Financed Emissions Initiative
Technical Working Group on Greenhouse Gas Risk Management

Project Overview

Background
Despite the scientific consensus that human activity has been the dominant cause of observed warming since the mid-20th century and that continued growth in greenhouse gas (GHG) emissions is likely to cause further changes to the climate system, current trends suggest that, absent significant policy action or market or technological changes, emissions will continue rising. In response, there has been growing attention to the role that the financial sector can play in helping to address the critical issue of climate change.

A growing number of investors and other stakeholders have warned that the financial sector could be exposed to significant risks associated with business and investments in carbon-intensive assets. Research from the International Energy Agency and the Carbon Tracker Initiative has suggested that a significant portion of the world’s fossil fuel reserves will need to remain in the ground (i.e., “unburned”) to reasonably avoid a rise in global average temperatures of more than 2° Celsius—the level required to avoid extreme and irreversible impacts on human and natural systems.

In response, some investors and other stakeholders have expressed concern that if governments take future (and potentially sudden) action to significantly tighten constraints on GHG emissions, it could have a negative impact on the value of investments in carbon-intensive assets and companies, such as those in the fossil fuel industry or those that are heavily reliant on fossil fuels. In an extreme scenario, it could even potentially result in a “stranding” of the value of those assets.

These concerns have led to discussions about whether the financial sector is adequately identifying and integrating considerations of potential risk in its business and investment decisions involving “carbon assets,” which are projects or companies with high direct or indirect exposure to GHG emissions. While concern over risks associated with carbon assets has grown, the industry lacks a comprehensive, generally-accepted framework that financial institutions, investors and other stakeholders can use to help guide their efforts on carbon-asset risk identification, evaluation and management.

Project Overview
To fill this gap, WRI and UNEP-FI are launching a Technical Working Group (TWG), as part of its Financed Emissions Initiative, that will be focused on developing a practical framework to help financial institutions and investors better understand, assess and manage potential risk associated with carbon assets. Through this process, the TWG will also explore the need for WRI and UNEP-FI to develop supplemental guidance to support risk assessment efforts for assets in specific sectors (e.g., oil and gas, coal and electric power, agricultural commodities).
**Proposed Scope of GHG Risk Guidance**

WRI and UNEP-FI propose including the following elements in the framework:

- Discussion of the types of risks (e.g., policy/regulation, social, market and economic risk, etc.) that could impact business performance or decisions or investments;

- Insight on the carbon emissions/intensity of different sectors and discussion of the types of assets most vulnerable to potential risks;

- Insight on how to assess potential risk in capital-raising through various financial products and services, and relative to various types of financial intermediaries and asset owners (the “Capital Stack”);

- Discussion of key market factors and other issues to consider when developing different risk scenarios that could impact the performance of an asset (e.g., investment timeframe, projections on commodity prices and fuel demand/supply, etc.);

- Approaches that could be used by financial institutions and investors to evaluate the potential impact of various risk scenarios (e.g., stress testing);

- Guidance on strategies that financial institutions and investors could pursue to manage potential risk (e.g., appropriate risk pricing, shareholder engagement on equities, promoting risk disclosure in capital markets transactions, etc.).

**Principles Guiding Development of the Guidance**

Throughout this effort, WRI and UNEP-FI will seek to ensure the framework:

- Can be used by a range of financial institutions and investors with different business models, ranging from banks to asset managers and investors;

- Serves financial institutions and investors with a range of risk appetites and perspectives on the probabilities of different risks occurring;

- Can be applied to different types of “carbon assets” across different sectors;

- Enables institutions and investors to consider a wide range of potential scenarios in their risk assessments, and does not endorse or support specific policy outcomes.
**Proposed Timeline**

The TWG will develop the guidance between February and September 2014. In September, the draft guidance will be released for public comment, with the goal of ultimately publishing final guidance in January 2016.