Briefing for Finance: Climate Action

THE BUSINESS CASE FOR ACTION

The World Economic Forum's Global Risks Report 2022 places climate action failure as the number one risk with the most severe impact over the next decade.[1] The impact of climate change and extreme weather, such as storms, floods and rising temperatures, is already affecting economies and society through significant disruption of agriculture, food production, transport and infrastructure. Disasters driven by climate change and extreme weather over the last 50 years have resulted in US$3.64 trillion in losses, with an average of US$202 million in damage occurring daily.[2]

The urgency is clear: to avoid the worst climate impacts and limit global warming to 1.5°C above pre-industrial levels, global greenhouse gas (GHG) emissions need to peak by 2025 at the latest and be reduced by 43% before 2030.[3] The scale and speed of the transition needed are unprecedented and will require rapid far-reaching and well-coordinated action across all business sectors.

Recognizing the urgency and the magnitude of the impact of climate change, organizations need to assess, report and reduce their exposure to climate risk, as well as play their role in limiting global warming through setting and delivering on net zero targets. Over 130 countries and more than 795 of the world's largest publicly traded companies have set net zero targets to drive and coordinate change through national regulatory systems and corporate action.[4]

Key facts

2.7°C
median global warming predicted at the end of the century, based upon current climate policy commitments, if all unconditional 2030 pledges are fully implemented[5]

43%
emissions reductions are needed by 2030 to reach the goal of limiting warming to 1.5°C[6]

130+
countries and over 795 of the world's largest publicly traded companies have set net zero targets[7]

US$3.64 trillion
in losses and over
two million
deaths due to disasters driven by climate change and extreme weather over the last 50 years[8]

A4S ACCOUNTING FOR SUSTAINABILITY

To find out more about net zero and what it means, please visit the A4S net zero webpage.

Climate action: progress so far

The Paris Agreement, adopted by world leaders in 2015, aims to keep global warming below 2°C above pre-industrial levels by 2100 and to strive for a maximum 1.5°C rise.[9] Many scientists agree that to avoid the worst effects of climate change, temperature increase needs to be limited to 1.5°C.[10] The Paris Agreement requires countries to prepare, communicate and maintain nationally determined contributions (NDCs), outlining how each country will reduce emissions and adapt to the impacts of climate change.[11]

Global policies currently in place to reduce baseline emissions are estimated to result in a median of 2.7°C global warming above pre-industrial levels.[12] The Intergovernmental Panel on Climate Change's report in August 2021 highlighted climate change as a 'code red for humanity';[13] the physical science demonstrates that climate change is widespread, rapid, and intensifying.[14]

The urgent action needed has led to the introduction of government systemic-level interventions such as:

Mandatory reporting of GHG emissions as the basis for assessing corporate-level contributions to national emissions.	Australia has mandated emissions reporting for companies that meet certain emissions thresholds under the National Greenhouse and Energy Reporting Scheme since 2007.[15]
Corporate disclosure requirements following the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.	In 2021, the federal government of Canada announced the mandatory adoption of the TCFD recommendations for Canadian crown corporations.[16]
Requirements for organizations to develop transition plans to articulate how they are taking action on climate change and translating net zero commitments into practical action.	In 2021, the UK Government announced a move towards mandatory transition plan disclosure for listed companies and financial institutions.[17]
Introduction of national green finance strategies and accompanying regulation.	In 2020, South Korea announced the Korean New Deal, with a US$144 bn funding package, over one-third of which is allocated to the 'Green New Deal' funding projects around infrastructure, renewables, energy efficiency and green technology.[18]

Alongside these government-led interventions, the private sector is taking climate action. At COP26, 450 financial institutions with $130 trillion in assets under management committed to net zero by 2050 through the Glasgow Financial Alliance for Net Zero (GFANZ).[19] GFANZ is a partner of the United Nation's Race to Zero global campaign, which brings together businesses, cities, regions and investors committed to net zero action.[20]

These net zero commitments must be turned into practical action if we are to avoid the most catastrophic impacts of climate change. To assist finance teams in this transition, A4S has produced Net Zero Guidance for cross-sector businesses and banks.

What are the risks to business?

Inaction on climate change has significant financial and valuation implications. In many instances, the foreseeable impacts threaten business continuity, for example, in the agriculture, food production and transport sectors. The consequences of climate change may also negatively affect the continued viability of some business models in the absence of an adequate climate change risk mitigation and adaptation strategy. For example, cities that border shorelines exposed to significant levels of sea-level rise and coastal flooding face considerable loss of real estate and coastal and inland infrastructure.

Key climate change risks include:

Physical risk

Physical damage to buildings, equipment and key infrastructure as a result of extreme weather can halt supply chains, manufacturing and distribution networks. It can also lead to resource shortages, eg of water or land. These can result in asset impairments or write-offs of 'stranded assets' and increased operating costs and insurance premiums.

Transition risk

The transition to a low-carbon economy has resulted in changes to the regulatory and consumer landscape. Organizations that do not keep pace increasingly risk being left behind as supply chains reorganize as part of lower-carbon or decarbonised value chains.

Carbon-intensive processes and products are being impacted by increasing regulation, such as carbon taxes, and reduced demand for high-carbon products due to market and technological shifts. This can lead to regulatory and compliance costs and significant write-offs of 'stranded assets'.

Market and reputation risks increase as investors, customers and employees are increasingly considering the climate and wider sustainability policies of companies, which are often used as a proxy for good governance.

What are the benefits for business of taking action?

Forward-thinking organizations are assessing and mitigating climate risk, reducing their overall GHG emissions, formally committing to a net zero target and publishing a detailed transition plan. Some organizations are going further – adopting a climate-positive response strategy by developing and incorporating carbon removal methods and technologies. Organizations that show leadership in acting on climate change can benefit in the following ways:

1. **Prepare for regulatory requirements**
   The achievement of a government's net zero commitment will be facilitated by legislation and policies; organizations that are already considering climate risks, have set net zero targets, and developed a credible transition plan will be better prepared.

2. **Align with customer and employee interests**
   Customers and employees are increasingly focusing on addressing climate change. An organization that has embedded climate change considerations into its strategy and products will likely benefit from access to larger markets and better staff recruitment and retention.

3. **Foster long-term resilience**
   The impact of climate change is undeniable. Even if we limit global warming to below 1.5°C, there will be widespread negative impacts on the planet. Organizations that are evaluating and mitigating climate risk will be more resilient in the future.

4. **Improve reputation**
   As more organizations set net zero commitments and global, sector-wide net zero initiatives become the norm, those without commitments will likely be called out and suffer reputational damage.

5. **Develop innovation opportunities**
   Responding to the climate emergency provides organizations with the opportunity to position themselves as industry leaders by developing innovative products, services and approaches that are aligned to net zero.

6. **Participate in the value chain**
   An increasing number of organizations are now mandating that supply chain participants have creditable net zero plans, and some offer financial incentives for climate action. The A4S Essential Guide to Incentivizing Action along the Value Chain provides a framework for finance professionals to consider climate action in their value chain.

7. **Access finance**
   A credible net zero transition plan and focus on climate resilience can provide better access to finance and potentially lower borrowing rates through green, sustainability, sustainability-linked and transition financial instruments.

What action can finance take?

The options and guidance available for finance teams looking to engage with the challenge of climate action and delivering net zero commitments are increasing all the time, particularly as national regulatory systems become aligned.

Finance has a key role to play in aligning corporate strategy with climate change action. Below are some practical examples of action by finance teams, including links to our Essential Guide Series, where guidance and case studies are available.

Identify and educate

Identify and assess the actual and potential impacts of climate-related risks and opportunities on your organization's businesses, strategy, and financial planning. Articulate the business case and commercial rationale for action by calculating the value at risk from inaction and associated costs. Understand how climate change impacts impairment assessments. Present these findings to board members and executive management.

Review the data sources available on GHG emissions for your Scope 1, 2 and 3 emissions[21] and develop a transparent roadmap to improving data quality and coverage. Raise awareness within the finance team on climate change and net zero through reading resources and joining industry-wide groups.

Guidance:

- A4S Essential Guide to Managing Future Uncertainty
- TCFD Climate Scenario Analysis Guidance

Set and operationalize ambitious net zero targets

Set science-based, net zero targets as part of your organization's strategic priorities and state your commitment publicly. Operationalize these targets by including them in budgets, forecasts, Capex appraisals, data collection systems, management information, policies and executive remuneration. Develop a formalized transition plan that puts these targets into action, accompanied by governance and systems to monitor progress against your net zero transition plan.

Guidance:

- A4S Essential Guide to Management Information
- Net Zero Guidance for Cross Sector and Banks

Actions continue on next page...

Embed the cost of carbon into decisions

Develop an internal carbon price, an internal tax and / or a notional shadow cost. The carbon price can be used in performance measurement, position management, investment decisions, strategy or risk management to embed the cost of carbon into business decisions.[22] For example, including a carbon shadow price in Capex appraisals will improve the business case for low-carbon options. Including an internal carbon tax across business units will help budget owners see their decisions' direct monetary impact and incentivize behaviour towards selecting low-carbon options.

Guidance:

- A4S Essential Guide to Strategic Planning, Budgeting and Forecasting
- A4S Essential Guide to Capex

Report and disclose

Implement the TCFD recommendations in corporate reporting, including disclosures regarding climate governance, strategy, risk management, and metrics and targets.

Publish your transition plan to demonstrate how net zero ambitions are being turned into practical action, eg through interim targets, governance, policies, value chain engagement and products and services.

Guidance:

- TCFD Implementation: Top Tips for Finance Teams

Invest in climate solutions and access sustainable finance

Mobilize funds for investment in low-carbon alternatives, eg electric fleet or on-site renewable energy generation, by developing business cases aligned to decarbonization and climate-positive strategies informed by long-term value thinking and sustainable business principles.

Use funding from an internal carbon tax to invest in projects and assets that contribute to reducing GHG emissions, either internally or externally.

Align the organization's funding model and financing strategy to embrace sources of sustainable finance to help fund the transition to net zero, eg through green, sustainability, and sustainability-linked bond and loans and revolving credit facilities.

Guidance:

- A4S Essential Guide to Debt Finance
- Implementing a Sustainable Financing Framework: Top Tips for Treasury Teams

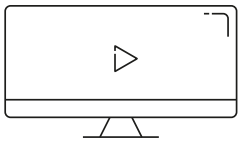
Further resources

Explore

- A4S TCFD Insights Series
- TCFD Knowledge Hub

Read

- A4S Net Zero Guidance
- Net Zero Practical Examples
- A4S TCFD Climate Scenario Analysis Guidance



Watch

- A4S Webinar on TCFD

Endnotes

1. Global Risks Report 2022, World Economic Forum
2. WMO Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes (1970–2019), World Meteorological Organization
3. The Evidence Is Clear: The Time for Action Is Now. We Can Halve Emissions by 2030, The Intergovernmental Panel on Climate Change
4. Net Zero Tracker
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8. WMO Atlas of Mortality and Economic Losses from Weather, Climate and Water Extremes (1970–2019), World Meteorological Organization
9. The Paris Agreement, The United Nations
10. Climate Experts Warn World Leaders 1.5C Is 'Real Science', Not Just Talking Point, The Guardian
11. Nationally Determined Contributions (NDCs), United Nations Framework Convention on Climate Change
12. Emissions Gap Report 2021, The United Nations Environment Programme
13. Secretary-General's statement on the IPCC Working Group 1 Report on the Physical Science Basis of the Sixth Assessment, The United Nations
14. Climate Change 2021: The Physical Science Basis, The Intergovernmental Panel on Climate Change
15. Mandatory Emissions Reporting Around the Globe, UL Solutions
16. Will TCFD disclosures become mandatory?, Responsibility Matters
17. COP26: UK firms forced to show how they will hit net zero, BBC
18. Can the Korean New Deal Deliver?, Green Economy Tracker
19. Amount of finance committed to achieving 1.5°C now at scale needed to deliver the transition, Glasgow Financial Alliance for Net Zero (GFANZ)
20. Race to Zero Campaign, The United Nations Framework Convention on Climate Change
21. The Greenhouse Gas Protocol Revised Edition (see page 25), World Business Council for Sustainable Development & World Resources Institute
22. 2021 TCFD Metrics Targets Guidance, Task Force on Climate-related Financial Disclosures