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Climate Report Is a Call to Action

The recent IPCC report underscores the urgent need to address carbon and methane emissions. Here's how investment managers can play a role.

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The Intergovernmental Panel on Climate Change (IPCC) recently released its sixth assessment of the state of scientific evidence on climate change. Since the first IPCC report was released in 1990, each new edition has become a catalyst for worldwide discussion of the future of climate change and of possible policies and institutions to address the associated problems. Specifically, the August 2021 report provides detailed, scientific evidence of the accelerating impact of climate change on inhabited regions across the globe and of the human influence on the climate system.

The IPCC report increases pressure throughout the world for collective ownership of the issues surrounding climate change.

Assessing the Climate Challenge

The report is timely, as accounting for and reporting of carbon emissions has sparked a wide-ranging debate among regulators, companies, climate experts, and market players. Reflecting the growing sense of urgency, the SEC is expected to release proposed rules for mandatory climate-risk disclosure by companies by the end of 2021.

The report that was just released is what is known as the "Summary for Policy Makers" of the first working group that focuses on climate science. The IPCC will then produce the assessment reports of its three working groups next year. The second and third working groups will provide special reports focused on climate adaptation and mitigation. These assessment reports are not prescriptive. However, conclusions from these reports are likely to inform behavior by market actors, as the world is catching up with the "unequivocal impact of humans' influence on climate change," in the now-famous words of the August 2021 report.

Compared to the IPCC report published in 2018-2019 (AR5), the most recent assessment shows an increased degree of certainty around the human impact on the climate system. "Evidence of observed changes in extremes such as heat waves, heavy precipitation, droughts, and tropical cyclones and, in particular, their attribution to human influence, has strengthened since AR5." This impact seems to be accelerating. As an example, "The frequency and intensity of heavy precipitation events have increased since the 1950s, while cold extremes (including cold waves) have become less frequent and less severe."

What Can Be Done?

It is likely that we will pass the 1.5°C temperature-rise level by 2040—a decade earlier than predicted in the 2018 IPCC report. The accelerated pace of warming points to the need for immediate action. Asset managers can play a key role in driving this action, by mobilizing capital toward those companies that can lay out and execute a well-articulated carbon-emission strategy, and by holding management of those companies accountable through proxy voting and engagement practices. We believe active asset managers are well positioned to influence companies' perspective on environmental, social, and governance (ESG) issues; this position will become increasingly relevant as the world learns more about the impact of climate change.

Wildfires, floods, and similar low-likelihood, but high-impact outcome events are an area of focus in this IPCC report and underscore the relevance of investment expertise around climate-risk exposure and management. These scenarios increase the demand for climate experts and for accurate climate-related data that can feed a framework for risk analysis and can help meet increasingly rigorous regulatory requirements.

Most of the media attention around climate mitigation focuses on the need to reduce carbon emissions. The IPCC report, however, points to the potential need for an evolving framework on non-CO^2 greenhouse gases, most prominently methane, as a reduction in methane emissions would contribute to slowing down the rate of warming and improving air quality, among other benefits. We may therefore see increasing pressure for reducing methane emissions.

Lastly, the report is somewhat cautious on the prospects of carbon capture and sequestration/carbon offsets, as these, while promising for offsetting any residual CO^2 emissions, do not replace the need to reduce them. As climate changes, the ability of the ecosystem to sequester carbon gradually declines, which in turn leads to further deterioration in climate. In addition, carbon offsets could have an undesired impact on water and food security.

A Final Word

In light of this report, as investors analyze portfolio companies' pledges to achieve net-zero emissions, they may increase their scrutiny of the methods that these firms will use to achieve these targets. As such, investors are likely to focus on managements' ability to evolve corporate business models (such as the use of more advanced technology or supply-chain enhancements) to manage climate risk more effectively, and ultimately, to have a positive impact on climate change. It would be good news indeed if the next IPCC report reflected that the efforts of companies, governments, and individuals have resulted in measurable progress in addressing the global climate threat.

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Glossary Definitions

Environmental, social, and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors use to screen potential investments.

"Net zero" refers to the global goal of achieving a balance between the greenhouse gases put into the atmosphere and those taken out.

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