Green | Finance

Banks' Hidden ESG Risks Exposed in Norway Wealth-Fund Review

- Climate risk is lurking in unexpected places, review finds
- Fund is under pressure to do more to brace for global warming

By Lars Erik Taraldsen
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Finance has emerged as one of the sectors around which climate risk is least well understood, according to a review intended to set a new investing mandate for the world's biggest wealth fund.

Norges Bank Investment Management, which oversees $1.4 trillion in assets, should be handed a new mandate to ensure the risks posed by global warming are properly reflected in its portfolio, the government-commissioned report found. The fund should also pursue investment strategies that are in line with the Paris Agreement's goal of achieving net-zero carbon emissions by 2050, it said. But to do that, it needs to identify the biggest climate risks.

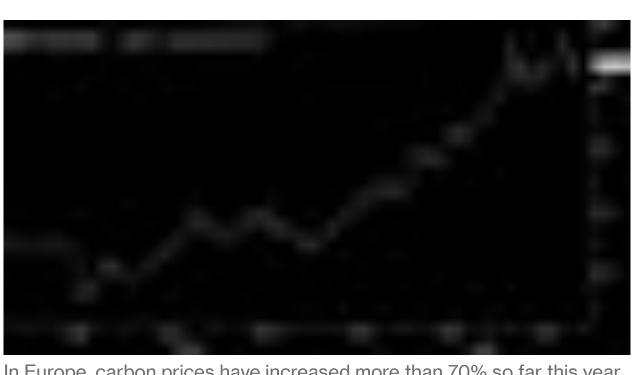
Martin Skancke, the report's lead author, says the fallout of climate change is still poorly understood for industries other than oil.

"It's hard to imagine that the market hasn't already taken all the information on climate risks facing oil companies into account," Skancke said in an interview on Friday. "But in other sectors, it can be hard to assess."

In its report, the expert group that Skancke led singled out the financial industry. It said banks' exposure lies in their loan books, which condense the climate risk represented by multiple sectors. Skancke said there's also reason to believe that markets are mispricing risks facing the real estate sector as receding shore lines and floods make some areas uninhabitable. Then there's the insurance industry, which will face an increasingly unpredictable world of vast claims stemming from ever more devastating weather events. He also said risks remain poorly understood in the transport industry.

"Risk is about the unexpected," Skancke said. "I think one needs to be very careful in assuming that the risks are greatest where they're most obvious."

Carbon Prices Likely to Be a Game Changer



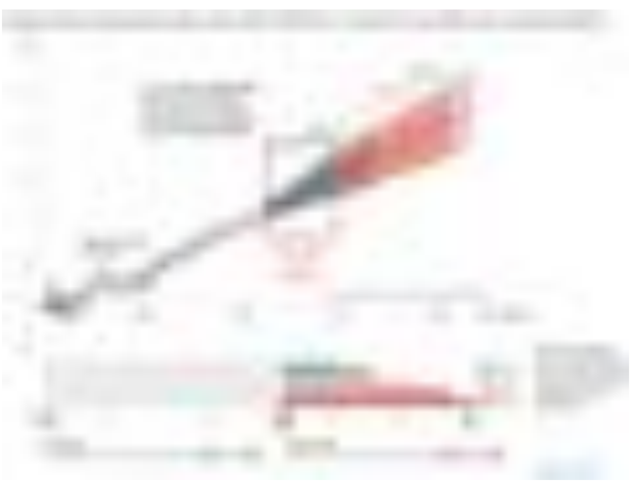
In Europe, carbon prices have increased more than 70% so far this year, reaching 56.6 euros as of Aug. 6, and a continued run-up in carbon costs could raise expenses for aluminum producers. The EU's "Fit for 55" proposal is a long-awaited reform to the EU emissions trading scheme and prices could reach 80 euros by 2028, according to BloombergNEF. Shaheen Contractor of Bloomberg Intelligence.

To lay bare these hidden risks, Norway's wealth fund should start requiring portfolio companies to subject themselves to climate stress tests, the expert group said. What's more, the investor itself should be subjected to climate stress tests, it said.

The fund is also being urged not to treat risk as a sector-wide phenomenon, but as something that's specific to individual companies. Even if the oil industry as a whole represents a big climate risk, "it's conceivable that a given oil company will manage a transition and become a leader in renewable energy," Skancke said.

Norway, western Europe's biggest oil exporter, is under growing pressure to set more ambitious climate goals for its wealth fund amid clear evidence that the planet is overheating at an increasingly dangerous pace. But for now, the principal concern for the wealth fund and other investors remains how best to guard against portfolio losses that stem from global warming. That's as the financial industry at large embraces environmental, social and governance (ESG) strategies.

IPCC Modeled Scenarios



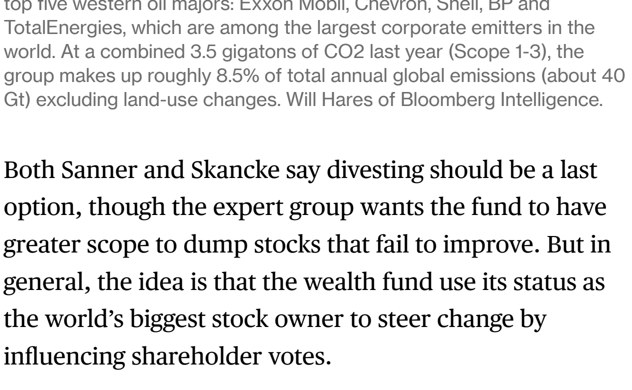
A net-zero emissions scenario by 2050, the most ambitious envisioned by the IPCC, would stabilize average temperatures in the second half of this century at roughly 1.5 degrees above pre-industrial levels, limiting the worst effects of climate change and extreme weather events but requiring a breakneck pace of decarbonizing the global economy. Will Hares of Bloomberg Intelligence.

Jan Tore Sanner, Norway's finance minister, has already indicated he views the expert group's recommendations favorably. Parliament still needs to give its go-ahead for the formal proposal, and a final decision won't be reached until well after September elections, in which the Conservative-led coalition is likely to be replaced by a more left-leaning bloc.

But Sanner says the fund shouldn't stray from its ultimate goal of putting financial returns first. The expert group worked within the wealth fund's current framework, he said, which is "to aim for the highest possible financial returns given an acceptable risk."

Within its existing mandate, Norway's wealth fund has already tried to step up pressure on polluters. Carine Smith Ihenacho, the fund's chief corporate governance officer, says there are "absolutely" portfolio companies that aren't doing enough to reduce their carbon footprint. She points to Exxon Mobil Corp. and Chevron Corp. as examples where investor activism was needed to force management to accept tougher emissions goals.

Oil Major Scope 1-3 Emissions Profile



The findings in the IPCC report will shine an unwelcome spotlight on the top five western oil majors: Exxon Mobil, Chevron, Shell, BP and TotalEnergies, which are among the largest corporate emitters in the world. At a combined 3.5 gigatons of CO2 last year (Scope 1-3), the group makes up roughly 8.5% of total annual global emissions (about 40 Gt) excluding land-use changes. Will Hares of Bloomberg Intelligence.

Both Sanner and Skancke say divesting should be a last option, though the expert group wants the fund to have greater scope to dump stocks that fail to improve. But in general, the idea is that the wealth fund use its status as the world's biggest stock owner to steer change by influencing shareholder votes.

Havard Halland, a former senior economist at the World Bank who started a pressure campaign on sovereign investors to commit to net-zero emissions, said the expert group's recommendations change the landscape for Norway's wealth fund.

"It's really a very positive" outcome, he said. "A goal of net-zero emissions by 2050 and alignment with the Paris Agreement…the expert group's recommendations go a long way."

(Adds comment from report's lead author in sixth and eighth paragraphs)