NZSUPERFUND
Te Kaitiaki Tāhua Penihana Kaumatua ō Aotearoa

Climate Change Strategy - Q&A

What are the investment risks associated with climate change?

These risks come from multiple, interacting drivers, including the physical effects of climate change and regulatory action designed to address these risks. The impact of climate change is felt variably across different investment sectors, geographies and asset classes.

For example, companies with higher carbon emissions are more at risk of regulatory measures, including carbon pricing. Companies owning fossil fuel reserves may see these assets devalue as policies are brought in to reduce emissions. It is not just the energy sector that is affected, however; climate change risk directly and indirectly influences other sectors through revenues, operations, expenses, supply chains and distribution.

We believe that the current market is not fully pricing in the potentially negative impact of climate change policy on asset valuations. Reducing the Fund's exposure to the assets which most affected will help us manage this risk.

What are the investment opportunities associated with climate change?

Companies that are in the business of climate change solutions stand to benefit – in particular, companies that provide alternatives to fossil fuel-based energy and infrastructure.

Will this lower Fund returns?

No - we believe it will improve the portfolio. By taking out the most exposed companies (in terms of both emissions and reserves) and allocating money to more carbon-efficient companies, we will lower the level of risk in the portfolio.

What if policy makers don't take as much action as you anticipate?

If this happens, there is limited downside risk from this strategy for the Fund, and we will also have been protected in the event of significant policy actions and technological shifts.

We will also be making our portfolio more resilient to the physical impacts of (built in) climate change.

How will you measure your progress?

There is no single measure that captures all of the risks associated with climate change, and there is no single tool to mitigate those risks. There is also uncertainty around the timing and size of potential impacts of climate change risks. As a result, we are implementing a multi-faceted strategy to achieve our goal – making the Fund more resilient to climate change risk. We will report publicly on our activities and progress against all four parts of the strategy.

We will be measuring and reporting the reduction in the Fund's carbon footprint over time with respect to both reserves ("stranded assets") and emissions (Scope 1 and 2). Scope 3 (indirect) emissions are, at this stage, methodologically difficult to measure. Other greenhouse gases will be measured and converted into CO2 equivalent units (which is standard). We will use external advisers to assist in the completion of the carbon footprint across other relevant parts of the portfolio.

Why go down the targeted divestment route?

We have given careful consideration to our options including looking at off-the-shelf low-carbon indices. At the current time we think that building our own low-carbon methodology to target divestment of high risk companies is a better option for us. This way we can adopt an approach that focuses more accurately on carbon risk and we can introduce new measures as these develop over time. It is also a more operationally simple and cost effective option for us, given our current approach to portfolio construction. Developing our methodology is work in progress. We may change our approach in the future as other options become available.

What do you mean by targeted divestment?

We will build carbon measures into our portfolio construction methodology to target reduction in the Fund's exposure to both fossil fuel reserves, and carbon emissions. We will do this by targeting divestment at high risk companies in the equity portfolio, and through tailored reduction of other relevant exposures. This will result in the portfolio being divested from high risk companies based on their exposure to fossil fuel reserves and carbon emissions, and potentially to other carbon risk measures as these develop over time. This process will be developed in-house and customised to the Fund's portfolio. We believe we can materially reduce climate risk from our portfolio through this approach. It gives us flexibility, allowing a thoughtful and customised approach.

Why not divest all fossil fuel companies?

There are a number of reasons. Our focus is on making our portfolio more climate-resilient by reducing its exposure to carbon risk – this doesn't require blanket exclusions but certainly will reduce our exposure to fossil fuels significantly compared to the market. Blanket exclusions rule out the possibility of engaging with firms in the sector that may be able to transition, and may have a role to play in transitioning to a low carbon economy. We believe active ownership has a role to play in reducing carbon risks. Some companies will be part of the solution. We believe we can materially reduce the climate risk from our portfolio through more finely targeted exclusions.

What impact will this have on NZ companies in your portfolio?

The same approach will be applied in New Zealand as elsewhere.

Why haven't you set a specific target for reducing the Fund's carbon footprint?

Climate-risk extends beyond what can be easily measured by available carbon foot printing data, and hence improved resilience does not perfectly align with any given target. There are no perfect measures available and we have further work to do on the measures we will use. We will publicly report and measure on our progress in implementing our strategy from 2017. We may increase our reduction expectations over time if we find them to be easily achievable.

When will you be completing the divestment process?

The divestment and exposure reduction process will be implemented progressively i.e. in a series of steps. We will refine our approach in order to meet our reduction expectations over time.