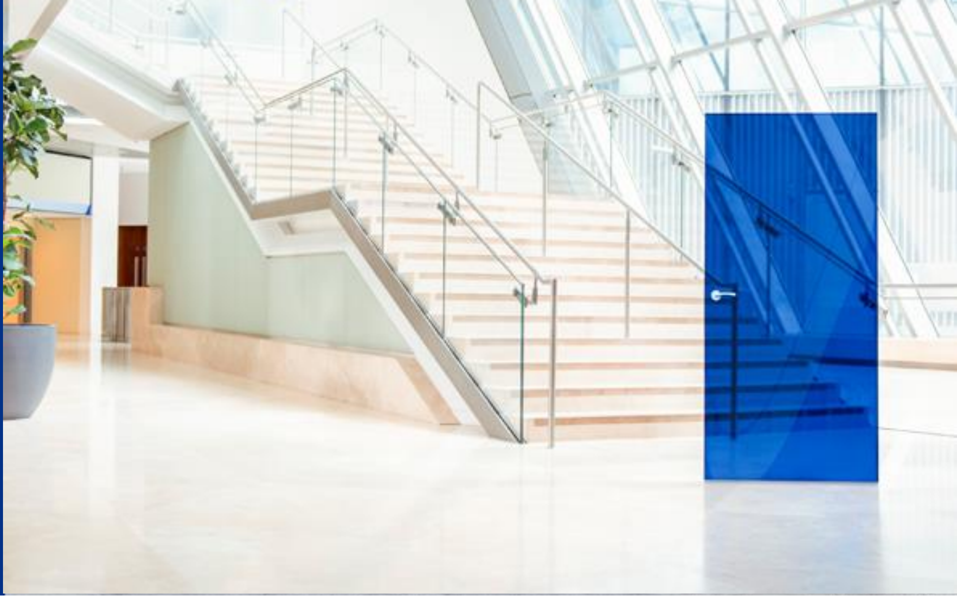

KPMG

Ten business myths about climate change

KPMG Board Leadership Centre

In this paper we set out ten common misconceptions about climate change that prevent businesses from turning climate risk into greater resilience and opportunity.

1. Committing to a Science Based Target (SBT) means my business is insulated from Climate Risk

We often hear from clients that they have pledged to reduce their carbon emissions and therefore climate change does not pose a risk to their business. Whilst committing to an SBT is an indicator of responsible business, it does not protect a business from other impacts of climate change. These risks include both physical impacts (e.g. flooding, storms, drought and wildfire), and transition impacts (e.g. technology-driven market shifts, supply chain disruption and changes in resource costs). A carbon reduction target will likely be part of an appropriate mitigation to your transition risk exposure, but the Taskforce on Climate-related Financial Disclosures (TCFD) recommends companies consider a wide range of physical, market, reputational and legal risks in their approaches to climate risk identification, assessment and management.

2. We have an A in our CDP, so we're on top of climate risk

The Carbon Disclosure Project (CDP) assesses disclosures on climate change and decarbonisation but does not assure the quality of the disclosure or underlying analysis. Plenty of companies who disclose to CDP, even those with 'A' scores, may not be appropriately assessing climate risks and opportunities internally or using the most robust analytical approaches. Stakeholder expectations are also shifting on how climate risk assessments are reflected in the assumptions underpinning company financial disclosures. Here are a few questions you can use to understand the quality and completeness of your climate risk disclosures:

— Has the financial impact of all climate risks and opportunities been quantified in a consistent way under different future scenarios?

— Have climate risks and opportunities been clearly linked to the company strategy, informing an assessment of your organisation's strategic resilience to climate change?

— Are climate related assumptions disclosed and applied consistently across the front half and back half of your annual reporting?

3. Climate risk analysis doesn't provide a return on investment, therefore we are not interested in it

The purpose of climate risk scenario analysis is to assess an organisations' full exposure to the impacts of climate change, including both risks and opportunities over different timescales. Limiting climate change to 1.5 degrees will require deep economic transformation across sectors, whilst failing to limit climate change will result in significant damages from climate impacts globally. Given the scale of the changes expected, early and effective scenario analysis can deliver significant ROI through both revealing opportunities for value creation and mitigating the risk of value destruction.

4. I'm not impacted by climate change because I'm not in the fossil fuel sector

Whilst some companies will be more exposed than others to climate change, climate risk is a systemic risk, meaning it can impact all sectors of the economy. These impacts arise because direct impacts, such as government policies or infrastructure damage, then have indirect consequences across the economy. Globalised operations and supply chains can increase exposure to these indirect, systemic impacts. Given the complexity involved, scenario analysis is the best-practice methodology recommended by the TCFD for companies seeking to understand the risks or opportunities ahead of their TCFD disclosure. We recommend using a quantitative climate risk model, capable of capturing indirect macroeconomic impacts, as the best way to monitor and manage these systemic risks.

5. Climate change is a long-term issue, we must focus on quarterly and annual priorities.

Climate change is happening here and now. Damage and disruption from hurricanes, wildfires and floods cost the world $210 billion in 2020 and these costs have risen every decade since 1970, according to Munich Re.

These impacts are damaging infrastructure and assets and affecting insurance premiums today. Investor sentiment, a key driver for quarterly and annual earnings targets, is also increasingly shifting towards advocating for ambitious action on climate risk.

Recent developments such as BlackRock's communication to CEOs, S&Ps credit downgrade of several oil and gas companies and rapid growth in ESG investment or divestment has highlighted that climate is a near team financial and strategic risk for many companies. This combination of near- and long-term impacts means that your journey towards climate risk management should start now, with an assessment of what the most material climate impacts could be for your organisation. Given the speed of change in market expectations, having board-level governance of climate risk is also key to ensuring the risk assessment process remains live and continues to inform decision making and strategy development.

6. Our company has never been impacted by climate change before, why should I worry about it now?

As global temperatures continue to rise year on year, so does the frequency and intensity of extreme climatic events. From shifts in precipitation patterns and rising storm surges to the expansion of arid and dry land, locations previously deemed as 'safe' are now considered to be at risk from the impacts of climate change. Furthermore, the implications of climate change stretch beyond your company's own operations, posing a threat to each of your suppliers. Many businesses today are proactively responding to these risks by implementing mitigation measures, such as the installation of flood defences, embedding climate risk criteria into their group property strategy and engaging with suppliers with operations in vulnerable regions or markets.

7. Stakeholders love our work on ESG, why do we need a climate risk framework too?

Climate risk is one element of ESG, but the two are not the same. ESG involves measurement and action on reducing your business impacts across a broad set of environmental, social and governance factors. On the other hand, climate risk relates specifically to managing the impact of climate change on your business. This is reflected in the various reporting standards and frameworks; there are several ESG standards available, but the TCFD is the key standard for climate risk. This distinction means that some companies can perform well on broader ESG benchmarks, but climate risk remains a weakness or a vulnerability to their business model or strategy. For this reason, some companies are seen as **responsible** businesses, but not as **resilient**. Stakeholders and shareholders are increasingly understanding this distinction and discerning more closely between ESG and climate risk topics. We recommend fully implementing the recommendations of the TCFD as a complement to a broader ESG strategy, but neither can be substituted for one another.

8. We have insurance in place to protect us from climate change

Insurance policies play a key role in the traditional risk management process to protect businesses against physical damages from extreme weather events. However, with climate risks becoming more prominent, insurance companies are refraining from offering policies in at-risk locations, and where insurance is available, policy prices are rising to unaffordable rates.

'Insurance leakage' is also a growing risk, where providers are reducing coverage and the scope of their policies in order to respond to the changing climate risk profile. Market leaders are recognising these new forms of insurance risk are amplifying over time and are reacting by integrating climate adaptation and resilience into their core strategy.

9. Responding to climate change is too costly and we can't justify the expense

There is a common misconception that in order to respond to climate change a business must invest a significant amount of capital into new infrastructure and technologies. In many scenarios, by framing the issue of climate change strategically, it becomes apparent that reducing emissions, waste and resource use can come hand in hand with reducing your cost base.

Responding to climate risks can also deliver significant avoided costs from reduced physical risk exposure, or increased revenues from capturing market share in growing markets for low carbon or environmental products and services. Assessing and quantifying climate risk and opportunities is the first step towards identifying the most financially material climate impacts for your business. This financial quantification then unlocks an informed conversation on the costs and benefits of responding to climate change.

10. The sustainability function can manage climate risk and incorporate it into CSR reporting

Mitigating climate risks and capturing climate opportunities often requires strategic changes to an organisation. For these changes to be successful, action needs to be managed and driven from the top. This reflects the systemic nature of climate risk, which can impact all product lines, business segments and locations in ways that vary over time and between locations.

Effectively tackling this new risk profile requires climate risk integration into enterprise risk frameworks, strategy development and financial planning processes, moving beyond what can be achieved by a sustainability function alone. To deliver these changes, the TCFD recommends treating climate as a cross-functional issue. At a minimum, we recommend engagement from finance, strategy, risk and sustainability functions in order to understand and act on climate risk effectively.

Contact us

If one or more of the above issues resonates with your business, do get in touch with our team of climate risk experts to discuss how we can help you form a robust approach to climate risk management and strategy.

Bridget Beals
Partner, Co-Head of Climate Risk and Decarbonisation Strategy
T: +44 (0)7464 494545
E: bridget.beals@kpmg.co.uk

Simon Weaver
Partner, Co-Head of Climate Risk and Decarbonisation Strategy
T: +44 (0)7799 606529
E: simon.weaverl@kpmg.co.uk

The KPMG Board Leadership Centre

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