

## PRESS RELEASE

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**Carbon risk being underappreciated by markets: modelling indicates a USD75 increase in carbon prices could cause 20% average fall in global equity prices.**

- New analysis from Van Lanschot Kempenn models the extent to which higher carbon prices could lead to a decline in global equity markets.
- A global carbon price shock of USD75 on polluting companies could cause a 4-20% fall in global equity valuations; ranging from 4% in the case of Scope 1 and 2 emissions, and 20% in case of Scope 1, 2 and 3 emissions<sup>1</sup>.
- The impact of higher carbon prices and the scope of emissions coverage is not yet priced into markets – this could create opportunities for investors allocating to the transition economy.
- Van Lanschot Kempenn estimates that adopting a climate-positive portfolio could add 20% to returns over the next decade.

New analysis by Van Lanschot Kempenn indicates the extent to which higher carbon prices could lead to a decline in global equity markets. Van Lanschot Kempenn has modelled the impact of shock increase in carbon prices globally, implemented through either a carbon tax or emissions trading scheme (ETS), as part of research into how responses to climate change can be integrated into investment analysis to protect and enhance the portfolios of long-term investors.

The research analyses both the impact of different carbon prices on equity markets and also the effect of higher prices across emissions Scopes 1 to 3 on different parts of company value chains<sup>1</sup>. To improve the return/risk profile of the investment portfolio, Van Lanschot Kempenn decided last year to add carbon price as a risk indicator to the investment risk framework for its fiduciary management clients.

### **Impact of USD75 increase in global carbon pricing**

USD75 per tonne of carbon dioxide equivalent (tCO<sub>2</sub>e) is the global average carbon price needed to reduce emissions to a level consistent with the 2°C target set out in the Paris Climate Agreement, according to the IMF<sup>2</sup>. Most countries are currently well below this level and, with

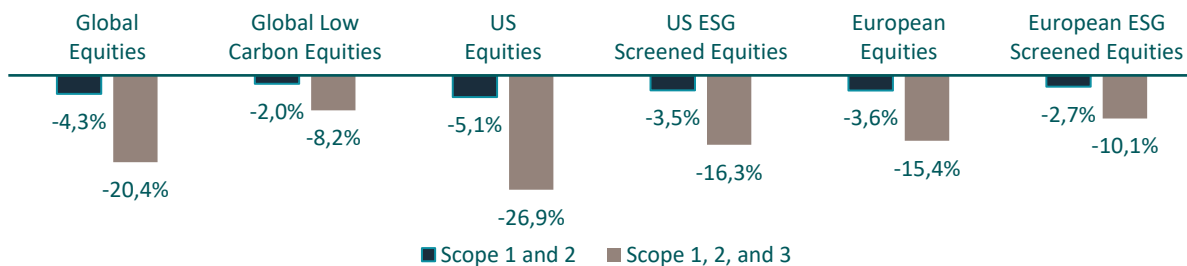
developed countries likely to set higher carbon prices than developing countries, it is expected that a significant rise in carbon prices is needed.

Van Lanschot Kempfen's base-case shock analysis models the impact of a USD75 increase in carbon prices from current levels, implemented through either a carbon tax or emissions trading scheme (ETS), across two scenarios covering emissions Scopes 1-2 and 1-3<sup>3</sup>.

The research suggests a price rise of USD75 per tCO<sub>2</sub>e on polluting companies' Scope 1 and 2 emissions could knock an average of around 4% the value of global equities. If the tax were applied to polluters' scope 1, 2 and 3 emissions the hit to equities could average -20%.

The impact of higher carbon pricing varies significantly across markets and sustainable indices are far better protected from the negative impact than their traditional alternatives. US equities, for example, would be worst affected by a Scope 1-3 tax (-27%) but a sustainable counterpart, such as an index of ESG-screened US equities, would fare much better (-16%) in our model.

### Impact on equity markets of USD75 carbon price rise applied on emissions scopes



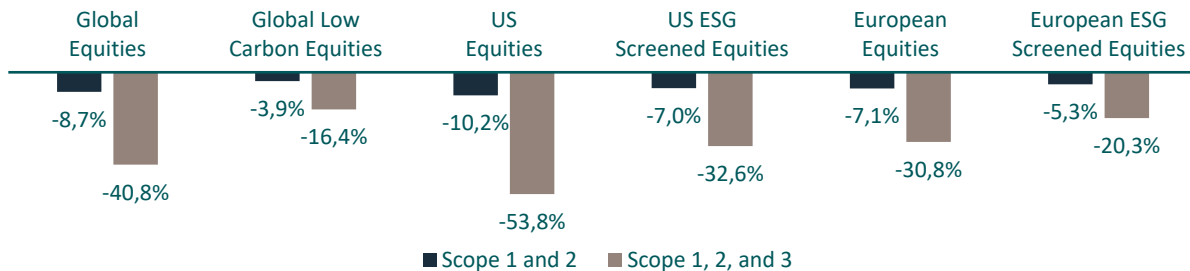
### Impact of USD150 increase in global carbon pricing

Given the accelerating pace of global warming, it is likely that a USD75 rise in the global average carbon price might not be sufficient to meet the Paris targets. Van Lanschot Kempfen's secondary shock analysis of an increase of USD150 per tCO<sub>2</sub>e highlights that with a higher carbon price level, which accelerates beyond the Paris Goals, equity prices fall even more significantly over time.

A price rise of USD150 per tCO<sub>2</sub>e on polluting companies' Scope 1 and 2 emissions could knock an average of 9% off global equities. If the tax were applied to polluters' Scope 1, 2 and 3 emissions, the hit to equities could average -41%. Again, the impact varies by market, but sustainable indices remain far better protected against climate transition shocks.



## Impact on equity markets of USD150 carbon price rise applied on emissions scopes



**Michel Iglesias del Sol, Managing Director, Investment Strategy Advisory, said:** “*Given the risks posed by climate change, the question is when not if global markets will be negatively affected. In the worst-case scenario, we will see returns fall due to our collective failed efforts to combat global warming. In a more positive scenario, avoiding the physical risks of climate change – such as rising temperatures and more extreme weather conditions – bears a transitional cost.*”

*“There is growing evidence that ESG-aware strategies have lower risk and potentially higher returns. An investor such as a DB or DC pension fund with a time horizon longer than ten years is likely to be impacted by climate transitional risks, and investors with longer term horizons are likely to face both transitional and physical risks if low carbon thinking is not built into equity portfolios.”*

### **Adopting a climate-positive portfolio could add 20% to returns over next decade**

Van Lanschot Kempfen’s analysis suggests that the costs and benefits of decarbonization are not yet priced into equity markets, thereby creating opportunities for investors to avoid the worst of the impact from higher carbon prices without damaging returns.

Van Lanschot Kempfen estimates that adopting a climate-positive portfolio could add 20% to returns over the next ten years, even compared to a lower carbon / sustainable equity approaches.

This could be achieved through a combination of reducing the transition risk from existing equity holdings (by reallocating existing equities to lower carbon or climate transition tilted equities) as well as seeking out opportunities to benefit directly from the transition economy, for example by investing in green technologies through new focused allocations across both public and private markets.

Long term asset owners, such as pension schemes, should reposition equity portfolios to make them more robust to deal with changes in carbon pricing and regulation. Schemes need to



reallocate away from standard indices and benchmarks towards more sustainable alternatives, as the research suggests an ESG leader or carbon-light portfolio will be better mitigated against the risks of higher carbon tax.

Thematic strategies—focusing on clean energy, clean water, food supply and farmland are key long-term allocations that should benefit from the climate transition and mitigate physical climate risks, alongside satellite opportunities within infrastructure (listed and unlisted) and impact-focused private equity strategies focusing on disruptive technologies.

**Nikesh Patel, Head of Investment Strategy UK, said:** *“The longer we wait to increase carbon prices, the more severe the regulation will need to be to have the same effect of significantly reducing emissions – and the greater the impact on equity valuations. Investors don’t need to wait to see the extent of any carbon regulation before taking action. Once the debate concludes around carbon taxes and the costs have been priced in, investors can only mitigate against risk rather than identify opportunities.*”

*“In case of climate risk, there is a strong upside potential; for example, if there is a higher carbon tax, that money will need to be spent, for example on green infrastructure or clean energy. New products, services, infrastructures and intellectual properties will have to be created which offer investors a chance for attractive returns.”*

## Ends

### Notes to Editors

<sup>1</sup> [The GHG Protocol Corporate Standard](#) classifies a company’s GHG emissions into three ‘scopes’. Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy. Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

<sup>2</sup> International Monetary Fund, [Putting a Price on Pollution](#), December 2019

<sup>3</sup> Van Lanschot Kempen has modeled this analysis as a change in carbon pricing, not an absolute level; i.e. the USD75 analysis concerns a USD75 increase rather than an absolute price of a USD75. There are globally 64 different pricing mechanisms already in force as at May 2021, so the starting point is different depending on the region. For context, the majority of global economies are currently less than USD30 / t CO<sub>2</sub>e. The Nordics & Switzerland are outliers, with a range from USD60 / t CO<sub>2</sub>e to USD130 / t CO<sub>2</sub>e.

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### **About Van Lanschot Kempen**

Van Lanschot Kempen, a wealth manager operating under the Van Lanschot, Kempen and Evi brand names, is active in Private Banking, Asset Management and Merchant Banking, with the aim of preserving and creating wealth, in a sustainable way, for both its clients and the society of which it is part. Van Lanschot Kempen, listed at Euronext Amsterdam, is the Netherlands' oldest independent financial services company with a history dating back to 1737.

For more information, please visit [vanlanschotkempen.com](http://vanlanschotkempen.com)

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