GARP
SCR | Sustainability and Climate Risk

THE CLIMATE IMPERATIVE: OPPORTUNITIES FOR RISK MANAGERS

THE 2020 SUSTAINABILITY AND CLIMATE RISK MANAGEMENT REPORT

THE CLIMATE IMPERATIVE: OPPORTUNITIES FOR RISK MANAGERS

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INTRODUCTION

To see the effects of climate change, one need not look far ahead. Climate change is already here. Sustainability and climate risk (SCR) are triggering transitions in the global economy. In response, corporations, financial services firms, and governments are taking action to reduce the effects of climate change. In 2019, the Global Association of Risk Professionals (GARP) conducted a study on SCR. The study results show organizations generally agree that more action is needed, though nearly half are uncertain about what steps to take. Most respondents, however, see managing climate risk — and acquiring SCR knowledge — as important.

An increase in frequency and severity of natural disasters imposes tragic consequences on the planet in terms of both lives and money.[1] Such events are especially hard on banks that issue commercial and personal loans, insurance and reinsurance companies, and manufacturers and distributors in supply chains. For example, three types of events wreak havoc on businesses and communities every year:

Windstorms. Hurricanes, tornadoes, and severe thunderstorms annually kill thousands and cause billions of dollars in business interruption and property damage. The hurricane trio of Harvey, Irma, and Maria made 2017 the worst year on record for insured catastrophe losses.

Wildfires, drought, and heat waves. Next to storms, no other set of related natural disasters causes more insured losses annually than wildfires, drought, and heat waves. Deadly wildfires in the western United States and Australia in 2019 drew global attention.

Floods. Globally, floods are the most frequently occurring, and deadliest, natural catastrophe. Annually, they cause more than $40 billion in damage.[2]

THE TRANSITION TO A LOWER-CARBON ECONOMY CREATES RISKS TOO

And then there is the environmental impact of climate change. How grim is the forecast? It includes:

- Species extinctions
- Loss of life in natural disasters
- Migration of populations
- Diminished crop yields
- Scarcity of fresh water

Other risks of climate change include geopolitical tensions and slower economic growth.

Public attitudes around the world favor sustainability and attending to climate risk. This growing consensus is prompting mandated disclosure of climate change policies. In addition, more organizations are committing to meet certain goals, such as carbon-neutral footprints and reduction of CO_2 emissions. Some are going further, divesting activities with negative environmental impacts. If SCR is not influencing decisions today, it soon will be.

The transition to a lower-carbon economy creates risks too. SCR issues are already causing changes in regulations, supplier contracts, and expectations from customers and investors. Knowledge is key to navigating the transition. With SCR knowledge, individuals, business leaders, and government officials can make better informed decisions on how to respond to climate change.

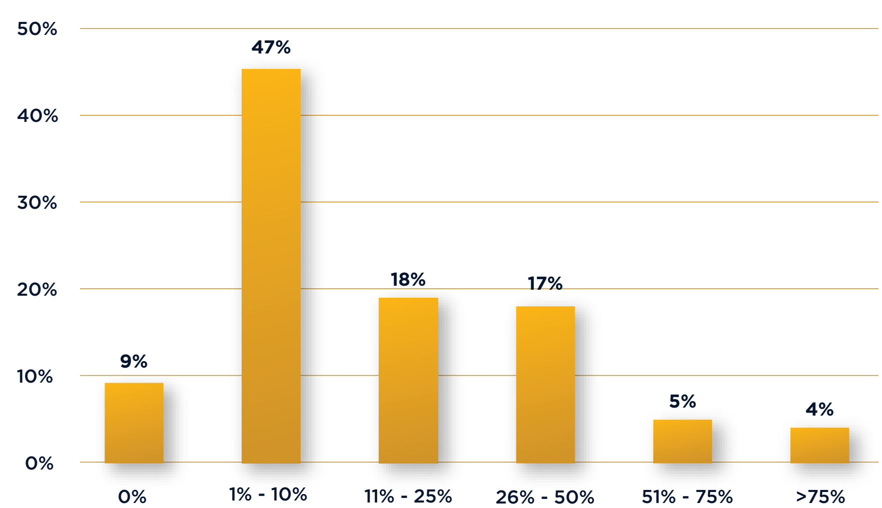
SCR ISSUES BECOMING A PRIORITY ACROSS INDUSTRIES

MORE THAN
8 IN 10
RESPONDENTS EXPECT THEIR ORGANIZATION'S FOCUS ON SCR ISSUES TO INCREASE IN THE NEXT TWO TO FIVE YEARS.

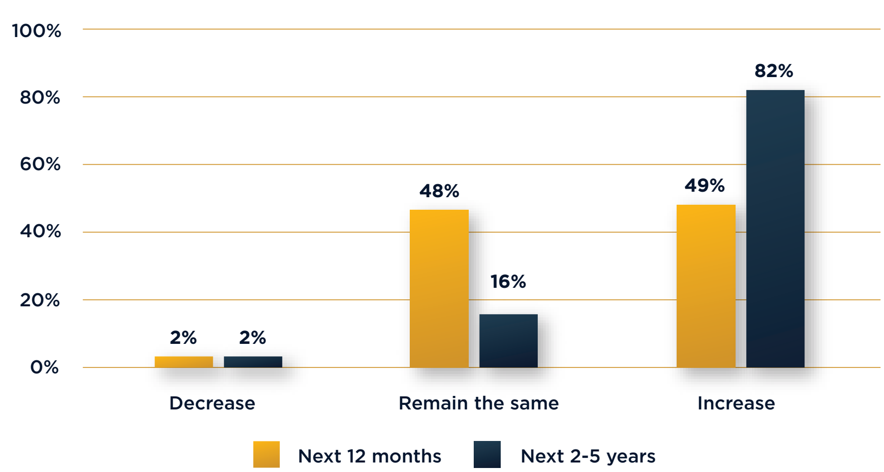
GARP's study surveyed a broad sample of organizations and risk professionals.[3] Respondents represented 99 countries and included banks, consulting firms, asset management companies, energy or power companies, academic or research organizations, and other industries.

The study found that even with risk professionals spending relatively little time on sustainability and climate risk now, SCR issues will be a long-term strategic focus for their firms. In fact, more than 8 in 10 respondents expect their organization's focus on SCR issues to increase in the next two to five years.

PERCENTAGE OF TIME SPENT IN SCR



EXPECTED CHANGE IN ORGANIZATIONS' FOCUS ON SCR



GARP's study asked respondents to rate 53 topics relating to SCR on importance to their organizations and risk professionals' individual need to acquire knowledge. The study found similar ratings on some topics, and a need by individual risk professionals to gain advanced knowledge on others.

Respondents said they need or want to acquire basic knowledge in different SCR areas. Areas in which respondents said it was highly important to acquire knowledge were:

- Approaches to managing financial risks from climate change and integration into existing risk management practice, 86%
- Scenario-based climate risk assessment and methodologies, 86%
- Stranded asset risk due to new regulations, change in demand, or legal action, 85%
- Credit risk assessment and credit risk impact of climate change, 84%
  - Financial impact of climate change, 83%
  - Innovative finance for sustainability and climate change, 83%
- ESG risks and opportunities, 81%
- Factors in implementing sustainability strategies, 81%

86%

OF RESPONDENTS SAID THEY WANT A BASIC KNOWLEDGE OF SCENARIO-BASED CLIMATE RISK ASSESSMENT AND METHODOLIGIES.

Based on the study, risk professionals said the biggest need areas for advanced knowledge are:

- Financial impact of climate change, 60%
- Approaches to managing financial risks from climate change and integration into existing risk management practice, 56%
- Credit risk assessment and credit risk impact of climate change, 52%
- Scenario-based climate risk assessment and methodologies, 50%
- Renewable energy finance: financial instruments and mechanisms to fund renewable energy projects, 47%

Trends that may fuel a risk professional's need for advanced knowledge of SCR topics include:

Environmental damage. For the first time, environmental risks have dominated the World Economic Forum's Global Risks Report.[4] Appearing on the WEF's list of risks with the greatest likelihood and greatest impact in the next 10 years are:

- Climate action failure
- Extreme weather
- Biodiversity loss
- Natural disasters
- Human-made environmental disasters

Regulatory actions. Particularly outside the United States, regulators are requiring disclosure of climate change policies. The Taskforce on Climate-Related Financial Disclosures (TCFD) is a voluntary framework that companies widely use for reporting the financial effects of climate change. For example, a February 2020 U.K. Department of Work and Pensions proposal would require pension funds to disclose their climate change strategies under the TCFD.[5]

Credit ratings. Credit rating agencies, including Moody's and S&P Global, are including SCR criteria and looking at companies' exposure to climate change-related financial risks.[6]

Litigation. Activist investors and non-governmental organizations have filed lawsuits in more than two dozen countries, challenging policies or seeking to hold greenhouse-gas emitters accountable.[7] Defendants include global energy companies and governments.

Reputation. Expectations are shifting for public and private organizations, as customers and investors focus on corporate reputation. A growing part of reputation is environmental, social, and governance responsibility. One example: A global industrial company in Europe had to respond to public outcries and negative headlines over a contract to supply rail signaling equipment outside a controversial coal mine in Australia. The company's governance was questioned when the public learned its European management board was unaware of the contract at a time when bushfires ravaged Australia and prompted environmental protests.[8]

Organizations are taking various actions, from enhancing disclosure of SCR strategies to divesting operations that contribute to carbon dioxide emissions. An example: Insurance companies are no longer insuring fossil fuel exploration and extraction. As more corporations commit to becoming carbon-neutral, some are exploring ways to go carbon-negative — removing more carbon dioxide from the atmosphere than their operations contribute. The transition to a lower-carbon global economy is just starting.

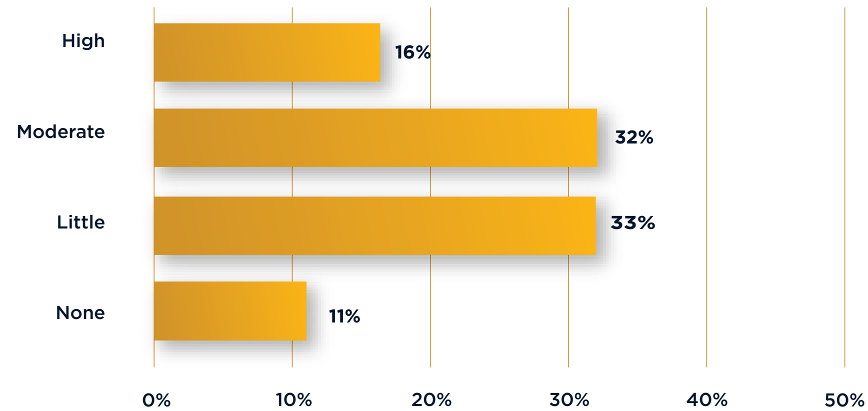
OPPORTUNITIES FOR RISK MANAGERS TO LEAD SCR MANAGEMENT EFFORTS

The function of a risk manager is to identify, measure, monitor, and manage risk within an agreed upon risk appetite framework. Key tasks are understanding risks and assessing whether they are within the organization's tolerance. Risk managers therefore must understand how their organizations can lose money or value, now and in the future. Because sustainability and climate risk can cause both direct and indirect financial loss, risk professionals play a crucial role in managing SCR.

GARP research suggests risk managers and organizations can do more on SCR. For example, less than half of the firms have embedded climate risk into their day-to-day operations, and about half (44%) have little to no awareness of SCR issues in their organization.

These findings show clear opportunities for risk managers to enhance their knowledge and take on responsibility in SCR management.

LEVEL OF AWARENESS OF SCR ISSUES IN ORGANIZATION



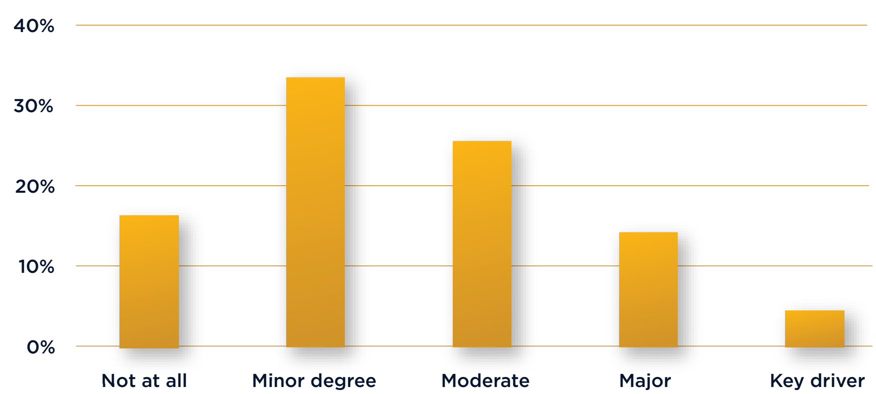
ONLY

18%

OF RESPONDENTS SAID SCR IS A KEY DRIVER OR HAS A MAJOR INFLUENCE ON THEIR ORGANIZATION'S DECISIONS.

Responsibility for responding to SCR issues varies. In financial services, about 80% of boards oversee climate-related risks and opportunities, according to a GARP Risk Institute study in 2019. Still, SCR issues have limited influence in decision-making, the GARP SCR study found. Only 18% of respondents said SCR is a key driver or has a major influence on their organization's decisions.

IMPACT OF SCR KNOWLEDGE ON ORGANIZATIONS' DECISIONS



VALUE OF SCR KNOWLEDGE

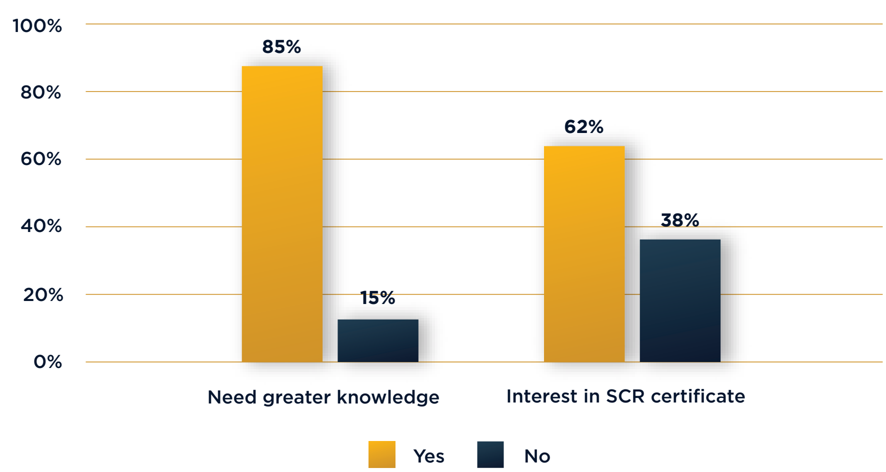
Knowledge of SCR can equip risk managers to create value for their organizations and the global community. GARP SCR survey respondents strongly believe they and others need to know more:

- 85% believe they need greater SCR knowledge themselves
- 81% say others in their organization need SCR knowledge
- 62% are interested in a certificate related to SCR education

85%
OF RESPONDENTS BELIEVE THEY NEED GREATER SCR KNOWLEDGE THEMSELVES.

Respondents cited several benefits to obtaining a certificate. The most-cited benefit, selected by 69%, was validation of specialized knowledge. Interestingly, the least-cited benefit was increased salary, chosen by only 34%.

INTEREST IN GREATER KNOWLEDGE OF SCR OR CERTIFICATE IN SCR



The GARP study also found respondents shared motivations for seeking greater SCR knowledge. Among the reasons were:

- Climate change and sustainability are important topics, and they need to bolster their knowledge in this area
- Personal interest in the topic
- SCR knowledge is a marketable area of expertise

When viewed alongside respondents' expected benefits of completing a certificate in SCR, most risk professionals appear interested in increasing their knowledge because it's good to do, not just because it might help their careers.

CONCLUSION

The impact of sustainability and climate change risks is systemic. Every industry and every government, in every geography, will experience its effects and the transition to a lower-carbon economy. If organizations are not developing SCR strategies and incorporating SCR issues into their business decisions, they soon will.

For the world's risk professionals, the ability to manage SCR presents a key opportunity. Management of SCR, and any emerging risk, begins with the pursuit of knowledge. Acquiring SCR knowledge will empower risk managers to help their organizations understand the risks and enhance risk management's value in protecting the organization's people and assets. In addition, as regulators turn their attention to SCR policies, organizations and risk professionals that embrace SCR are more likely to have a voice in setting standards and reporting frameworks.

ENDNOTES

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GARP | Global Association of Risk Professionals

Creating a culture of risk awareness®

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ABOUT GARP | The Global Association of Risk Professionals is a non-partisan, not-for-profit membership organization focused on elevating the practice of risk management. GARP offers role-based risk certification — the Financial Risk Manager® and Energy Risk Professional® — as well as the Sustainability and Climate Risk® certificate and on-going educational opportunities through Continuing Professional Development. Through the GARP Benchmarking Initiative and GARP Risk Institute, GARP sponsors research in risk management and promotes collaboration among practitioners, academics and regulators.

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