Reporting on climate risks: Are you ready to meet the requirements?

November 2020

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Executive summary

We all need to be thinking about climate risks and opportunities impacting our businesses today and in the future, and the need for a clear climate change narrative.

In summary:

- Climate risk is not just a regulatory issue but a board- level strategic issue. Failure to take appropriate steps now is likely to leave an organisation exposed to material business risks.
- Transformational change across environmental, social and governance (ESG) is being driven by a combination of investor, regulatory, employee, peer, customer and supply chain pressure.
- It will be **mandatory** for all UK listed companies and large asset owners to report on their risk exposure and management, as well as the risk mitigation and resilience strategy, governance and metrics in respect of climate change by 2022 at the latest.
- The UK is hosting and chairing COP26 in Glasgow in November 2021. The UK Government will need to present a coherent plan on how to meet its legally-binding targets for emissions reduction, which in turn will present risks and opportunities for business.
- The potential impacts of climate change on companies will manifest in the short term as well as long term, and so are directly relevant to business decisions taken today.
- Taking the time now to think about climate risks, running appropriate impact scenarios and making the relevant changes to business models and strategies gives companies the opportunity to take advantage of the new technologies and market opportunities these changes present.
- Mark Carney, Special Envoy to the UN on Climate Change and Finance, has warned that "Companies and industries that are not moving towards zero-carbon emissions will be punished by investors and go bankrupt".[1] However, responding to climate risks effectively has the potential to achieve the opposite, resulting in a positive impact on profitability.
- New regulations on financial institutions mean that they will ask for more detailed information on ESG factors before deciding whether to invest in, lend to or insure a corporate. This presents an opportunity for companies to be ahead of their competitors in meeting the new requirements.
- These new regulations could have significant implications for the share value or fundraising ability of listed corporates, private enterprises and infrastructure projects.

1 https://www.theguardian.com/environment/2019/oct/13/firms-ignoring-climate-crisis-bankrupt-mark-carney-bank-england-governor

Introduction

It is time for business leaders to step up, put climate risks at the forefront of their strategy and ensure that they can be proud to tell the next generation how they used their position of power and influence to address the challenges that will be central to all our lives for the future.

The immediate pressures on boards can make it difficult to stop and reflect, but taking the time to think about climate risks, running scenarios and making the relevant changes

to business models and strategies can help us stretch the corporate and political planning horizons, so that we can all respond to the challenge of climate risks effectively.

Putting in place an authentic 'climate change narrative,' which articulates how your strategy and business model is responding to the climate crisis, will help ensure that you can make the necessary changes to respond effectively and remain agile as a company.

KPMG can help you think about the risks and opportunities impacting your organisation, how this feeds into your corporate strategy and ultimately how you communicate this to the market.

Why we need to act now

67%

of the British public care more about the environmental impact of their consumptions than they did five years ago…and 62% said they look to corporate Britain to make sure their consumption is responsible.[6]

Awareness, sentiment and regulatory action related to climate change have accelerated exponentially over the last 24 months. In addition, COP26 (to be held in Glasgow in November 2021) is expected to accelerate change in the way governments think and regulate around climate change.

COP26, originally scheduled to take place in 2020, marks the five year anniversary of the Paris Agreement and countries will be assessed on how they are meeting their global warming mitigation targets agreed in Paris. We expect this to highlight the insufficient progress made to date and the need to ratchet up the targets post COP26.[2] This will cement climate risk's place at the forefront of the wider ESG agenda for the foreseeable future.

In June 2019, the UK government passed a law to end its contribution to global warming by 2050. They are currently joined by 125 other countries and a number of states and cities who have or are considering implementing the same, totalling over half of the world's gross domestic product (GDP).[3] Under the EU Green Deal, the EU has committed to reaching net-zero carbon emissions by 2050.

Achieving these "net-zero" targets will require transformational change across all sectors of the economy. This can be done via a combination of policy and regulation changes, either through incentives (for example, renewable subsidy regimes and industrial grant funding), deterrents (such as more stringent carbon pricing, tightening emissions standards and financial reform to influence investment and lending decisions) or a mixture of both.

Different levers will create different risks and opportunities for business, but all will go to the bottom line.

Adding to this, a swathe of reporting and investment regulation is now, or will soon be, mandatory. This includes:

- The revised EU Non-Financial Reporting Directive, effective from 2018, which requires large entities and groups to disclose information on their development, performance and position and the impact of their activity, including reporting on their climate risk.[4]
- The Sustainable Finance Action plan: The European Commission issued guidelines to provide practical recommendations on reporting the impact of economic activities on the climate and of climate change on businesses. These guidelines aim to strengthen financial stability and asset pricing. Click here for further details.
- The EU Green Deal: In mid-January 2020, the EU unveiled its financial plan for moving to a green economy, in order to make Europe the first climate-neutral continent – with an ambition to get at least €1 trillion of investment over the next 10 years.[5]

2. https://unfccc.int/process-and-meetings/the-paris-agreement/what-is-the-paris-agreement

3. https://eciu.net/netzerotracker and https://sdg.iisd.org/news/one-sixth-of-global-economy-under-net-zero-co2-emissions-target-eciu-analysis-shows/

4. https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en

5. https://www.euronews.com/2020/01/14/eu-commission-to-unveil-green-deal-to-make-europe-the-first-climate-neutral-continent

6. https://home.kpmg/uk/en/home/media/press-releases/2019/07/consumers-look-to-manufacturers-to-make-consump- tion-sustainable.html

What types of risks need to be considered?

Principles for Responsible Investment (PRI) assesses two broad categories of climate risks – physical and transition risks.

1. **Physical risks** are those that arise as a direct result of the changes in weather and climate, for example extreme weather events or declining water reserves.
2. **Transition risks** are those that arise due to changes in legislation, market forces, or technological changes as we move towards a zero-carbon economy.

By undertaking scenario analysis KPMG can help you explore and develop an understanding of how the risks and opportunities of climate change might impact your business over time. By using insights from climate scenarios, market trends and regulation, in the context of your business strategy and market position, we can help you identify and quantify key risks, propose mitigation strategies, and provide a roadmap on how to exploit the opportunities.

Due to the lack of historical data on climate risks and the time span over which the risks will manifest, there is a possibility that the market is underestimating and potentially underpricing climate risks in their financials. But with the increased disclosure requirements and the increasing regulatory considerations for financial institutions this will change.

Changes in climate policies, new technologies and a growing number of extreme weather events will prompt reassessments of the value of virtually every financial asset, as financial models are updated to reflect these risks and opportunities. We can help you get ahead of the curve to mitigate the impact of climate-related risks and improve the resilience of your business.

Core elements of recommended Climate-Related Financial Disclosures

Governance

The organisation's governance around climate- related risks and opportunities.

Strategy

The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning.

Risk management

The processes used by the organisation to identify, assess and manage climate-related risks.

Metrics and targets

The metrics and targets used to assess and manage relevant climate-related risks and opportunities.

Source: TCFD[7]

What needs to be disclosed to the market?

As part of the climate negotiations in Paris in 2015, Mark Carney and Michael Bloomberg announced the creation of the TCFD – the Financial Stability Board Task Force on Climate-related Financial Disclosures – to help investors understand their financial exposure to climate risk and help companies disclose this information in a clear and consistent way.

Enhanced reporting requirements will require UK listed companies to report on their strategy, risks, governance and metrics around climate risk by 2022 at the latest.

The TCFD recommendations will create a step change in the expectations of disclosure to the market and consequently the attention that the disclosures will get from investors and wider stakeholders.

KPMG have created a climate risk reporting timeline, so that you can understand what requirements you need to meet and by when. Click here to take a look.

The implementation of the recommendations will move the focus from reporting on a business model's carbon footprint (a corporate social responsibility issue) to the financial impact of climate risk on the business model (a key risk and financial issue).

Whilst currently voluntary, the UK government has announced that it plans to mandate TCFD-based reporting for all listed companies by 2022; and the PRI is mandating it for all signatories by 2020.

Disclosures will need to be clear, transparent and easily comparable with your peers to meet the expectations of your investors and wider stakeholders. In order to deliver this, companies must act now to ensure they understand the climate risks that could impact the business in both the short and longer term; have a clear approach to minimising them or capitalising on opportunities understand the data that needs to be collated to provide the required disclosures; and can define a clear climate change narrative.

7. https://www.fsb-tcfd.org/

What is a climate change narrative?

Companies must be able to demonstrate how their strategy and business model are evolving as a result of climate change, linked to their purpose and backed up by metrics and targets – investors, lenders and credit rating agencies will be using it to compare companies and make their sustainable investment decisions; it will be a key driver in the ability to

retain and attract top talent; and customers will take notice and potentially change their spending behaviours as a result.

The TCFD acknowledges that the financial impacts of climate- related issues on organisations are not always clear or direct, and that, for many organisations, identifying the issues, assessing potential impacts and ensuring material issues

are reflected in financial filings may be challenging. The main reasons for this are often:

1. Limited knowledge of climate-related issues within organisations.
2. The tendency to focus mainly on near-term risks without paying adequate attention to risks that may arise in the longer term, or the connectivity and velocity of these risks.
3. The difficulty in quantifying the financial effects of climate- related issues.

This is where KPMG can help you.

8. https://www.theguardian.com/business/2019/oct/08/corporations-told-to-draw-up-climate-rules-or-have-them-imposed

Where to start

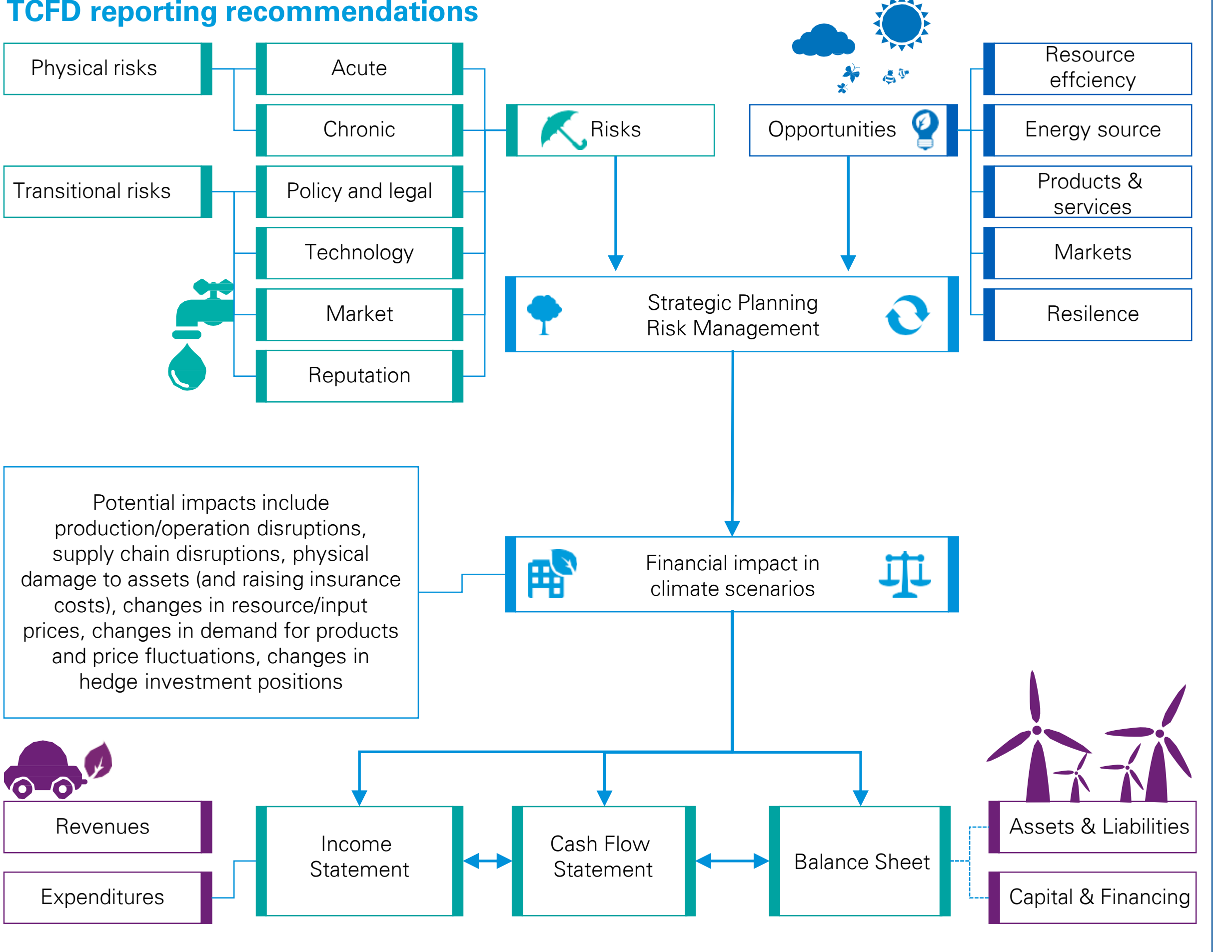
The TCFD recommendations include some useful guidance on the potential risks that need to be considered and how these can impact financial performance.

Climate risks are likely to be prevalent throughout an organisation's value chain and therefore require tailored, granular thinking – as well as a strategic top-down assessment – to identify the risks and determine what can be done about them. It is crucial to think about how these risks will evolve over time, how they are connected with each other, and the speed at which each one can affect the other. The nature of climate change means that the related risks require longer term consideration, but there are both transitional and physical risks that will materialise in the immediate term – companies around the world are already incurring financial losses as a result of climate change.

This is a board-level issue, not something that only the sustainability function needs to think about.

Expert input is needed but it is critical to see this as a core financial and strategic issue, sitting at the heart of the organisation. And an issue where independent external assurance can add to the robustness of the information reported.

TCFD reporting recommendations



Source: TCFD9

9. https://www.fsb-tcfd.org/

So should this change the way companies are run?

Absolutely! Three of the biggest failings of corporate governance and risk management today are:

1. The inherent focus on short term gains over the longer term viability of an organisation.
2. Seeing risk management as a function rather than hardwiring it in to the overall strategy and business model for the organisation.
3. Scenario modelling based on historical data which is not sufficiently refined to support the identification or quantification of unprecedented events.

Taking the time to think about climate risks, running relevant scenarios and making the necessary changes to your business model and strategy has the opportunity to stretch your organisation's planning horizons and ensure you have a resilient future.

Ultimately companies and industries that are not moving towards net zero will face increased funding costs and will be under greater pressure from investors moving towards more sustainable investments.

Only

10%

of Fortune 500 companies from 1955 exist today and the pace of change has been comparatively slow for the majority of the 65 years since.[10] Given the current pace of change companies need to act now to ensure their business model is resilient to respond to climate and other related changes.

10. https://www.aei.org/carpe-diem/only-52-us-companies-have-been-on-the-fortune-500-since-1955-thanks-to-the-creative-destruction-that-fuels-economic-prosperity/

How can KPMG help you?

01

Climate risk assessment:

The first step is identifying the risks and opportunities linked to climate change throughout your value chain. If you have started this assessment, we will challenge your thinking, to help improve your analysis – including the quantification, assessment and prioritisation of the risks.

Our experts can take you through the expected regulatory changes and the risks and opportunities that we would expect for your company by sector and country.

02

Strategic advice and risk management:

Once you have a thorough understanding of the risks and opportunities, we can assist you in building a strategy that supports your longer-term vision for the company, ensuring you have the right climate change narrative to tell by 2022 at the latest.

03

Preparing enhanced disclosures:

We will review your current climate-related disclosures and benchmark you against your peers and the TCFD recommendations, advising you on what shareholders, lenders, insurers, customers and other stakeholders are expecting in terms of metrics, targets and disclosures.

We can help you come up with and implement a robust data and technology solution to enable you to capture and report on key metrics efficiently and effectively with good governance and controls – ultimately helping you prepare the disclosures that best tell your climate change narrative. As ever, quality is more important than quantity.

04

External assurance:

Where you are expected to (for example as a result of investor pressures) or have to (for example due to local regulatory requirements) obtain external assurance over your disclosures, we have a dedicated team who can guide you through this process and provide you with the required assurance opinions.

We will bring together experts from across KPMG to bring you the right experience and tailored advice on your energy transition and decarbonisation strategy, and how to transform in the most effective way for your company.

Conclusion

Climate risk is not just a regulatory issue but a board-level strategic issue – failure to take appropriate steps now is likely to leave an organisation exposed to material business risks. Expert input is needed but it is critical to see this as a core financial and strategic issue, sitting at the heart of the organisation.

No matter where your organisation is on its journey to a sustainable future, understanding how climate risk will impact your business and your climate change narrative will help you ensure that your organisation is ready to meet these challenges, both short and long term.

It is time for us all to step up to address the climate challenges that will be central to our future.

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