

KEYNOTE INTERVIEW

Reconciling climate risk and financial performance



*LBP AM chief investment officer **Guillaume Lasserre** dispels the notion that investing in the climate transition will negatively impact performance*

Shrinking financial performance is a persistent fear among some asset managers wary of investing in the climate transition. Guillaume Lasserre, chief investment officer at French asset manager and sustainable finance specialist LBP AM, describes why the opposite is true: investing in the climate transition would preserve financial performance over the long term.

Q Where is conversation at on investing in the climate transition and the risk to financial performance?

The idea that performance must be sacrificed to finance the climate transition is outdated. As the sustainable finance market matures and industries embark

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on their transition journeys, investors may witness some short-term surprises that undercut financial performance. Historically, however, it's hard to pinpoint any clear link between climate transition costs and underperformance when you look at the data. There's no major pattern.

However, the impact of climate change is clear, most recently this summer with heatwaves, wildfires and droughts across Europe. Long term, there will be a huge financial cost to economies and investors not taking any action. A simple, immediate example is

the cost to business of historically low water levels in Germany's Rhine River due to extreme heat. The drought this summer has disrupted shipping and pushed businesses to use other, more expensive ways to transport goods, such as trains and trucks. And as climate impacts become obvious, we're seeing investor focus shift from climate mitigation to climate adaption in response to changing business behaviours.

Q What should investors think about when incorporating climate risk into investment decisions?

The first consideration is transition risk and the possibility that a high-emitting business will not be able to adapt. Any

ability to change depends on future management behaviours and decisions, and those are difficult to evaluate. So, we have developed proprietary indicators that track progress against a company's transition plan: the Transition plan scoring (TPS).

The second headline risk is physical. Where are the business's assets located and how exposed are they to climate events? What impact does that have on a business's viability and financial risk? There are good data providers out there that supply assessments on physical climate risk.

Q How does your risk assessment differ across assets?

By modelling business performance, it's relatively easy to understand the impact of the climate transition on the financial performance of equities. With credit assets, it's much more difficult. We're not there yet with incorporating climate risk into the capacity and solvency of a business. Climate change clearly effects financial performance, but we lack a framework to make a credit assessment that includes scenarios for how different climate impacts could prompt a default.

Q Given current macroeconomic and geopolitical volatility, where do climate issues sit in terms of investor priorities?

These topics are interconnected. Political and economic priorities may change in response to volatility, but climate change is an ongoing phenomenon that will impact financial performance over the long term. We're witnessing a shift toward deglobalisation and a move toward greater sovereign capacity for individual economies. The question then, is whether managing climate risk and decarbonisation is important to each economy. And the answer is, yes.

An example of how this trend has impacted the way we invest is in the use

of macroeconomic indicators. A year ago, we used the price of a barrel of oil as our sole energy indicator. Today, we observe that for economies that have started to transition away from oil toward gas as their major source of energy, measuring electricity prices could be as relevant as the oil price.

For those economies, the price of gas is as important as the oil's one since it is pushing up electricity prices, driving inflation and reshaping our long-term assessment. Due to the energy transition, new, local sensitivities will arise. Oil is no longer the benchmark. We need to review a broader, more complex range of increasingly precise data to make informed investment decisions.

“Demand for increasingly large and detailed datasets, reports and other information is rising”

Q How do you distinguish between companies that are preparing to meet the challenges of the climate transition and those just talking about it?

It's difficult. Even with a regulation like the EU's Corporate Sustainability Reporting Directive, which was intended to standardise sustainability reporting and increase comparability between different companies, in reality, data still varies between businesses.

Ideally, all companies would produce a periodic assessment of their transition plans presented to shareholders, which defines the plan and tracks its execution. In the absence of that, we developed our proprietary transition score that includes a limited

set of relevant data points that we can compare across markets to determine which companies are transitioning and which are not. The score largely reflects what we observe when we conduct an in-depth qualitative assessment of a company.

Q What is the ideal climate transition model comprised of?

One that would allow us to make a relative assessment between companies by incorporating everything from its balance sheet to its debt position, as well as physical climate and transition risk, and climate-related opportunities. Such a model would translate that assessment into price to identify what's over- and underpriced. There are some indicators out there already, such as value-at-risk and its impact on the P&L, but it's still oversimplified.

Q Looking forward, what will drive financial performance in relation to climate-related issues?

Capacity to transition is key, including the emergence of stranded assets. Is the contribution of these assets to current valuations significant? In future, this is likely to drop to zero. What steps can a business take to reduce physical risk, which is well understood by investors, but not fully materialised yet?

To make these assessments, investors require precise information to discern specific impacts on individual businesses, which may be located in the same country and subject to the same regulatory environment and macroeconomic conditions, but operate in places with very different climate-risk profiles.

As a result, demand for increasingly large and detailed datasets, reports and other information is rising. The good news is the evolution of artificial intelligence and large language models means asset managers can ingest high volumes of data to model impacts, which is changing how we approach portfolio management. ■