

Financial markets are again misunderstanding or ignoring risk, and are certainly under-pricing it, both as individual institutions and systemically. The risk is another global financial crisis.

The GFC of 2008 had its roots in sub-prime housing loans in the United States – simply a punt on US house prices continuing to rise - on which financial institutions built a mountain of debt instruments (CDOs, CLOs, credit default swaps, and the like) that were poorly understood, and certainly over-rated, and underpriced.

When sub-prime loans hit the wall, the mountain collapsed, many institutions failed, the whole global financial system was pushed to the brink of collapse, the global economy to a recession, and governments and policy authorities found themselves mostly rudderless, in uncharted waters. They are still struggling with an effective global response.

This time the risk is climate exposed investments, a risk that Hank Paulson, Secretary of the US Treasury at the time of the last GFC, has said dwarfs the risks run at the time of the sub-prime crisis. Governor of the bank of England Mark Carney has now talked openly of potential financial instability. He has driven the Financial Stability Board which he chairs to investigate.

The risk is that either extreme climate events, and/or government responses to the challenge of climate change, and/or technology – more likely a combination of all three- precipitate a collapse of asset values, stranding these assets in the portfolios of the world's major financial institutions. We cannot even estimate the range of financial instruments that might be affected,

I chair the [Asset Owners' Disclosure Project \(AODP\)](#) that surveys, rates and ranks the world's largest asset owners - the top 500 pension and super funds, sovereign wealth funds, insurers, and some foundations and endowment funds, with assets totalling some US\$38 trillion - on their management of climate risk.

The focus of our surveys is threefold – asset owners are assessed on their engagement; on the effectiveness of their measuring, monitoring and managing of climate change risks within their portfolios: and on the extent of any low-carbon investments held.

[The results of our most recent survey](#) suggest that the big investors are beginning to take climate risk seriously. But, overall, the results reveal a significant lack of a sense of urgency and preparedness that is most disturbing.

While it is encouraging that 31 leaders are rated A and above (an increase of 29%); and the most significant increase is a 52% rise in asset owners rated CCC-C, indicating many more are acknowledging and more importantly taking action on managing climate risk in their portfolios; and the D group has shrunk by 18%; still nearly half the index remains X rated, with no evidence that they are taking any action at all.

There were only 12 AAA-rated funds – those considered most successful in managing climate change risk in their portfolios, up from 9 last year. Three Australian superannuation funds were rated AAA, up from two last year. Local Government Super, rated second worldwide, was joined by Australian Super and First State Super (which rose from an “A” rating in 2015), which gives us the biggest number of top-rated asset owners.

Australian funds also perform relatively well in aggregate ranking third only to Sweden and Norway on mean average ratings, but remain a mixed bag. And so they should since we are exposed in a way that few other countries are to the physical and transitional impacts of climate change.

At the bottom end of the scale, IOOF Pension Scheme was the only Australian fund to receive an X rating. Four Australian funds moved from D last year to BBB this year.

While AODP has been attempting to focus debate on climate financial risks for some 6-7 years now, it has been most encouraging to see the Bank of England’s Mark Carney, and the G20’s Financial Stability Board, recently lift the profile of, and emphasise the urgency of, this issue, especially with the establishment of the Bloomberg Task Force on disclosure.

However, our survey results would suggest that few are acting on the warnings they have issued, particularly that climate action could leave fossil fuel investments as worthless stranded assets, and 246 of the top 500 investors with some US\$14.1 trillion in funds are ignoring climate risk completely. Thus many of our longest term investors are taking the same bet on short term markets that they did in 2006.

World's biggest investors risk another more severe global financial crisis

Written by The Conversation USA

Pension and superannuation funds and insurers that ignore climate change risks are gambling with the savings and financial security of hundreds of millions of people around the world and risking another financial crisis.

Apart from any other considerations, the directors and trustees of these institutions are breaching their longer-term fiduciary responsibilities, for example, in pension and superannuation funds, to manage these investments so as to maximize the benefits to their members over their working lives.

To be clear, the risks they running, both individually and collectively, are multiples of the risks that were run in the recent sub-prime based GFC.

Disclosure

John Hewson is chair of the Asset Owners Disclosure Project, and was federal leader of the Liberal Party from 1990 to 1994.

Read more <http://theconversation.com/worlds-biggest-investors-risk-another-more-severe-global-financial-crisis-58721>