Only Connect

A Radical Idea to Address Climate Change

Today, there is a US$2-3trn gap in the annual financing needed to meet the aspirations of the Paris Agreement. Greenhouse gas (GHG) emissions continue to rise globally. Harnessing private low-carbon investment and reducing the fiscal burden on governments of paying for the public good of a stable climate is a focus of policy discussions. 'Win-win' investments achieving positive financial and climate outcomes do exist in the absence of public subsidies or regulation. However, as the Stern Review stated in 2006: "Climate change… is the greatest example of market failure ever seen."

Socially Responsible Investing (SRI) has become mainstream. Moreover, there is evidence private investors are willing to sacrifice some financial return in order that their savings contribute to positive environmental and social outcomes. This is especially the case for climate change: understanding that conservatively invested savings will include many investments contributing to GHG emissions means end-investors would like to contribute to solutions. They recognise the benefit of collective action and scale.

This 'willingness to pay' could be scaled up to go beyond current SRI models. These typically exclude 'bad things' or are predicated on achieving the same or better returns as normal investments. It could also extend beyond sensible risk-management strategies to avoid 'stranded asset' investments in fossil fuels.

We propose a simple model to match investors' willingness to pay for climate change mitigation with an understandable desire their savings track mainstream investment returns. Investors could commit a very small percentage, say 0.20%, of the nominal value of portfolios to pay for a special platform supporting credible government and philanthropic programmes, for example for clean-energy R&D or tropical forest conservation. The platform could be called the Global Climate Finance Foundation (GCFF).

Would the public be prepared to pay? We believe there is vast untapped private willingness-to-pay for climate change mitigation. SRI has grown rapidly – assets in the five major markets stood at $30.7trn in April, a 34% increase in two years (according to GSIA). ESG has become a major feature of investment management. Climate-themed financial products, such as 'climate bonds' and low-carbon indices (e.g. MSCI) are being developed, albeit 'climate bonds', unenhanced by public subsidy, generally have the same commercial terms as vanilla bonds and do not lower the cost of capital for climate-friendly investments. Investors increasingly appreciate the value of fossil fuel companies must reflect the risk of a stronger regulatory response. Last but not least, investment fees have been materially lowered in recent years, which should encourage willingness-to-pay from private savers, and there is no reason why the nominal payment need not apply equally to passive funds.

Further evidence of consumer willingness to address global issues is visible in 'impact' investing, a subsegment of the SRI universe ($502bn AUM according to GIIN), aimed at solving social or environmental problems. Around 36% of surveyed impact investors, unencumbered by fiduciary responsibilities, intentionally invest for below-market-rate returns.

There are also examples where the manager unilaterally demonstrates a willingness to pay. Through the UBS Oncology Impact Fund, 20% of performance fees and 1% of royalties on treatments are donated to oncology research and cancer care access.

However, the opportunities for a broad range of savers beyond philanthropic funds to deploy capital on concessional terms are extremely limited. While regulatory frameworks may be starting to insist on ESG governance practices, maximising financial returns remains the fiduciary responsibility. It is hard to target investment for a sub-commercial return while retaining confidence the principal will be recoverable. Many of the most impactful investments need to be in the form of grants that will not generate any return, while investments risking material negative returns are unsuitable for most savers.

Therefore, standard SRI investments necessarily target commercial returns. Yet there is no willingness to pay for public goods from investment vehicles that require commercial returns. They do not lower the cost of capital. Public policy and public funds continue to carry the burden of generating signals in the real economy for low-carbon investment.

This raises questions over how such an annual voluntary payment would affect the different stakeholders. Taking private savers first: they would need an administratively simple way to pay and the GCFF platform would need to replicate the tax benefits of international charities. Public climate finance programmes could commit to match investor donations in some proportion, giving savers the feeling their largesse was leveraging additional public funding. The power of joint action would be obvious to all.

For investment managers, the opportunity for their clients to donate twenty basis points on top of management fees has the advantage of administrative simplicity, with the 0.20% 'voluntary fee' transferred to the GCFF. It would also ensure fees are transparent.

Public actors and philanthropic foundations could work with leading


It could snowball

investment management firms to develop a Plus Climate Impact or GCFF brand. Investment managers could simply offer savers a ‘tick the box’ option alongside their usual investment products – for example, a Global Equities SRI Plus Climate Impact/GCFF product. This would allow investors to know donations were guaranteed to co-fund government-supported investment programmes.

Despite the lack of additional revenue, many managers could participate as part of a CSR strategy if public and philanthropic actors successfully develop the model. With momentum behind a GCFF, there could be a competitive advantage for managers who include this offering. Indeed, there is likely to be a snowball effect and over time many savers could come to expect or demand this option.

Initial feedback has been positive from informal discussions with senior investment managers. Most accepted the case for public enthusiasm and considered the primary hurdle to be a credible GCFF. Investors would need to see a strong governance structure, clear spending priorities and effective vehicles for delivering funds. To be credible, a GCFF would require public leaders with convening power to engage a broad coalition of investment managers and philanthropic foundations to outline a strategy for effective use of funds.

Leading philanthropic foundations active on climate change could play an important role, building on existing programmes. They would direct funding and coordinate with investment managers and governments in developing an institutional structure that connects larger scale government and multilateral funding commitments.

How much might such a voluntary fee raise? An ambitious capital-raising goal could be $10bn pa within five years (twenty basis points on $5trn) – compared to $161trn in total investor assets as of 2016 and $31trn in SRI assets today. Moreover, $10bn pa of non-returnable grant funding to help cover the incremental costs of climate change mitigation could leverage much greater overall financing flows.

Private investor donations could therefore support large-scale climate finance programmes that require non-returnable grant funding in non-commercial areas. These might include avoiding deforestation and restoring forests, or clean-energy R&D.

This is an international initiative. Successful multilateral funding programmes that would benefit from additional resources to bring about transformative change should include Norway, Germany, the UK and the Environmental Defense Fund’s REDD+ programmes. Donations could also help Mission Innovation (a global initiative of 23 countries) to develop a new global clean-energy fund.

At present, private investors have little opportunity to deploy capital on concessionary terms for climate impact. We argue a material percentage of SRI and mainstream investors would be willing to pay a modest donation above management fees to support climate change mitigation and associated co-benefits, while overall returns tracked mainstream investment performance.

Enabling investors to pay such a donation would be relatively simple administratively and has the emotional pull and financial potential to scale rapidly, particularly if governments commit to matching donations.

It would require leadership of senior public figures and philanthropic foundations, in addition to the CIOs of large investment funds. Private investors would need to be convinced they were part of a credible programme offering scope for structural benefits from widespread collective action.

There is strong potential for such an approach to engage a public who currently feel powerless. Solutions are needed. For we are confronted by a climate crisis that is overwhelming the capacities of governments and of mankind to co-operate effectively at a global scale.

Rupert Edwards
Senior Advisor, Forest Trends

This essay is based on a published paper: www.forest-trends.org/wp-content/uploads/2019/05/doc_5752.pdf