The Economist

Green Asset Classes are Proliferating

Green financial assets are a small but significant share of the total

If the world is to tackle global warming, vast amounts of money—$3.5trn annually from now until 2050, according to the International Energy Agency, a forecaster—will have to flow into clean-energy research and generation. Capital will have to shift from carbon-intensive industries into clean ones. That means asset managers will have to offer more green investment products, and regulators will have to set standards that enable investors to make green choices.

Much has already been done. In a decade green-tinged assets under management have grown from almost nothing to a small but significant share of the total. In America, where scepticism about climate change is common, climate is the most frequently used "esg" (environmental, social and governance) criterion among asset managers, reckons us sif, an industry group. As of this year, $3trn of the $46.6trn in professionally managed American assets take climate issues into account—more than double the amount in 2016.

The first "green" bonds, which raise funds for environmental projects, were issued by the World Bank in 2008. Just ten years later more than $170bn-worth are issued annually, reckons seb, a bank. That is 2.5% of global bond issuance. Last year the biggest single issuer was Fannie Mae, one of America's mortgage giants, with $27.6bn in securities backed by mortgages on energy-efficient properties.

Definitions still vary. China, for instance, allows green bonds to finance “clean” coal projects; Western rules do not. The money raised has mostly been spent in rich countries; projects in poor ones tend to be too small and perceived as too risky to merit issuance.

But green bonds’ success has inspired other environmentally friendly asset classes. In September Vasakronan, a Swedish property-management firm, issued the first green commercial paper, ie, short-dated debt, for funding the short-term expenses of the firm’s environmentally friendly buildings. The Seychelles recently issued a “blue” bond to fund sustainable fisheries and ocean management. Equity investors can put their money into low-carbon index-trackers.

Investors are not simply motivated by concerns about the planet. Climate change could directly affect firms: rising sea levels could damage a factory making crucial parts, say. Some fear effects on their portfolios from changes to government policies—such as higher carbon taxes, which would hit the share prices of big emitters. Mercer, a consultancy, reckoned in 2015 that average yearly returns from coal firms could fall by 26-138% over ten years. So far, though, the returns of a low-carbon portfolio are similar to those of less green ones.

Some institutional investors are applying green principles across their portfolios. One approach is to exclude polluting firms or assets: Norway’s $1trn sovereign-wealth fund, for instance, stays away from coal. Another is to stay invested in polluters, but to seek to mitigate the harm they do.

Probably the largest group seeking to engage in this way is Climate Action 100+, which comprises institutional investors with $32trn in assets. It is using its muscle to try to get the world’s 100 most-polluting companies, representing two-thirds of global greenhouse-gas emissions between them, to reduce emissions faster and to provide investors with more climate-related information. Most investors mix divestment and engagement. cdpq, Quebec’s C$300bn ($226bn) pension fund, aims to cut carbon emissions per dollar invested by a quarter by 2025.

Regulators are starting to ensure that investors get more of the information they need to make green choices, and that banks are thinking about climate risks. The European Union is planning to mandate that financial advisers tell clients about esg investment options. The Bank of England requires banks and insurers to report on their vulnerability to climate change.

But lack of data remains an issue. Just 21 firms worldwide reported all of their direct emissions in 2016, says the 100% Club, a lobby group. And most rules on disclosure still lack teeth. Although it has grown fast, green finance is still undeveloped. As elsewhere in the fight against climate change, that makes it both a success and unequal to the problem it is trying to solve.

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