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THE COST OF *climate change*

CHANGING WEATHER PATTERNS MIGHT NOT INSTANTLY RAISE CONCERNS FOR YOUR BUSINESS, BUT THE COST COULD BE ASTRONOMICAL.

WORDS • **ALEXANDRA CAIN**

No-one can deny that the seasons are changing, but the impact climate change has on business also needs to be acknowledged and factored into the C-suite's decision-making. The Taskforce on Climate-related Financial Disclosures has galvanised debate on how businesses should measure and disclose their risks.

The TCFD is now widely accepted as a leading framework CEOs can use to report the potential positive and negative financial impacts their activities may cause to the environment.

Its emphasis on using scenarios as a way of discussing potential risks is a more sophisticated way of talking about climate change than using quantitative methods only, although these are still important.

While the taskforce is a step in the right direction, according to ratings agency MSCI ESG Research, only 60 per cent of companies report Scope 2 greenhouse gas emissions, which are indirect emissions from the generation of the electricity purchased and consumed by an organisation. So there's still a long way to go.

Executive Director of MSCI ESG Research Michael Salvatico says for those businesses that are yet to disclose climate change risks, the starting point is carbon emissions.

"Companies are paying more attention to their carbon emissions, from both a risk perspective and an opportunity perspective. They are looking for opportunities to reduce emissions or find alternatives such as renewable sources of energy or locating operations in energy-efficient rated buildings," Salvatico says.

"But we're still behind where we need to be to have the best available information as an investor, to understand individual companies' exposures or strategies. That means we have to produce estimates for these companies. We have very sophisticated estimation models, but only if a company releases its reported data accurately and across all of its operations," he adds.

MANAGING RISK EXPOSURE

While emissions are a starting point, investors are no longer using carbon emissions alone to analyse companies' climate risks. "We want to understand how businesses manage their climate risk exposures across their emissions as well as their exposure to fossil fuels, whether that's through ownership of reserves or through other factors like transport, pipelines or distribution. We want to know the exposure to which assets are potentially stranded [rendered »

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uneconomic by regulation or technological change],” Salvatico explains.

The energy efficiency of their buildings and whether the company is exposed to sea level rises or storms are other risks investors want to know about.

California-based Courteney Keatinge, Director, environmental, social and governance research with proxy advisory service Glass Lewis, says CEO support is essential if a business is serious about measuring its climate change risks.

“This is all about company culture and tone at the top. If the CEO takes this seriously, management will too,” she says.

Keatinge says it’s important for CEOs to surround themselves with people who can educate them on climate change measurement and risk analysis.

“A talented chief scientist will be able to explain material risks in plain language. It’s also important for CEOs to stay on top of regulatory trends and reputational issues around climate change,” she adds.

One reason businesses have been slow to embrace climate change risk measurement and disclosure is because it’s so complex and the risks are different for every business. This is why scenario analysis is now an important part of breaking down the information.

“Scenario analysis enables the business to consider multiple views on its climate change risks and allows a diverse range of opinions from across the business as well as external forces coming into the business to be heard and stress tested,” says Peter Holt, General Manager of strategy and policy for carbon management consultancy Energetics.

SETTING THE SCENE

Scenario analysis allows the business to consider and demonstrate the potential range of situations that could affect the business, covering technology, regulation and physical impacts of global warming. Ian Woods, AMP Capital’s Head of ESG and investment research, says this helps businesses deal with the uncertainties replete in climate change disclosures. For instance, no business can have a clear line of sight into how different countries might price and tax carbon emissions in the future.

“That’s the point of scenario analysis. If you demonstrate you’ve covered a spectrum of possible outcomes, it doesn’t really matter if you haven’t covered them all because you can be confident your business is going to be resilient through any of the outcomes you have considered,” Woods explains.

Holt says a multidisciplinary approach is required. “What we’re seeing is collaboration between the risk management, strategy and sustainability functions, along with finance. But one blind spot is the potential impact of climate change on markets. Multinationals need more time to synthesise the information, and that’s what’s happening at the moment.”

It’s essential for CEOs to be closely involved in this process. Michael Chandler, Governance Director of corporate governance consultancy Morrow Sodali, says the CEO needs to be involved in the stakeholder engagement process the company conducts when assessing the materiality of environmental risks and opportunities.

“Where most CEOs go wrong is by looking at how other companies report these risks, which is not a very good strategy. In the first instance, they need to do a thorough assessment of the company’s individual risks, which requires considerable input from shareholders and key stakeholders such as customers, suppliers and environmental groups,” he says.

BOTTOM LINE EXPOSURE

Another area of concern, says Woods, is equity disclosures. “What’s important is to understand equity exposures, not just operational exposures.”

For instance, a business may disclose carbon emissions on a power plant it owns and runs, but it may fail to disclose emissions for an investment it owns in a business that operates a fleet of diesel trucks.

“As a CEO, you really want to know what your bottom line exposure to emissions is from an equity perspective,” he adds.

Ultimately, managing a business’s climate change risk is about good governance.

Says Salvatico: “We want to know what risk management means through the disclosure of metrics around exposures; that companies have targets on those metrics; and that they’re producing performance gains to those targets.

“Investors have moved on. They’re now focused on the resilience of companies in climate risk transition. Investors want to be able to identify where companies are delivering positive impacts from their products and services. That includes issues such as climate change and water management.”

The businesses that do this well will achieve a lower cost of capital and attract funds more easily. Those that don’t will ultimately find it harder to compete and investors will discount their stock. It’s a business case no CEO can ignore. ■