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Climate risk can be a catalyst to shift the corporate and political planning horizon

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Effective management of the climate risks facing our world today could deal with three of the biggest failings of corporate governance and risk management we see time and time again:

— The inherent focus on short-term gains over the longer-term viability of an organization.

— Seeing risk management as a function rather than hardwiring it in to the overall strategy and business model for the organization.

— The overreliance on historical data, which cannot support the identification or quantification of unprecedented events.

It is time for business leaders to step up, put climate risks at the forefront of their strategy and ensure that they can be proud to tell the next generation how they used their position of power to address climate risk.

The current pressures on boards make it very difficult to stop and reflect, but taking the time to think about climate risks, running scenarios and making the relevant changes to business models and strategies, can stretch the corporate and political planning horizons and enable us to respond to the climate crisis effectively.

Every company needs a climate change story

An organization's ability to tell the story of how their strategy and business model is evolving as a result of climate change, linked to their overall purpose and backed up by metrics and targets, is absolutely critical in 2020. Investors, lenders and credit rating agencies will be using it to compare companies and make their sustainable investment decisions; it will likely be a key driver in an organization's ability to retain and attract top talent; and customers will take notice and potentially change their spending behaviors as a result.

Awareness, sentiment, and regulatory action related to climate change has accelerated exponentially over the last 24 months. While the 18 years between the Kyoto and Paris Agreements demonstrated only moderate evolution, the COP26 (due to be held in Glasgow in November 2020) is expected to accelerate change in the way governments think and regulate around climate change. This will likely cement climate risk at the forefront of the wider environmental, social, and governance (ESG) agenda for the foreseeable future.

Climate change will impact every company

Changes in climate policies, new technologies, and a growing number of extreme weather events will prompt reassessments of the values of virtually every financial asset. The quantification of that change is not easy to determine but it needs to be calculated to build an effective strategy, and new regulations on financial institutions will mean that they will be demanding more information from their investments around ESG factors.

Mark Carney, outgoing governor of the Bank of England, who was recently appointed as Special Envoy to the UN on Climate Change and Finance, has recognized the role the financial markets need to play for over five years and, along with Michael Bloomberg, has been banging the drum to improve the transparency of companies' disclosures around climate risks and opportunities and their strategy to respond. Put simply "Companies and industries that are not moving towards zero-carbon emissions will be punished by investors and go bankrupt".

Only 10 percent of Fortune 500 companies from 1955 exist today and the pace of change has been comparatively slow for the majority of the 65 years since. Given the current pace of change, organizations need to act now to ensure their business model is resilient to respond to climate and other related changes.

Disclosures around climate change need to improve in 2020

There have been small improvements in the level of transparency in the last few years but a significant step change is needed. To provide the required transparency, the first step is for companies to identify the risks and opportunities they face as a result of climate change—in terms of both:

— Physical risks—arising as a direct result of the changes in weather and climate

— Transition risks—driven by the swathe of reporting and investment regulation which is now, or will soon be, mandatory.

And companies are struggling with this first step because of:

— Limited knowledge of climate-related issues within organizations

— The tendency to focus mainly on near-term risks without paying adequate attention to risks that may arise in the longer term, or the connectivity and velocity of these risks

— The difficulty in quantifying the financial effects of climate-related issues.

The nature of climate change means that the related risks require longer-term consideration but there are both transitional and physical risks that will materialize in the immediate term—companies around the world are already incurring financial losses as a result of climate change.

However, companies need to make this first step now. In the U.K., enhanced reporting requirements will require U.K.-listed companies to report on their strategy, risks, governance, and metrics around climate risk by 2022 at the latest. The requirements move the focus from companies reporting on their business model's carbon footprint (a corporate social responsibility issue) to the financial impact of climate risk on their business model (a key risk and financial issue). We expect other countries to follow.

One mistake KPMG member firms see boards making is considering climate risk reporting as something that the sustainability function needs to think about. Expert input is needed but it is critical to see this as a core financial and strategic issue, sitting at the heart of the organization.