



Climate change and your business
Questions Boards should be asking

Climate change poses new, significant and complex challenges

Why businesses cannot just “copy and paste” what is done for other risk types

- Regulators and standard setters worldwide have published several documents, setting out their expectations on climate risk management.
- The frameworks within which these expectations are developed are very similar to those that would apply for other risk types, meaning that businesses should be able to leverage, to some extent, existing governance and risk management architecture.
- However, there are a number of challenges which set climate risk apart from other risks and mean that businesses cannot just “copy and paste” to develop their climate risk management framework.

Data

There is a scarcity of relevant, granular, and forward-looking data. Even though there is an abundance of climate ratings agencies, divergent methodologies across vendors mean that the ratings assigned to each business can vary significantly.

Predicting future risks

Climate risks are highly uncertain and non-linear in their propagation, and can affect multiple risk categories simultaneously. Historical loss experience cannot be used to estimate the risks.

Due diligence

Due diligence in relation to climate risk is required on all (material) counterparties that are transacting with across the value chain. This may need to cover their clients' overall strategic resilience to climate risks, including their physical and financial assets.

Expertise

There is a lack of expertise on, and understanding of, climate risk across many industries at all levels of seniority, as the mix of skills, knowledge and experience required is new and complex.

Time horizon

Climate risks are expected to materialise over a long time horizon. This requires an extension of traditional strategic planning horizons which are typically three to five years.

Proportionality

There is uncertainty about the appropriate governance structures required for different sized firms and the level of detail needed to meet disclosure standards effectively.

Overcoming the challenges on climate risk

Boards should prioritise five themes to provide robust challenge and effective oversight on climate change



Strategy and business model

The business should embed climate change considerations into its strategy and business model, incorporating a clear path towards meeting global targets e.g. net zero emissions. The business must ensure it converts words into action.



Governance and culture

The Board is responsible for setting the “tone from the top” and establishing the strategy, risk culture, risk appetite and internal control framework on climate risk, ensuring allocation of responsibilities across the three lines of defence.



Risk management

The Board is responsible for setting the business’s risk appetite, but first must be confident in the firm’s risk identification and the risk metrics being used. In the decisions it takes, the Board needs to understand the uncertainties in the firm’s climate risk data.



Scenario analysis

The business must develop a fully integrated approach to scenario analysis. The Board must ensure that the business’s scenario analysis supports its strategy and its ability to meet climate-related targets.



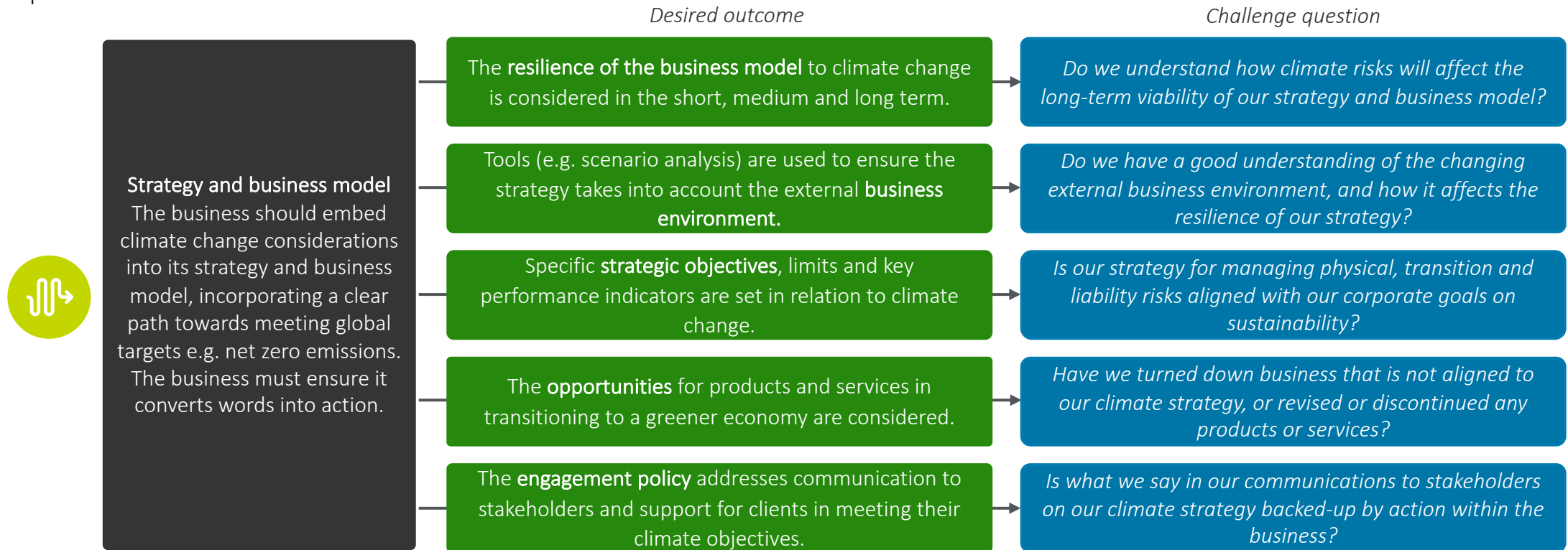
Liability risk

The Board should ensure that liability risks in relation to disclosures and its conduct are managed effectively.

Strategy and business model

To ensure long-term resilience, the business must address climate risk as well as opportunity within its business strategy

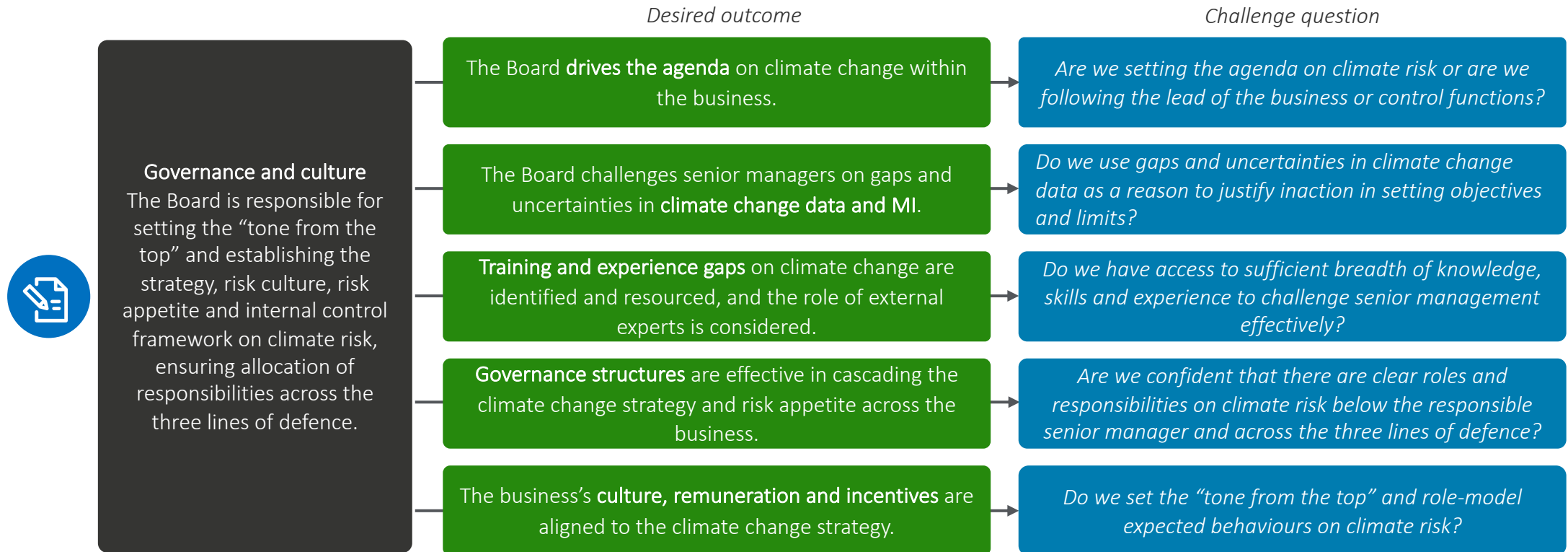
- The business should embed its climate change considerations and the commitments that it makes into its business strategy. This is an essential step to ensure that the decisions the Board takes about how to respond to climate risk cascade through to the business activities that the business undertakes and to how risk is managed.
- Moreover, if stakeholders perceive that the stated ambitions of the business are not reflected in its actions, the business will be exposed to reputational risk.
- In setting its strategy, the Board needs to consider whether it wants the business to be a “first mover”, for example, on market disclosures, or the development of new products and services.



Governance and culture

The business's governance structure and culture must support climate risk management and be effective in cascading the climate risk strategy and risk appetite throughout the firm

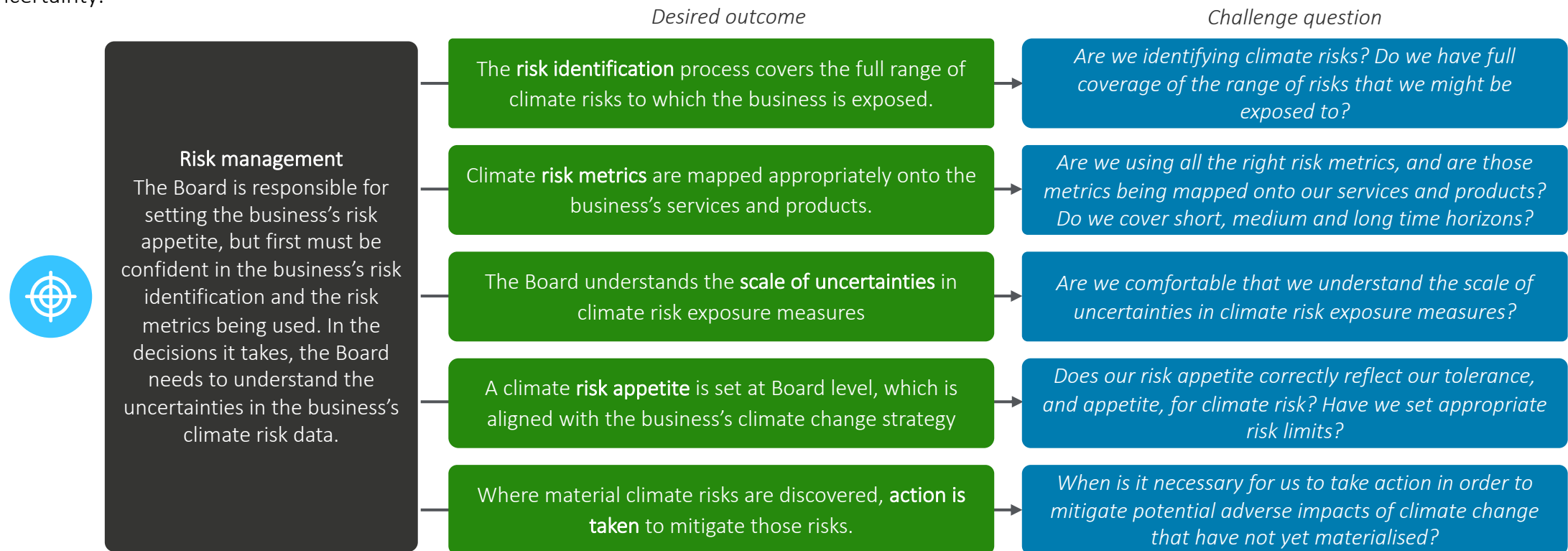
- There should be tangible evidence that climate risks are assessed, monitored and reported at all appropriate levels and that climate-related information is influencing decisions.
- Business must develop a roadmap for addressing the identified risks and opportunities.
- Governance structures and risk management must be resourced adequately.



Risk management

Climate risk must be fully integrated into the business's risk management framework, from setting risk appetite, through risk identification, to risk mitigation

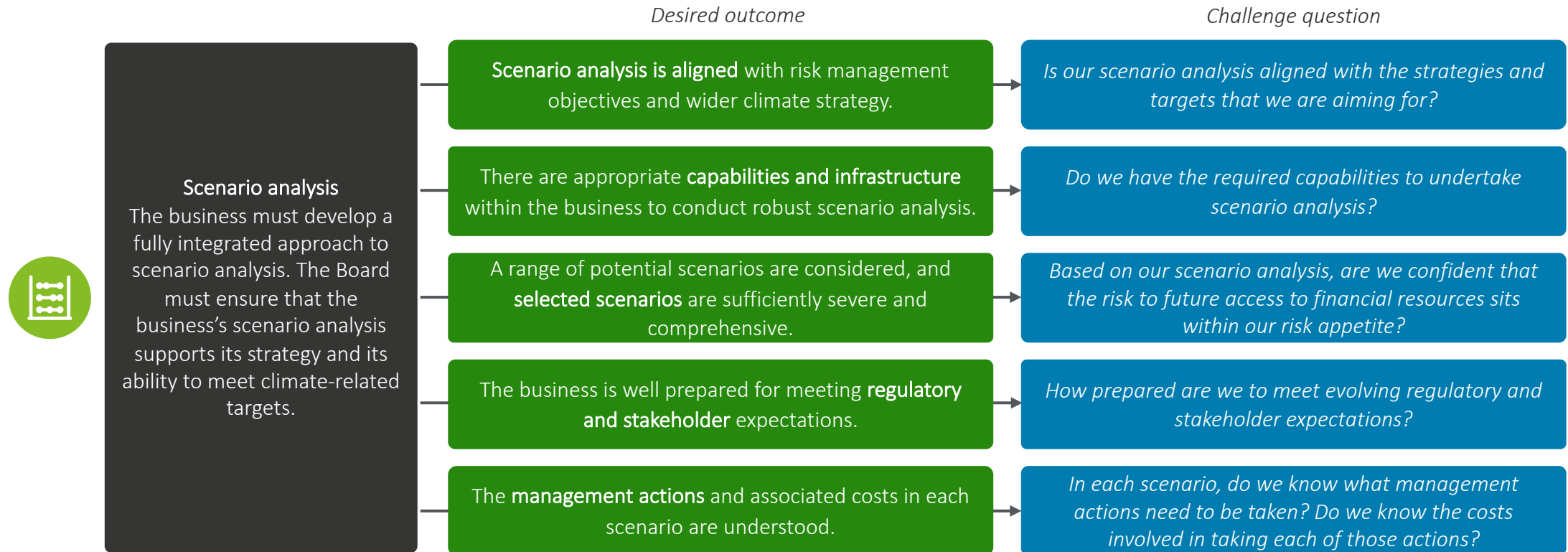
- Risk management will take time to achieve, in particular as data availability and risk-modelling techniques evolve.
- However, supervisors and stakeholders expect to see businesses investing sufficient effort in developing their risk management capabilities, with a clear plan for investment to develop their capabilities further.
- A key task for the Board is to ensure that it is aware of uncertainties in climate risk data, and confident that the business has a plan for managing those areas of uncertainty.



Scenario analysis

Scenario analysis is an important tool for understanding the scale of exposures to climate risk, and for strategic planning

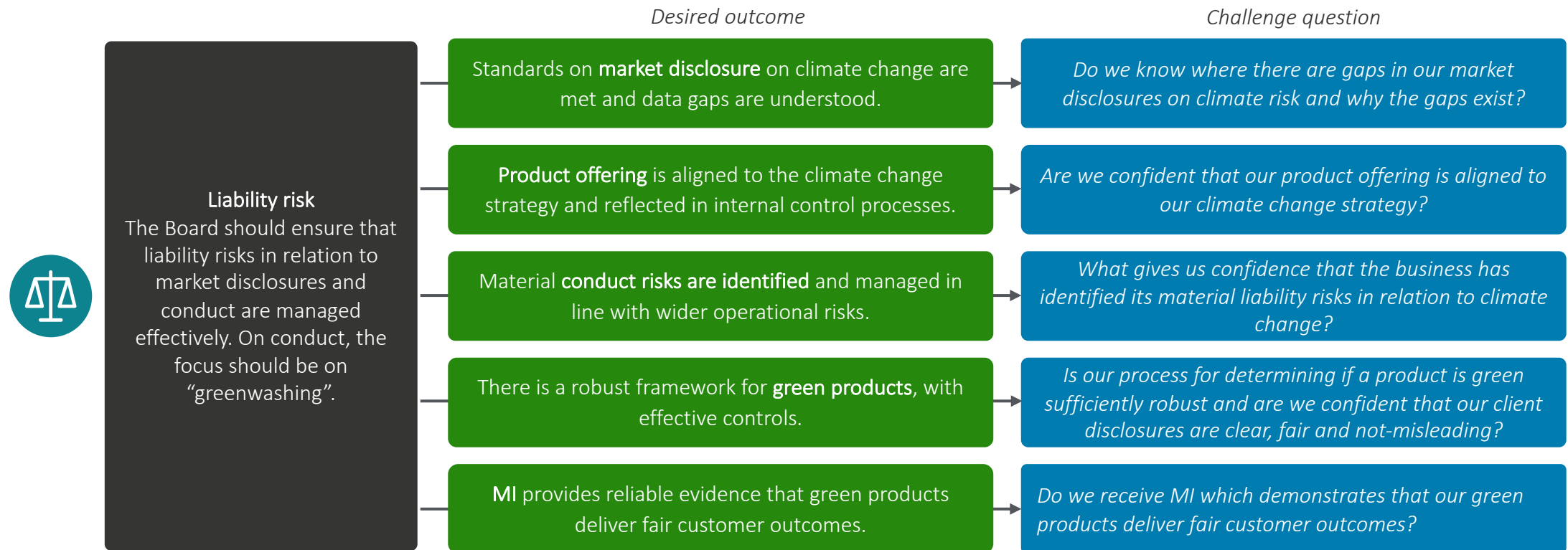
- The Board should be confident that the business has the required capabilities and infrastructure to undertake rigorous scenario analysis, and that the scenarios being used are sufficiently severe and comprehensive.
- The Board should challenge senior managers on whether they are confident that, under each of the scenarios used, the business will have sufficient access to financial resources.



Liability risk

Climate change raises a number of liability risks for business, with market data and “greenwashing” of particular concern

- It is key that businesses provide the market with sufficient reliable information about their material exposures to climate change in line with regulatory and stakeholder expectations and consider their alignment to the TCFD guidelines which are establishing themselves as the prevailing standards.
- Action to channel funding to sustainable investments provides a business with opportunities to capture new markets and revenues. However, the business must guard against “greenwashing”.





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