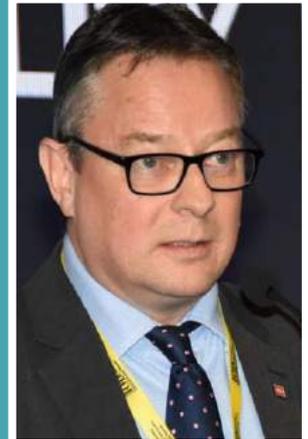


The Key to the New CSR Landscape - Understanding Climate related Financial Risk

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The Covid-19 pandemic has pushed an important topic from our global awareness – that of climate change and climate risk for business and finance.

As India and other countries begin tentative steps out of lockdown, the governance of climate risk must be given a strong role across all forms of recovery plans. The additional shocks presented by climate change have the potential to not only hamper recovery efforts but to wipe them out completely, putting lives and livelihoods at risk for decades to come.

For organisations, creating sustainable long-term value is challenging during these Covid-19 times. They are facing myriad challenges – including economic shock and other geopolitical forces such as the rise of populist policies. But reconfiguring their business models so that they are climate resilient and at the same time ready to make the most of climate-oriented recovery packages will build a healthy and sustainable future. Board level understanding of climate risks is vital if recovery from Covid 19 is to be secured.

These challenges come at a time when climate change is raising sea levels and temperatures. The recent research from the IPCC has shown us, if global action does not limit temperature rise to 1.5 degrees, we will not only see a rising incidence of extreme weather, extreme, and killer, heat and regular flooding that will cause more devastation to more and more livelihoods. But more broadly, there will be a generalised dislocation of all the processes that our economies and markets take for granted today. Value at risk due to climate change is becoming better understood and will radically alter costs of doing business across the board.

The role of the Board and how they view Climate Change

We know that for this reason that the board and leadership team play an important role in addressing and managing the climate-related risks and opportunities. That's why there is a growing imperative and interest in understanding how a board is involved in assessing, managing and overseeing climate-related issues.

To face up to the climate challenges, business and finance have had to radically alter how they view climate change. This means not just looking to their own impacts on the climate, but on the impacts of climate change on their own operations. And the main areas of focus

for ACCA and IOD India members are the recommendations set out by the Taskforce for Climate-related Financial Disclosures (TCFD).

The TCFD state in their recommendations, when “*assessing organisations' financial and operating results, many investors want insight into the governance and risk management context in which such results are achieved.*” Hence, the role of the board is critical if this risk is to be governed effectively.

And we know from our ongoing work talking to regulators, businesses, investors and working with our partners and networks around the world that there is a growing demand for consistent, comparable and decision-useful climate-related disclosures. We are also pleased to know that there is recognition by investors that the overall quality of climate-related disclosures is improving.

Environmental, social and governance (ESG) factors and risks

The increased focus on ESG factors and climate related risks comes in response to demand from asset owners – such as pensions funds, insurance companies, sovereign wealth funds, foundations, and others – for asset managers to take these factors into account when implementing their investment mandates. This is not a trend but is here to stay. ESG funds have experienced tremendous growth in recent years; according to leading investment research firm Morningstar, assets under management in ESG-related funds increased by 60% from \$655bn in 2012 to \$1.05 trillion in 2019. And during the pandemic this has been born out. Businesses with strong ESG credentials have outperformed those that lack this better appreciation and systematisation of multidimensional risk management fit for the 21st century.

This demand for ESG investments reflects several factors. Firstly, with greater societal attention to environmental factors such as climate change, there is greater interest among some investors in investing beyond traditional risk and return considerations. This can be considered a paradigm shift in which investor utility is a function not only of risk and return, but of non-financial considerations, such as the impact of a given company's activities on the local community, or toward achieving specific social or environmental outcomes.

The demand for ESG also reflects push-and pull-factors for investment managers. Push factors include regulation, largely stemming from Europe and parts of Asia, where sustainability has become a specific

policy objective in several jurisdictions. This policy-push is manifested in corporate reporting standards, obligations for investment managers to take sustainability factors into account in the investment process, and to enhance the reporting and disclosure of such practices to clients.

The growing focus among central banks on the financial stability implications of climate change risk, including balance sheet exposure to stranded assets and associated capital adequacy provisioning is driving investors to form a more holistic view of risk.

Pull factors include enablers such as more widely available and better quality ESG data, metrics and analytics, as well as an emerging and broadly-supportive body of academic literature on ESG issues in investment management.

Overcoming the obstacles

However, there are several obstacles to more widespread adoption of ESG investment approaches, including a lack of comparability of ESG data and disclosures across firms, which may reflect the multitude of corporate reporting practices and standards around non-financial information, as well as incomplete, unreliable, or unspecific data prohibiting a consistent appraisal of ESG risks and opportunities. Because of their links to financial risks, TCFD disclosures are a critical part of this new ESG information landscape.

And they are important because they set out a new way to approach corporate reporting on climate risk that responds to the current crises and demands in a new way that dramatically improves existing non-financial reporting. There are a number of differences from reporting frameworks, the main three being as follows:

1. The focus is not on how a company contributes to climate change and the environment but rather on how climate change risks affect that company.
2. Reporting must be incorporated into existing financial reporting – as a minimum in the annual report, but more frequent reporting is recommended.
3. The recommendations are strongly forward-looking, involving scenarios, risk evaluations and stress tests. The purpose of this information is for the financial community to gain insights into how climate-related risks and opportunities will affect the company's future cash flow, assets and liabilities.

The 2 °C scenario

And another key feature is that alongside reporting on a set of criteria that are closely aligned to other reporting frameworks, such as the <IR> Framework, the TCFD recommendations also ask companies to prepare 2 °C scenarios for their business.

This is to report on a scenario in which the world average temperature increases by a 2 °C. Risks to be factored in include direct physical and environmental impacts on a company. For example, rising water levels could flood a factory, or operating facility or wildfires could destroy a food producer's crops. But other risks arise from new laws and taxes.

Opportunities ahead, and good governance

Hopefully this demonstrates the radical changes that we want business to be thinking about. But also, there are opportunities ahead. Consider that new products and services could open up in

new markets that meet shifting customer preferences. More resource-appropriate local agriculture might gain relevance or new ways of offering mobility, for example, electric vehicles or ridesharing, may overtake traditional models.

These disclosures close the knowledge gap and aim to move investors out of carbon intensive businesses and sectors that are exposed to climate risk.

There is a momentum behind TCFD. By June 2019, when the last status report was published, over 800 private and public organisations had announced their support for the TCFD including financial firms responsible for \$118 trillion.

will enable action to flow down through a business and out through its supply and value chains. Covid recovery plans will inevitably be best structured if they are also climate focused. This requires leadership and commitment to help rebuild from the devastating impacts the world and India is facing right now.

We can take on this challenge, we must and I am convinced that we will.

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