the cost-benefit-budgets.

So that the financial sector acts, more pressure from the side of the consumer and shareholders needs to come. Customers have to demand information about greenhouse gas risks associated with investment decisions. Options that are without much risk and climate-friendly should be given as investment possibilities.

The financial sector should help corporations by investigating, presenting and communicating the possible carbon risks. Besides that low-risk products and production processes should be made available.

### ***How should the next steps be planned so that they will be successful?***

Only when the process is anchored in the decision-making level it can result in changes in all parts of a company; especially the executive boards and management need to be involved.

An adjusted risk management strategy has to be developed:

- Climate change and its consequences have to be better understood within the financial sector (climate literacy).
- It is therefore important to understand the terms "likely" and "unlikely" from the IPCC Third Assessment Report with the following percentages, which the IPCC has decided upon: "virtually certain": over 99% chance that a result is true; "very likely": 90-99%; "likely": 66-90%; "medium likelihood": 33-66%; "unlikely": 10-33%; "very unlikely": 1-10%; "exceptionally unlikely": <1%)

### ***The role of the NGOs***

How can NGOs support this process? How can they put pressure on corporations?

- Various approaches to putting pressure on corporations and on the financial institutions make sense. Direct discussions with corporations will be seen as more effective, as considered through the eyes of the media, stockholders and stakeholders. However, the latter form of exerting pressure is always available as a course of action.
- The decision-makers in private and public corporations should be in closer contact and work more closely with NGOs. Even in the planning phase could NGOs bring innovative ideas into the decision-making process in a reasonable and profitable manner.
- A NGO who wants to be respected and successful in its work has to work with the classical three steps and decide - depending on the counterpart and his willingness to cooperate – the appropriate means: "help them, harm them or hump them."

Which organizational platform do NGOs need?

- The differences in the NGOs make it possible for each to find its appropriate approach. Germanwatch has specialized on the instrument of "strategic alliances". This can be combined with public pressure when the corporations too strongly reject to enter into a constructive dialogue.
- Every individual can speak with members of the executive board and management. The language used, however, must be that which the CEOs understand. One has to argue from the viewpoint of the CEO. There is the risk to fail because of an inappropriate language or form. The acceptance in using this form and language of the counterpart needs to be successfully reflected. Personal ideas and positions cannot, however, be simply smoothed over.
- Personal contact is absolutely necessary.
- The differences in relating to leaders, middle people and stragglers should be considered obvious in lobby work.

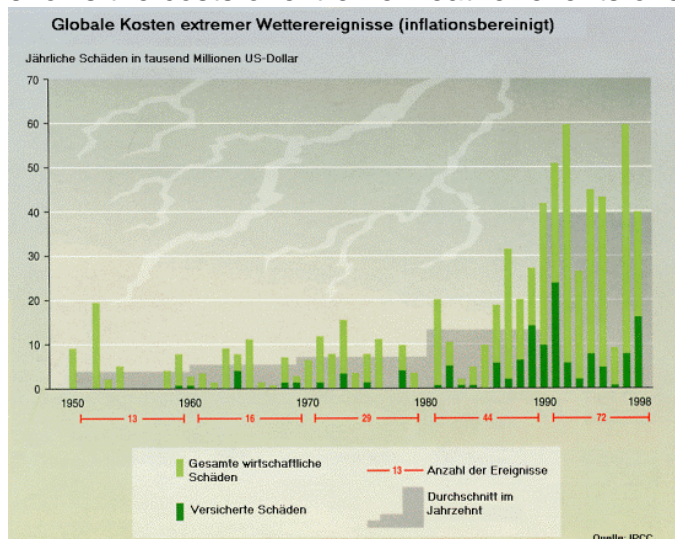
### **Digression: EU – USA**

The competition for more sustainability between the corporations in the EU has an impact on the corporations in the USA – this effect is worth taking advantage of.

- In the private sector in the USA, there is already a positive development that can be observed. Some US states do not follow the "Bush" line-of-thinking. The US government continues in its refusal to take part in the Kyoto process. What sort of impact will this have when emissions trading with parties who have NOT signed will be refused? It is possible, according to the Kyoto Protocol, that non-Kyoto countries, like the USA or US states, can sell emissions credits, but only to Kyoto countries (those who have signed).

### **The Cost of Climate Change**

How expensive will climate change be in the coming years? The following figure shows the costs of extreme weather events over the last few decades.



### **Chances Climate Change Offers the Economy**

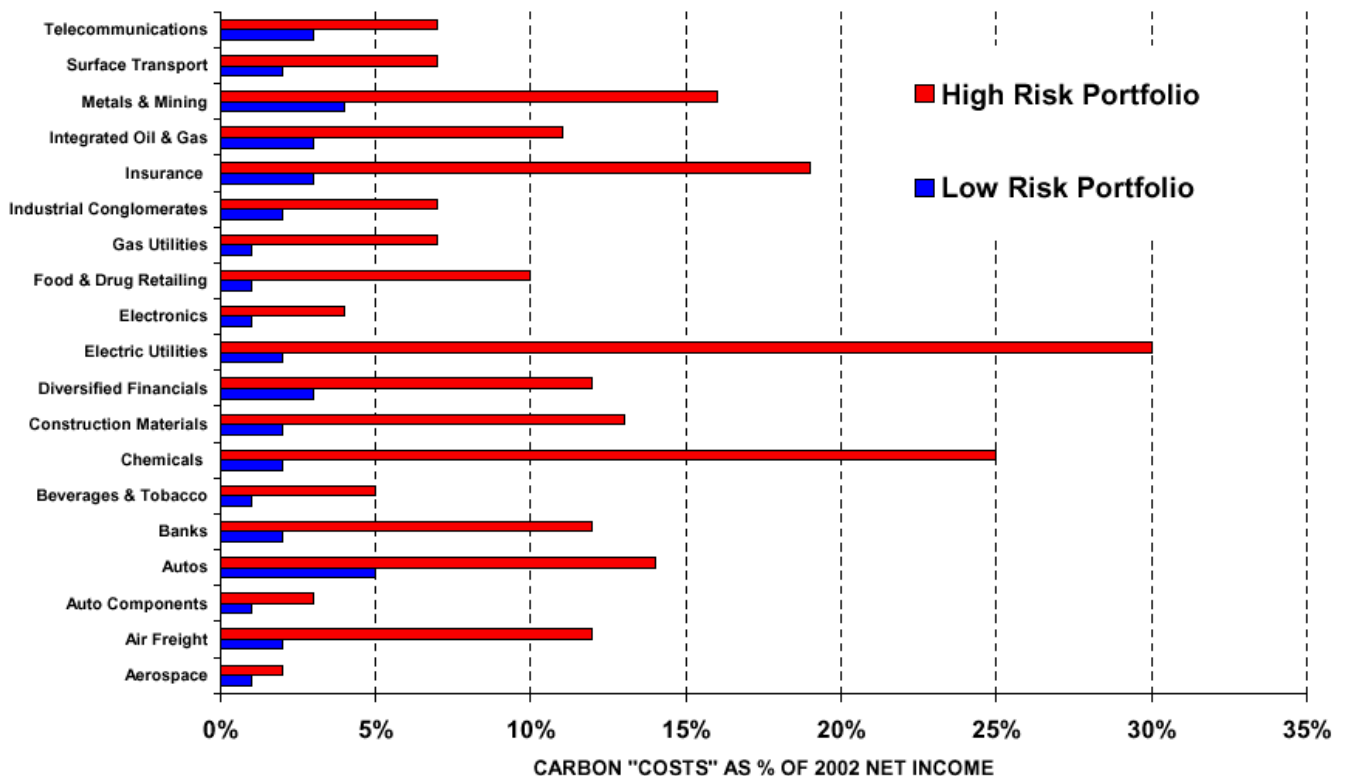
The production sector has not yet realized the changes and possibilities that will come with climate change.

The financial sector should be challenged to approach the hindrances in the financing of, for example, greenhouse gas-friendly technology. (Or if necessary, demanding action from the politicians.)

With all pressure: climate-friendly attitude shall pay off. There are more and more cases where it already has positive impacts on corporations' budgets and in any case it will mean a reputational gain for individual corporations. Protecting the climate can be added to the marketing scheme.

A difference between those corporations with high carbon risk and those with small carbon risk will be evident. (After the workshop Innovest made this principle clearer with the following figure.)

**SAMPLE CVAR PORTFOLIO AUDIT**



from: "CARBON BETA AND PORTFOLIO RISK: FINANCIAL IMPACTS OF CLIMATE CHANGE. The Carbon Value at Risk Portfolio Audit <sup>TM</sup>Innovest Strategic Value Advisors, März 2003.

The carbon-producing market is a self-preserving one. "Business as usual" is heard almost everywhere. Carbon certificates play only a very small role in trading, and stay at a very low level in reference to volume and trading. One can not expect that carbon certificates will be worth 30-50 US\$ per ton in the near future. Considering



the current weakness of emission targets, the price level will probably be about 10 US\$ per ton, compared to today's 3-5 US\$.

## Results of the Working Groups

### ***Working group 1: What should short- and mid-term action plans look like and which actors need to be involved?***

- The individual working steps, as well as the analysis and choice of target audiences should be done with much care.
- Sometimes the CEO, who is under pressure from competitors and other stockholders, is not the best target person. After choosing the target group, deciding upon a contact person is the next step.

The important events in the upcoming months need to be taken advantage of to bring the topic further into the discussion. It is better to use the upcoming events, rather than developing one's own. Especially those contacts and events at the EU level should be used to talk about problems.

A) EU: Influence of the regulation on the finance markets: Transparency and required reports are necessary in general and especially in climate change. These prepare the way for the next steps and generate helpful information. The investor groups should also be included in this.

B) Investors in Germany, the United Kingdom and other EU-countries set a good example when they make investment decisions based on climate-relevant facts. These examples could be used as informational material or work. It is important to network these groups, for example, by coordinating a mutual drive at the EU level.

C) Lawsuits from the side of the victims of climate change could eventually be an excellent way to bring the problems of climate change into the public conscience. The "equity gap" refers to the fact that the main CO<sub>2</sub>-emitters are in the North and those mainly affected from climate change are in the rural regions of developing countries. This signifies a means of moral pressure to act, an excellent public relations opportunity and something which could prove helpful when planning lawsuits.

D) Target group *financial analysts*: How can financial analysts be sensitized to this topic? What is their role?

- First, sustainability reports and simple, classical rating systems must be compatible with an evaluation system. Only then can the analysts be confronted with the results. Should the analysts be approached *now* with this topic or would that just be wasted energy?



### ***How can carbon risks be managed in carbon-intensive industries?***

The second working group concentrated themselves on the role and responsibility of the industrial countries as they are the main actors in the implementation of the Kyoto Protocol – even when carbon risks present a hazard for all carbon-intensive corporations.

The considerations included:

- Management
- Stakeholder community
- Liability risks of the corporations: social and environmental risks, as well as the anticipation of coming standards
- Shareholder: Need to be encouraged to ask about what corporations are doing in response to climate change, its direct consequences and its coming regulation as a result of policymakers.
- Market situation

Corporations who are beginning to rearrange their product palette:

- "going solar", a marketing challenge

What do the important first steps of the investigation into unsecurity look like? The management of carbon risks will demand a future comparison in prices within different scenarios.

For the public it is not understandable how much CO<sub>2</sub> a corporation emits, and how a corporation stands in comparison to other corporations in the same branch. (For example, how an oil company stands in comparison with other oil companies.) Reports and other basic approaches (like Carbon Disclosure Project, sustainability development reports, etc.) need to be developed.

## **Overview**

Throughout the discussion it became clear that the risks for capital investments are increasing. Climate experts impressively elucidated the predictions of the IPCC Third Assessment Report, where the increase in various strong weather events is viewed as probable or very probable. It would be helpful to quantify these scenarios for further predictions and damage prognoses.

Many paths were revealed for which further success-promising work can be done: report formats, transparency, and further examination of action courses for share- and stakeholders, etc.

An important short - middle term goal is bringing the sustainability ratings of corporations into a form with which the language of analysts and fund managers is compatible and which can be a helpful tool in the investment-making process.

The discussion was summarised in a plan of action:

## Climate Change and the Financial Sector Plan of Action - 1

### Who:

- - Political Actors: national and European level
- - Financial Sector
- - Shareholders of business, insurers
- - NGOs
- - Carbon Disclosure Project (follow up?)
- - Financial Sector: analysts, tools, CEOs

The plan of action is divided in actors as mentioned above and concrete next steps under "What":

## Climate Change and the Financial Sector Plan of Action - 2

### What:

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>■ long term political framework</li> <li>■ integrate climate change <ul style="list-style-type: none"> <li>■ asset management</li> <li>■ investment</li> </ul> </li> <li>■ legal action</li> <li>■ regulation of insurance investments</li> <li>■ financial reporting requirements</li> <li>■ develop climate literacy / awareness</li> <li>■ investor activism</li> </ul> | <ul style="list-style-type: none"> <li>■ new generation of carbon liabilities <ul style="list-style-type: none"> <li>■ asset write downs</li> <li>■ profit warnings</li> </ul> </li> <li>■ NGO: help-hurm-hump</li> <li>■ translate issue into CEO language</li> <li>■ incentives for innovative investment</li> <li>■ encourage disclosure</li> <li>■ „duty to take into account“</li> <li>■ investors group on climate change</li> </ul> |
|---|--|

The necessary and most important developments for the ongoing process are identified under "milestones":

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**Climate Change and the Financial Sector  
Plan of Action - 3**

## **Milestones**

- Kyoto-Protocol Ratification
- Emission Trading
- EU transparency directive
- Carbon Disclosure Project



Already action is being taken in the area of climate risks and investment decisions, suggestions that came from this workshop. One of these is the work of the Carbon Disclosure Project and another is a Germanwatch project, "Institutional investors and climate protection." More information can be found under:  
[www.germanwatch.org/rio/siagenda.htm](http://www.germanwatch.org/rio/siagenda.htm).

There were many inquiries about material to the workshop. Already a few days after the workshop all presentations and pictures of the workshop were available on the Germanwatch website at [www.germanwatch.org/rio/siws1102.htm](http://www.germanwatch.org/rio/siws1102.htm).

**For further questions contact:**

Stefan Rostock  
Germanwatch  
Bonn office  
Kaiserstr. 201  
53113 Bonn  
Tel: +49 (0)228/ 60492 –11, fax: -19  
[rostock@germanwatch.org](mailto:rostock@germanwatch.org)  
[www.germanwatch.org/rio/si.htm](http://www.germanwatch.org/rio/si.htm)

**Minutes written by:**

Christoph Bals, Dorothee Horskötter, Stefan Rostock, Dora Schmidt

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## List of Participants

(sorted by institution)

<b>Name</b>	<b>First Name</b>	<b>Institution</b>
Mansley	Mark	Claros Consulting
Rusnok	David	DEG
Braun	Hans-Gert	DEG
Goncalves	Eduard S.	Delbrück Asset Management
Köster	Olaf	DEUTSCHER INVESTMENT-TRUST, DIT
Klein	Axel	ECC Kohtes Klewes
Böswald	Klaus	Factor Management AG
Ghose	Anjana	Fund manager, Maintrust
Roderick	Peter	Friends of the Earth International
Bode	Aiko	Gerling Group
Ganse	Joachim	Gerling Group
Kohler	Dirk	Gerling Group
Ludwig	Ingrid	Gerling Group
Paus	Hans-Leo	Gerling Group
Rumberg	Michael	Gerling Group
Bals	Christoph	Germanwatch
Horstmann	Britta	Germanwatch
Rostock	Stefan	Germanwatch
Robins	Nick	Henderson Global Investors
Groscurth	Helmuth	HEW
Jones	Aled	Innovest Group
Hild	Paul	ISO Institut zur Erforschung sozialer Chancen
Montag	Michael	Pictet Funds GmbH, Frankfurt
Patt	Anthony	PIK
Förster	Hannah	PIK
Rosinski	Niki	SAM
Milke	Klaus	Stiftung Zukunftsfähigkeit, Germanwatch
Kühleis	Christoph	UBA
Kartschall	Karin	UBA
Flemming	Scott	UNEP - Finance Initiatives
Busch	Timo	Wuppertal Institut
Ahferom	Goitom	Germanwatch, conference assistant
Kier	Gerold	Germanwatch, conference assistant
Horskötter	Dorothee	Germanwatch, minutes
Schmidt	Dora	Germanwatch, conference assistant, minutes