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Climate change and your business
Questions Boards should be asking

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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.

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.

Desired outcome	*Challenge question*
The **resilience of the business model** to climate change is considered in the short, medium and long term.	*Do we understand how climate risks will affect the long-term viability of our strategy and business model?*
Tools (e.g. scenario analysis) are used to ensure the strategy takes into account the external **business environment.**	*Do we have a good understanding of the changing external business environment, and how it affects the resilience of our strategy?*
Specific **strategic objectives**, limits and key performance indicators are set in relation to climate change.	*Is our strategy for managing physical, transition and liability risks aligned with our corporate goals on sustainability?*
The **opportunities** for products and services in transitioning to a greener economy are considered.	*Have we turned down business that is not aligned to our climate strategy, or revised or discontinued any products or services?*
The **engagement policy** addresses communication to stakeholders and support for clients in meeting their climate objectives.	*Is what we say in our communications to stakeholders on our climate strategy backed-up by action within the business?*

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.

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.

Desired outcome	*Challenge question*
The Board **drives the agenda** on climate change within the business.	*Are we setting the agenda on climate risk or are we following the lead of the business or control functions?*
The Board challenges senior managers on gaps and uncertainties in **climate change data and MI**.	*Do we use gaps and uncertainties in climate change data as a reason to justify inaction in setting objectives and limits?*
Training and experience gaps on climate change are identified and resourced, and the role of external experts is considered.	*Do we have access to sufficient breadth of knowledge, skills and experience to challenge senior management effectively?*
Governance structures are effective in cascading the climate change strategy and risk appetite across the business.	*Are we confident that there are clear roles and responsibilities on climate risk below the responsible senior manager and across the three lines of defence?*
The business's **culture, remuneration and incentives** are aligned to the climate change strategy.	*Do we set the "tone from the top" and role-model expected behaviours on climate risk?*

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.

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

Desired outcome	*Challenge question*
The **risk identification** process covers the full range of climate risks to which the business is exposed.	*Are we identifying climate risks? Do we have full coverage of the range of risks that we might be exposed to?*
Climate **risk metrics** are mapped appropriately onto the business's services and products.	*Are we using all the right risk metrics, and are those metrics being mapped onto our services and products? Do we cover short, medium and long time horizons?*
The Board understands the **scale of uncertainties** in climate risk exposure measures	*Are we comfortable that we understand the scale of uncertainties in climate risk exposure measures?*
A climate **risk appetite** is set at Board level, which is aligned with the business's climate change strategy	*Does our risk appetite correctly reflect our tolerance, and appetite, for climate risk? Have we set appropriate risk limits?*
Where material climate risks are discovered, **action is taken** to mitigate those risks.	*When is it necessary for us to take action in order to mitigate potential adverse impacts of climate change that have not yet materialised?*

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.

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.

Desired outcome	*Challenge question*
Scenario analysis is aligned with risk management objectives and wider climate strategy.	*Is our scenario analysis aligned with the strategies and targets that we are aiming for?*
There are appropriate **capabilities and infrastructure** within the business to conduct robust scenario analysis.	*Do we have the required capabilities to undertake scenario analysis?*
A range of potential scenarios are considered, and **selected scenarios** are sufficiently severe and comprehensive.	*Based on our scenario analysis, are we confident that the risk to future access to financial resources sits within our risk appetite?*
The business is well prepared for meeting **regulatory and stakeholder** expectations.	*How prepared are we to meet evolving regulatory and stakeholder expectations?*
The **management actions** and associated costs in each scenario are understood.	*In each scenario, do we know what management actions need to be taken? Do we know the costs involved in taking each of those actions?*

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".

Liability risk
The Board should ensure that liability risks in relation to market disclosures and conduct are managed effectively. On conduct, the focus should be on "greenwashing".

Desired outcome	*Challenge question*
Standards on **market disclosure** on climate change are met and data gaps are understood.	*Do we know where there are gaps in our market disclosures on climate risk and why the gaps exist?*
Product offering is aligned to the climate change strategy and reflected in internal control processes.	*Are we confident that our product offering is aligned to our climate change strategy?*
Material **conduct risks are identified** and managed in line with wider operational risks.	*What gives us confidence that the business has identified its material liability risks in relation to climate change?*
There is a robust framework for **green products**, with effective controls.	*Is our process for determining if a product is green sufficiently robust and are we confident that our client disclosures are clear, fair and not-misleading?*
MI provides reliable evidence that green products deliver fair customer outcomes.	*Do we receive MI which demonstrates that our green products deliver fair customer outcomes?*