The Need for Climate Risk Disclosure

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The scientific community has spent decades gathering and interpreting data regarding the nature and condition of Earth's climate. The output of much of this work is that the global climate has changed, and will change, in a manner inconsistent with past experiences. While climate projections, like most scientific prognostications, lack unanimity, it is apparent that the consequences of climate change for investors will be historic and profound.

Given the magnitude of potential upheaval associated with global climate change, corporate managers would be wise to consider its possible effects on their businesses and contemplate their business plans in the context of such risks. Further, as a result of recent guidance issued by the Securities and Exchange Commission (SEC), management is now legally obligated to determine the materiality of any threat posed by climate risk to the enterprise and to disclose that risk to investors. Prudence dictates such analysis; probity requires its disclosure.

Being publicly traded brings with it obligations on the part of corporations to report to shareholders and to the public material information. As the future of global climate has become increasingly unpredictable, the business risk to companies has increased accordingly. Now, the nature of that risk needs to be shared with investors, just as are other risks through the course of public filings. One simple example is that of the expansion of carbon taxes. As such taxes expand across the globe, companies reliant on carbon-based fuels will be at risk, while those that are able to utilize other technologies will have certain advantages.

The purpose of these disclosures is to ensure that the investing public has access to the necessary information for making responsible investment decisions. Clearly, such disclosure requirements can be onerous. However, no company is required to seek investment from the public, and can therefore choose to remain private and not be subjected to the multiple ministerial burdens that accompany access to the public markets.

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While the potential for favorable returns inevitably attracts the attention of investors, events since 2007 have reminded market participants that risks abound and need to be considered. Among other things, the precipitous disruption of global markets over the last few years reminds us that risk is simultaneously dynamic and nebulous. Risk factors are constantly changing, and the greatest risks are those about which one is unaware. For instance, few analysts in 2005 understood and quantified the risks associated with imbedding a small tranche of high-interest, mortgage-backed debt in securitized investments—and fewer still foresaw that such investments might threaten the global economy. Further, few holders of investment-grade mortgage-backed securities were aware they held sub-prime mortgages within those instruments, much less understood the consequences of their potential failure.

Investors must be able to process not only the risks that were realized in the past, but also other risks that might materialize today or in the future. Companies regularly disclose to investors volumes of data about the company, including information related to the corporate balance sheet, revenue projections, executive compensation, ownership, and taxes. This information helps investors evaluate a company in the context of the global market and the investors' own portfolios.

Disclosures related to climate risk will provide investors one more information set with which to make decisions. As investors manage portfolios, prudence will dictate that they understand and manage those risks and opportunities, not only within specific holdings, but across investment portfolios. If information disclosing climate risk is not sufficiently disseminated by corporations or investment management companies, investors will be left to seek out such data independently. Unfortunately, few investors have the capacity for this type of original research, and the quality and accuracy of their data would be suspect. While outsourcing such work might be a viable option, it would be costly. Also, each investor would have access to different types of information that may or may not be consistent. The consequence would be a bifurcation in the marketplace between those with access to climate data and those without, and a reduction in the overall efficiency of the public markets. Practically, it is unlikely that accessible, reliable, and usable information could be organically generated by the investment community under current circumstances. Unfortunately, that does not detract from the utility of the data.

Through public companies' standardized disclosure of data related to climate risk, investors will be able to make more-informed decisions. Not only will those investors be better-positioned to make efficient decisions about specific companies, but they will also be able to monitor climate risk across their portfolios just as they currently do with conventional risk metrics.

While assumptions regarding global climate have historically held fairly constant—it is cold in the Arctic, it is hot in Ethiopia, there is *x* amount of fresh water in the world, and there is *y* amount of annual rainfall in Kansas, etc.—it is becoming increasingly likely that such assumptions will need to be revisited going forward. As those assumptions change, and the extent to which global climate change is realized, investors will require new data with which to calculate the future values of investment opportunities. This constantly evolving data would be invaluable to investors—both asset owners and managers. It would enable them to better fulfill their fiduciary duty by improving their ability to quantify and manage newly identified climate risks as well as properly evaluate and access new investment opportunities. Ultimately, this would result in being better able to manage portfolios, achieve investment objectives, and meet liabilities. Further, as the climate changes and acknowledgement of climate change becomes universal, the whole investment landscape will be altered, as those conventionally assumed constants become variable.

History is littered with the bodies of investors felled by a lack of adequate, usable information. The hazard was clearly evidenced by the effects on market participants by the recent and ongoing recession. Such ignorance, a lack of material information about investment opportunities, presents the greatest possible risk to investors, as well as to corporate managers. Such risk can only can be managed and mitigated by information, and through the disclosure of information. That is the ultimate utility of climate risk disclosure: to provide investors with material, critical information about current and potential investments.

The investing community requires straightforward data to evaluate the potential effects of climate change on their investment portfolios. The source of analogous data has been public companies themselves, and so should be the source of these new, critical data sets now and in the future.

Biography

Bill Atwood has served as Executive Director of the Illinois State Board of Investment (ISBI) since March of 2003. ISBI is responsible for investing assets totaling over $12 billion for the State Employees' Retirement System of Illinois, Judges' Retirement System of Illinois, and General Assembly Retirement System of Illinois. Since joining ISBI, Bill has managed the restructuring of its investment portfolio, established an emerging manager program, initiated the utilization of a general consultant, expanded the portfolio's exposure to alternative investments, increased the Board's shareholder activism, and made improvements to the State of Illinois' Deferred Compensation Plan.

Bill has professional experience in both the public and private sectors, including service on the staff of U.S. Senator Charles Percy and service in the administrations of Governor

Jim Thompson and Governor Jim Edgar, both of Illinois. In 1994 he joined Investment Counselors Incorporated, an institutional money management firm located in St. Louis, Missouri, where Bill served as its Vice President for Business Development. At ICI he was responsible for marketing, client service, and all functions of the firm not directly related to portfolio management. Bill formed Midwest Managed Money Services in 1997 through which he provided consulting services to money management firms working in the public and Taft-Hartley pension plan arenas. He worked closely with equity, fixed income, and real estate investment companies and a variety of institutional plan sponsors.

In addition to his duties at ISBI, Bill has served as a Director of the Chicago Stock Exchange, is a regular speaker at professional symposia, and has completed the Masters of Liberal Arts program at the University of Chicago. He lives in Chicago with his wife, Reagen, daughter Ainsley, and son William.