MARSH & McLENNAN COMPANIES | Global Risk Center

CDP
DRIVING SUSTAINABLE ECONOMIES

REPORTING CLIMATE RESILIENCE: THE CHALLENGES AHEAD

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Key Takeaways

- The growing focus on climate resilience is driven by the view that companies that assess and understand climate-related risks and opportunities will be able to make better decisions for their future business.
- Companies in all sectors, including the financial-services industry, are being asked: What are the implications of climate change risks and opportunities for your organization's financial performance?
- The release of the Task Force on Climate-related Financial Disclosures (TCFD) recommendations in June 2017 has accelerated this focus by providing a framework for disclosures on the financial impacts of physical and transition climate-related risks.
- One year from the release, there is accelerating support for the TCFD recommendation from policy makers, invesll skes17.4 (o(t)12.06 (mlN)a)1.6J-ur(c)19d c
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Exhibit 1: Broad acceptance of TCFD recommendations

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Canadian Provincial Securities Regulators C e e a i i g TCFD ec e da i

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Exhibit 2: A paradigm shift to climate resilience

About the TCFD Recommendations

The TCFD was tasked with developing a set of voluntary, financially relevant, climate disclosure recommendations that could promote informed investment, credit, and insurance underwriting decisions on assets exposed to climate related risks.

The recommendations are applicable to organizations across sectors and jurisdictions and are related to the core elements of how organizations operate. They are supplemented by specific recommendations to support organizations in providing climate-related financial disclosures in their public filings.

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Governance and securing leadership support

Adopting the TCFD recommendations requires the support of senior leadership and enhanced governance of climate risk assessments to properly define the impact of climate change on financial performance. Sustainability teams will need to reorient directors and C-suites to take a focus on climate resilience and drive that approach into business units and operations. Many surveys indicate that boards of directors, CEOs, and the C-suites "talk a good talk" on climate change and environmental issues, but may need to expand their horizons in considering climate risks. Mindsets will need to broaden to focus on climate resilience to match the wider scope of climate analysis recommended by the TCFD.

For example, while many companies do discuss environmental issues at the board level, few are turning their awareness into action. Research undertaken by CDP and its sister organization CDSB (the Climate Disclosure Standards Board)

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provides the figures: among 1,681 companies

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3 *Ready or not: Are companies prepared for the TCFD recommendations?* CDP and CDSB 2018

4 National Association of Corporate Directors' *2017 2018 NACD Public Company Governance Survey*

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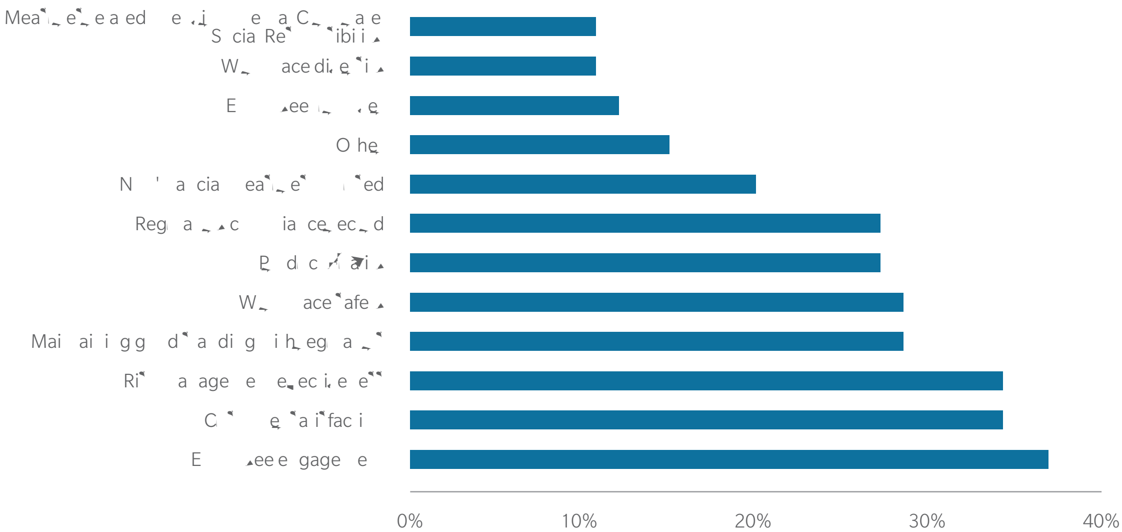
Exhibit 4: What are the key non-financial metrics used by your board to set CEO pay?



Source: National Association of Corporate Directors; 2017-2018 NACD Public Company Governance Survey

Research by the MMC Global Risk Center flagged disconnects between corporate finance modelling / risk management and corporate sustainability departments. (See Exhibit 5.) Their research showed how climate risk assessments can be significantly impacted by a lack of clarity around defining the

Application of scenario analysis

7 The TCFD report *Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-related Risks and Opportunities* (June 2017) offers descriptions of various climate change scenarios

Second, organizations must translate climate-economic scenarios into meaningful financial terms. Most models were developed as economic or academic use cases, not financial ones. Industries within a sector can have distinct sector-level risk factors.

Next, scenario analysis should be integrated into existing risk reporting, again raising the question of processes. For example: is scenario planning for climate change integrated with other corporate scenarios planning? Who should lead this analysis? And what is the language of scenario planning for climate change?

Finally, organizations need to describe how top-down scenario impacts link to future business performance, mapping out direct and quantifiable impacts. Unfortunately, there is often limited empirical data to inform the relationship between macroeconomic scenario impacts and individual corporate financials. The issue is further complicated by the temporal disconnect between financial planning and the long-term time horizons of climate-related scenario impacts beyond the scope of routine business planning. The lack of precision raises concerns for organizations' financial reporting. Uncertainty over whether companies are under- or over-

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Next steps

Companies are focusing increasingly on the impact of the climate change and environmental issues on current and future corporate performance. Business leaders have begun to realize that climate risks and opportunities are not abstract concepts, but instead are essential for creating a business model that delivers long-term value. As one utilities conglomerate said: "The real gain in disclosing climate-related risks is in the identification of new risk areas not typically captured under the lens of traditional risk assessments." Going forward, as regulators and investors continue to increase their interest in climate-related financial disclosures, it will become critical to review their climate reporting processes.

Most organizations are only in the early stages of this, but they are already realizing that adopting the TCFD recommendations will require a shift in existing processes. Firms will have to overcome a variety of challenges, especially within the areas of governance and leadership, risk management processes, and scenario analysis. The TCFD Knowledge Hub, with more than 400 resources for companies to explore, offers a starting place for companies as they combat these challenges on the road to TCFD implementation.

Over the next 12 months, CDP and Marsh & McLennan Companies' Global Risk Center will explore how corporates (such as non-financial institutions) are approaching the TCFD recommendations, and develop insights and guidance to help address the challenges. This will be accomplished by conducting a detailed scan of corporate intent to adopt recommendations, identification of key questions and challenges, and initial lessons from first movers, slow movers, and non-adopters. This research will leverage findings from other TCFD-related initiatives such as the project lead by Oliver Wyman, Mercer, and the UNEP FI with 16 of the world's leading banks to promote consistency and comparability

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ABOUT CDP