Climate-related financial policies have many origins.\(^1\) An October 2019 Citi Global Perspectives and Solutions Report identified two financial risks of climate change: 1) the risk of stranded assets, and 2) the cost of doing nothing. These two risks have been echoed many times over the last several years.

There is a third risk that has yet to garner attention although it is rapidly surfacing as climate policies emerge around the world and in the United States.

Sound investment decisions are based on many factors that are unique to the investor and investment. Importantly, the factors are also unique to the point in time when the decision is faced even though an investment decision often has a market impact for many years. Energy investment decisions made today will impact subsequent energy investment decisions and energy markets for decades.

The Paris Agreement\(^2\) is intended to adjust the flow of capital. Responding to the Paris Agreement, the Financial Stability Board created the Taskforce for Climate-
Related Financial Disclosures to develop voluntary, consistent financial risk disclosures for use by companies to provide climate related risk information to lenders, insurers, investors and other stakeholders. Since that time, several banks announced changes to their lending portfolios, development banks adopted frameworks to screen assets for investment, and corporate credit rating agencies announced plans for how climate-related risks will be assessed.

These actions, especially when viewed alongside the growing trends of state laws and regulations share a common theme – a narrow focus on carbon emissions with a prescription for those investments that are to be deemed suitable. In some instances, the investment prescriptions are intended to drive a policy agenda. The risk lies here.

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country, its economy would be the third largest in the world. Bloomberg Philanthropies also notes that more than 1,000 businesses operating in the United States and representing $25 trillion in market capitalization have voluntarily adopted greenhouse gas emission reduction targets. According to the Center for Strategic and International Studies, 51 carbon pricing initiatives exist today covering 20 percent of global greenhouse gas emissions. Further, more than half of U.S. states have adopted renewable portfolio standards or fuel source goals for their energy utilities. In some instances, the fuel source goals are economy-wide, extending beyond the energy utilities.


5As an example see the Moody’s Investors Service June 28, 2016 Sector In-Depth Environmental Risks Report available at https://www.eenews.net/assets/2016/06/29/document_cw_01.pdf.


7The Energy Modeling Forum 27 work at Stanford University suggests that predicting absolute world energy demands by type carries uncertainty as the scenarios are heavily influenced by technology and policy assumptions. This reflects unpredictability in the pace and breadth of changes in the global energy landscape.

8There are 17 United Nations Sustainable Development Goals: No poverty, zero hunger, good health and well-being, quality education, gender equality, clean water and sanitation, affordable and clean energy,
Just as diversity mitigates risk in a stock portfolio and builds resilient companies, a diversity of paths is key to attaining our world’s environmental objectives. Investment decisions once based on a variety of competing market factors are instead increasingly limited to a prescribed list of acceptable technologies, a narrow time window\(^9\) and the single perceived environmental externality of carbon emissions.

As policies increasingly direct capital investment based on a narrow set of criteria that is informed by today’s technologies, the underlying market ceases to respond to the ever-changing and evolving push-and-pull of competition and diversity of thought, objectives and alternatives.

Dramatic change comes from innovation that is born of competing and diverse ideas. Yet today, purse-strings are held in the hands of prescriptive capital investment policies that are replacing the existing rigorous and multifaceted diverse capital investment decisions.

Systemic financial risk is mitigated when commodity markets are diverse and regulatory frameworks ensure that all eggs are not in a single basket.\(^{10}\) The third

\(^9\)Even with a variety of environmental goals, different approaches and time horizons, the targets tend to focus on the year 2050. The “mid-century” reference stems from the 2014 United Nations Intergovernmental Panel on Climate Change (IPCC) report. The climate science consensus pointed to this timeframe where significant emission reductions were needed to limit global warming to 2 degrees Celsius above pre-industrial levels. These mid-century and end of century dates were then carried into the framework of the Paris Agreement.

financial risk of climate change is the missed innovation stemming from capital policies that over-ride the market and narrowly conform investment.

If energy investments are driven by a predetermined view of what is acceptable, and investments are channeled by regulatory forces, market distortions are inevitable and consumer risk is elevated.

neutrality in development bank financing decisions and the leadership role that the United States Treasury must play in ensuring sound long-term energy investment decisions.