

STRANDED ASSETS

Climate Change and Sustainability Division (INE/CCS)
Roundtable Series November 16-17, 2015 Room B-232

Over the last few years the topic of 'stranded assets' created by environment-related risk factors, including physical climate change impacts and societal responses to climate change, has loomed larger and larger. Not only has it sparked off one of the fastest growing social movements in history - the fossil free divestment campaign - it has also prompted reaction from a wide-range of key global actors.

While stranded assets are a regular feature of economic systems and are a phenomenon inherent in the 'creative destruction' of economic growth, some of the causes of asset stranding might be changing. Environment-related factors are increasingly stranding assets across a wide range of sectors and geographies and this trend appears to be accelerating. The factors range from physical climate change, through to new environmental regulations (including climate policy), developments in clean energy technology, resource constraints, evolving social norms, and litigation.

Despite its growing prominence as a topic, there has been little work specifically looking at these issues in Latin America and the Caribbean (LAC). While work on stranded assets in the context of environmental factors has developed rapidly in North America, the European Union, China, and Australia, very little of this work has focused on or been applied to LAC. This is a significant omission, given LAC exposure to environment-related risk factors, the presence of extensive fossil fuel resources that may become 'unburnable' given carbon budget constraints, and the particular challenges and opportunities facing lower income and emerging economies in LAC.

To help formulate a practical and implementable approach to this topic, three independent roundtable discussions are organized on the following topics:

1. Understanding systemic climate risks: implications for the financial sector and lessons for central banks and financial regulators
2. Stranded assets and development: Ensuring low carbon development pathways are resilient to asset stranding
3. Investor exposure to stranded assets: Managing investments and portfolios exposed to environment-related risks

UNDERSTANDING SYSTEMIC CLIMATE RISKS: IMPLICATIONS FOR THE FINANCIAL SECTOR AND LESSONS FOR CENTRAL BANKS AND FINANCIAL REGULATORS

Monday, November 16th 2015, 2-4pm (Meeting room B232)

The extent of global financial exposure to carbon-intensive investments could become a major problem as we transition to a low carbon economy. At present regulators are not monitoring the concentration of these investments in the financial system and have no view on what level would be too high. While exposures to carbon-intensive sectors is certainly large to overall assets and there is significant evidence to suggest that investors face problems pricing environment-related risks because they are novel, non-linear, require interdisciplinary expertise to assess, and lack adequate data, the evidence to suggest that corrections would be disorderly is less clear cut. Though scenarios can be constructed that result in disorderly transitions and previous experience suggests that repricing risk on such a scale is unlikely to be a straightforward adjustment, more analysis is needed in this area. Some of the following questions might be appropriate to consider:

- 1) What is IDB member country exposure to high carbon, extractive and environmentally unsustainable investments?
- 2) How could exposure and relative values, between high carbon and low carbon investments, could change over time and how this might affect different parts of the financial system and the system as a whole?
- 3) If this is indeed akin to a systemic risk in our financial system, what macroprudential and microprudential instruments might be designed and deployed to help to restrain the build-up of risk?
- 4) What is the role of financial regulators and what expertise do they require?
- 5) What might we do to create sustainable, low carbon alternatives for investors with the right risk-reward profiles?
- 6) How could we predict and manage the risks associated with sudden changes in exposures and relative values?

Draft agenda

2:00 – 2:05pm	Welcome remarks Amal-Lee Amin, Chief, Climate Change and Sustainability Division, IDB
2:05 – 2:25pm	Ben Caldecott, Director, Stranded Assets Programme, University of Oxford
2:25 – 2:45pm	Irene Monasterolo, Boston University
2:45 – 3:50pm	Questions and moderated dialogue
3:50 – 4:00pm	Summary and conclusions

STRANDED ASSETS AND DEVELOPMENT: ENSURING LOW CARBON DEVELOPMENT PATHWAYS ARE RESILIENT TO ASSET STRANDING

Tuesday, November 17th 2015, 9-11am (Meeting room B232)

Low-carbon development plans (LCDPs), particularly for developing countries endowed with natural resources, could imply stranded assets in carbon-intensive sectors. In the energy sector stranded assets could occur upstream (e.g. reserves), midstream (e.g. transmission), or downstream (e.g. generation). But other sectors could be affected too, for example forests, transport, the built environment, and agriculture.

The faster the pace of decarbonisation, the greater the chance of stranded assets in different sectors and the larger the likely economic, social, and political consequences that might need to be managed. The mere threat of stranded assets could result in groups potentially affected actively or passively frustrating or destabilizing LCDPs. These groups could include the owners of assets potentially impacted, the businesses operating assets, communities hosting assets, and policy-makers reliant on tax revenues generated from assets. This is an under researched area. To date the majority of stranded assets research has been concentrated on developed countries and their financial markets. The dialogue will attempt to address some of the following issues:

- 1) Which sectors are most likely to be affected by stranded assets under LCDPs?
- 2) Can we create a framework for systematically identifying potential stranded assets and the stakeholders that could be affected for these countries?
- 3) How might stakeholders be affected by stranded assets and what might the impacts be over different time-horizons?
- 4) How could governments ensure that the political and social support for low-carbon development is not undermined by the threat of stranded assets? What issues can be designed out and what requires active management over-time?
- 5) How could LCDPs be optimized in light of analysis to maximize welfare, for example by adapting policies or introducing further ones?
- 6) How could LCDPs minimize potential opposition from affected stakeholders, for example through targeted early support?
- 7) What measures could be developed to support affected stakeholders?

Draft agenda

9:00 – 9:05am	Welcome remarks Tomás Serebriski, INE Sector Economic Principal Advisor, IDB
9:05 – 9:20am	Shelagh Whitley, Research Fellow, Overseas Development Institute
9:20 – 9:35am	Grzegorz Peszko, Lead Economist, Climate Change Group, World Bank
9:35 – 9:50am	Ben Caldecott, Director, Stranded Assets Programme, University of Oxford
9:50 – 10:50am	Questions and moderated dialogue
10:50 – 11:00am	Summary and conclusions

INVESTOR EXPOSURE TO STRANDED ASSETS: MANAGING INVESTMENTS AND PORTFOLIOS EXPOSED TO ENVIRONMENT-RELATED RISKS

Tuesday, November 17th, 2-4 pm (Meeting room B232)

Although a minority of investors are becoming acutely aware of how environment-related risk can strand assets and impact their portfolios, others remain unaware, or even in denial, about such risks. There are several explanations for why investors may be misperceiving the extent to which their assets are exposed: (i) conventions, especially in terms of standard disclosures and wide-spread risk-measurement practices based on Modern Portfolio Theory; (ii) endemic short termism; and (iii) outdated interpretations of fiduciary duty. New products and processes in the management and selection of investments are at the forefront of responses taken to address these issues by individual investment institutions including screening, divestment, hedging, and green indices amongst others. In addition, financial institutions are also taking action through disclosure standards, investment frameworks and joint ventures.

Some of the following questions might arise and be of interest for the discussion:

- 1) What can be done to encourage financial institutions to integrate environment-related risks into investment decision-making and due diligence? What impact would this have?
- 2) Are there issues related to financial norms, conduct, and practice that if addressed could help to improve risk management?
- 3) What voluntary and mandatory schemes might be desirable to ratchet up ambition and promote best practice?
- 4) What is the role of active ownership and what are the changes required to make this more of a reality?
- 5) What is the exposure of the IDB's own loan book and investment portfolio, and are there things the IDB could do to better price environment-related risk into decision-making in order to avoid stranded assets?
- 6) Are there investor coalitions or associations that could help financial institutions improve best practice in IDB borrower member countries?
- 7) Is the lack of low carbon or 'green' alternative investments an issue in terms of diversifying risk in the Latin America and Caribbean regions? What can be done to improve liquidity, for example 'green' bonds?

Draft agenda

2:00 - 2:05pm	Welcome remarks Gema Sacristán, Chief, Financial Markets, IDB (tbc)
2:05 – 2:20pm	Bob Litterman, Chairman of Risk Committee and Founding Partner, Kepos Capital
2:20 – 2:35pm	Christina Copeland, Industrials and Materials, CDP
2:35 – 2:50pm	Ben Caldecott, Director, Stranded Assets Programme, University of Oxford
2:50 – 3:50pm	Questions and moderated dialogue
3:50 – 4:00pm	Summary and conclusions