

CLIMATE RADAR

HOW CLIMATE CHANGE IMPACTS BUSINESS
BLOG SERIES BY ZIZZO STRATEGY



CLIMATE CHANGE AND THE FINANCIAL SECTOR

Welcome to the first entry in Zizzo Strategy's blog series exploring the implications of climate change for various economic sectors and the organizations and individuals within them. Climate change is recognized as a global challenge and a "threat multiplier" to other existing challenges. Climate change's magnitude can make it seem like an overwhelming topic, especially if all you want to know is what the next steps should be for your organization or your specific role. Throughout this series, we will delve into the significance of climate change for particular sectors, discussing both the financial and non-financial impacts, and translating them into decision-useful considerations to provide clarity on relevant issues and help propel internal discussion and management of climate-related risks and opportunities. Each post will conclude with suggestions on next steps and tools you can use to prepare your organization for the challenges presented by climate change. Full article with links to more information at zizzostrategy.com.

Awareness and calls to action on climate change in the financial sector have gained significant momentum in the last few years, especially since the 2015 Paris Agreement and related private-sector initiatives. Increasing pressure is being placed on investors, including asset owners, asset managers, and banks due to the influence they have on the companies they own and the amount of assets they control.

Financial organizations have seen increased calls for transparency in the identification of their exposure to climate-related risk and their role in mitigating climate change risk overall. They are being asked how their organization will transition to a lower-carbon economy, adapt to a changing climate, and seize opportunities related to this transition and adaptation. These calls for increased transparency and action

show no sign of abating. Forthcoming standardization, developing reporting standards, and legislative requirements will all likely keep increasing the pressure for transparency.

We suggest that while transparency through reporting is an essential part of a company's climate change strategy, it should not drive the management of climate change impacts in your organization. The physical and economic transitions caused by climate change will have business impacts on the investments of all financial players. Ultimately, prioritizing business for your organization will depend on your relationship with your clients, members, and other stakeholders as well as your investment strategy and portfolio specifics. We believe there are three key areas of business impacts related to climate change that all financial organizations should consider:

1. Transparency and disclosure

The Financial Stability Board's Task Force on Climate-related Financial Disclosure's (TCFD) recommendations on climate change reporting are directed at all financial players as well as publicly traded companies outside the financial sector. Recent initiatives, such as the United Nations Environment Program Financial Initiative pilot projects, French legislation and early reporting efforts by significant industry players, have shown that reporting on these issues will become an accepted "norm" in the industry in the next few years. However, investors must

decide when to disclose, how much to disclose, and how to get that information to clients without disclosing trade-secrets or losing their competitive advantage. This disclosure does not (and arguably should not) drive decisions related to investment operations, but it does need to be genuine and must disclose how climate considerations are being integrated into business strategy. A good place to start is with existing processes, such as governance and risk management, that you may already have in your organization.

2. Accounting for volatility and quicker than expected change

Having an investment strategy to account for known risks is nothing new to financial players. However, climate change impacts have been shown to change historical patterns in the physical world (e.g. global temperature has risen approximately 1 Degree Celsius since pre-industrial times, and extreme weather events are now occurring more frequently than in the past) and are seeing economic responses (energy transitions driven by policy and market demands). Cognitive biases such as anchoring to the past and conforming with perceived consensus, will lead to risk underestimation and may not best serve organizational goals and objectives. For example, these biases may lead to gaps in scenario analyses, such as overly conservative scenarios of the energy future. Additionally, there are many energy system modeling issues that make predictions uncertain. Without more holistic views of the future, asset owners may not be adequately prepared for change. For example, the industry-standard IEA World Energy Outlook has consistently, and significantly, underestimated clean energy uptake. For an investment or corporate strategy to be truly resilient, it needs to push the boundaries of currently accepted scenarios. This could mean thinking more broadly and using tools such as scenario analysis that look beyond business-as-usual time frames as well as considering what would have, in the recent past, been considered "extreme" cases.

3. Focus on opportunity

Risk is often the easiest way to introduce climate change to an organization, and risk analysts are tasked with considering climate change issues. Most of what is written about climate change focuses on the risk related to a transition towards a lower-carbon economy, such as



stranded assets, and loss of value or cash flow associated with a price on carbon or reduced demand. However, climate change also undoubtedly presents asset owners with opportunities, whether measured as relative to the broader market or as a value add with exposure to new sub-sectors. For example, investments in the renewable energy market grew from \$47 billion USD in 2004 to over \$240 billion USD in 2016. While risk management for climate change impacts is certainly needed, opportunity should not be considered as just the “other side of the risk coin,” but should be seen as broadly encompassing what investments will be needed to support and thrive from a transition to a lower-carbon and more resilient economy.



Note for Asset Owners:

Certain institutional investors, particularly pension plans, have been targeted as the ultimate owners of the investments and influencers over other financial actors such as asset managers and others. With generally higher profiles and closer ties to end beneficiaries, an asset owner’s transparency on their approach to climate change is also a factor in their credibility and can be used to enhance their profile. Asset owners are being asked to prove they have appropriately thought about, incorporated, and planned for climate change impacts. For those asset owners that do not appropriately consider and plan for climate change impacts, some form of public naming and shaming is entirely likely. Asset owners have a unique opportunity to set the tone for the financial sector’s response to climate change while reporting and standards are in their infancy. These considerations should be included when designing an organization’s climate change response strategy.



Once you’ve determined the risks and opportunities most salient for your organization to consider, there are a variety of strategies and tools available to assist in their identification and management. Our suggestions for immediate and medium-term steps are:

A. Find out what strengths you already have in your organization. There are likely ways to build upon existing systems, roles and management. You may already be undertaking actions that, although not earmarked as such, identify and manage climate-related issues. These existing strengths, roles, and actions may need to be

further developed or systematized, but they will provide a basis for a strategy that will work for your teams.

B. Learn from existing progress by identifying and expanding on best practices. As many leading organizations and pioneering individuals are tackling these issues, it’s smart practice to build on existing knowledge and not “reinvent the wheel”. A thorough review of existing best practices, strategies, and tools applicable to your needs will help to determine what’s required to address priority concerns and whether existing practices have a place in your toolkit.

C. Think broadly. Climate change is a broad and complex issue and relatively new to the financial sector. It doesn’t fit neatly into the usual analytical tools and is particularly prone to cognitive biases. Scenario analysis can be tailored to your organization’s capacity and needs and is an excellent way to introduce “outside-the-box” thinking and integrate a longer-term perspective.

Contact Zizzo Strategy to understand how we can help you and your organization manage these climate-related business impacts. We can guide you in considering what to disclose and when and how to disclose it, as well as how to overcome cognitive and modeling biases and how to bring opportunities, as well as risk, into focus. Our services encompass the spectrum of climate change management processes from education to scenario analysis.

Zizzo Strategy is Canada's Only Climate Change Consultancy of its Kind

Look to our experts to help you:



Educate

Bring essential knowledge and current data to your board, leaders, executives and employees on climate developments



Identify

Clearly indicate climate-related risks and opportunities within your company



Strategize

Provide solutions and strategies that build your corporate resilience



EQUIP

Arm and prepare your teams to make smart business decisions and seize climate-related opportunities!

Zizzo Strategy has served leading companies in sectors, including:



finance



insurance



property management



electrical utilities



transportation

Our clients include leading Canadian and multi-national banks, REIT's, utilities, and manufactures as well as municipal, provincial and national governments.

About Zizzo Strategy:

- Multi-disciplinary team of lawyers, business consultants and engineers
- We bridge the gap between law, engineering, technical innovation and real world decision-making.
- Recognized by global leaders as a trusted advisor on climate-related issues
- Cutting-edge solutions set us apart from the risk identification offered by audit firms

We help our clients stay ahead of the curve and lead where the rest of the market will soon follow.

