

Developing and executing a climate risk strategy

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07 October 2020

An action packed agenda

- Insights into the PRA SS3/19, Dear CEO letter and beyond
- Proposed approach to building out your climate risk strategy
- Deep dive into the contents of a climate risk strategy
- What does the future hold for climate risk?

A few questions to get us started

1) Who is most likely to save the planet from climate change? (a) Elon Musk, (b) Mark Carney, (c) Greta Thunberg, (d) Bernard Looney, (e) National governments, (f) Actuaries, (g) None of the above - we're doomed.



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A few questions to get us started

2) To what extent do you think climate risk is an important consideration for actuaries?

[1 to 5 scale with 1 being not at all, and 5 being essential]

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A few questions to get us started

3) Do you explicitly consider climate risk in your current role?

[1 to 5 scale with 1 being not at all and 5 being everyday]

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Insights into the PRA SS3/19, Dear CEO letter and beyond

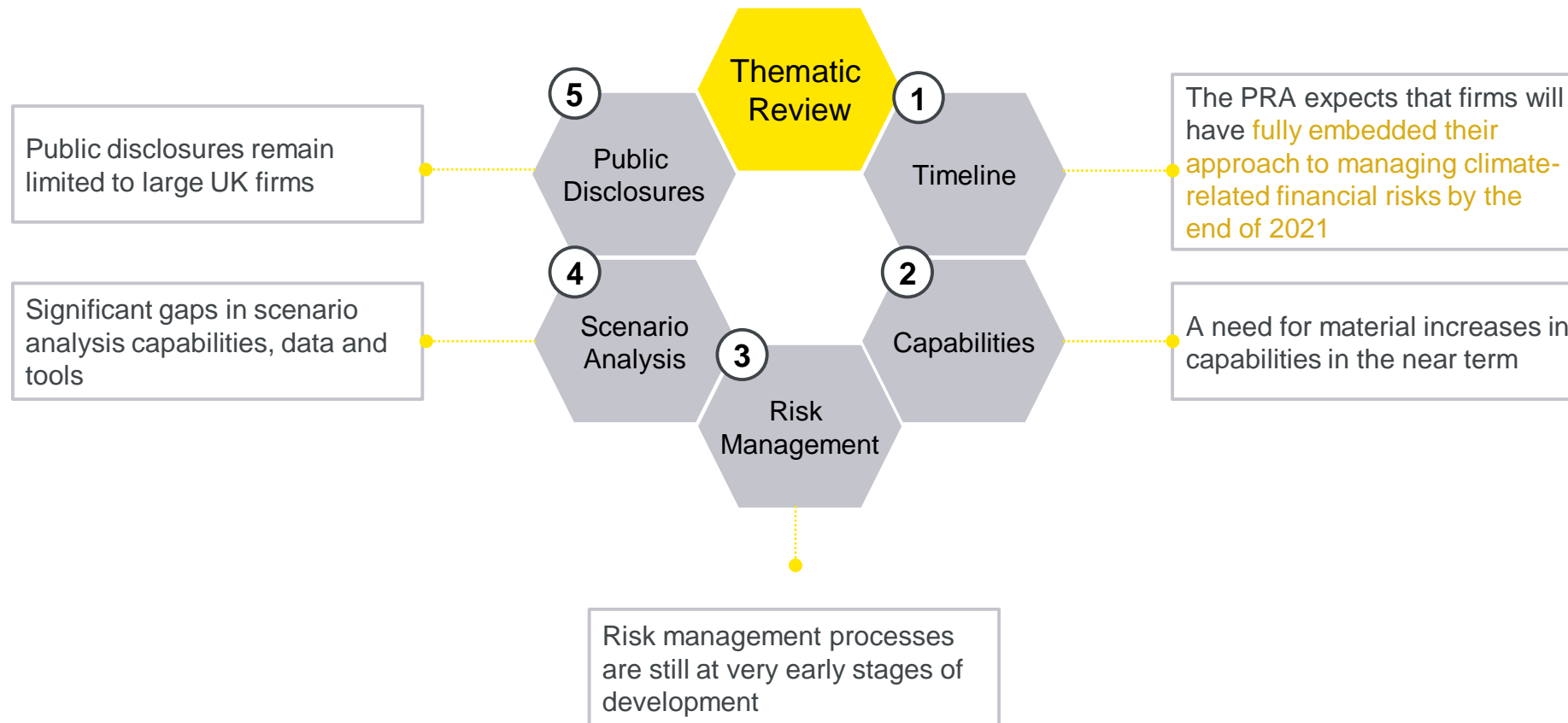


The PRA sets out its expectations for firms to address climate strategically (SS3/19)

Theme	Summary expectation		Considerations
Governance	<ul style="list-style-type: none"> • Clear allocation of responsibility to an SMF holder • Associated governance structure to cascade strategy • Board oversees development and implementation • Explicit consideration of impact on profitability and strategy 	➔	<ul style="list-style-type: none"> • Roles and responsibilities across all three lines of defence • Board has been trained and is updated on implementation plans • Strategy explicitly considers impact of climate risk • Client engagement and product and services review
Risk Management	<ul style="list-style-type: none"> • Credible plan for managing exposure by end 2021 • Estimation of potential financial loss (even if crude) • Alignment across identification, measurement, reporting and management, supporting decision making • Client engagement re potential risks and mitigants 	➔	<ul style="list-style-type: none"> • Understand current and forward risks • Alignment of risk appetite and strategy, and supporting control framework • Supporting ICAAP and broader disclosures • Proportionality of approach and expectation of evolution
Scenario analysis	<ul style="list-style-type: none"> • Requires investment of time irrespective of firm size, and can be both qualitative and quantitative • Consider a range of scenarios, including reverse stress test • Use to inform risk and strategy decisions 	➔	<ul style="list-style-type: none"> • Leverage standard, reference scenarios • Explore scenarios relevant to current balance sheet and forward strategy • Balance qualitative assessment and drive for quantitative impact estimates
Disclosure	<ul style="list-style-type: none"> • Develop decision-useful disclosures • Build capability and accelerate progress • Monitor industry developments and areas of evolving standards and harmonisation 	➔	<ul style="list-style-type: none"> • Specific audience • Peer practice and developing standards

Following with a PRA Dear CEO letter on 'Managing climate-related financial risk'

The Dear CEO letter highlights the findings from the PRA thematic review of plans to address SS3/19. It provides clarification on the timeline for compliance and highlights areas of focus and examples of good practice

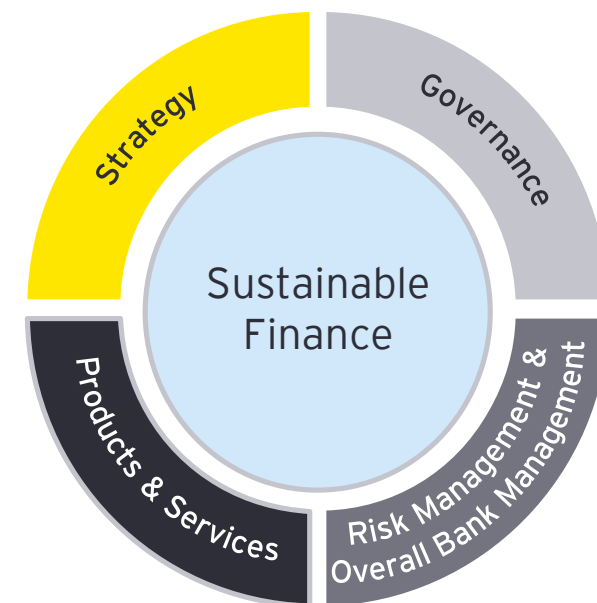



Next steps:

- ▶ The PRA notes that there will continue to be ongoing engagement on development of implementation and progress plans.
- ▶ There is the expectation that firms will continue to provide updates to Boards on the progress towards implementation.

EU Action Plan on Sustainable Finance

EU Taxonomy & Standard	<ul style="list-style-type: none">▶ EU Taxonomy adopted by EU Council (18 June 2020)▶ Technical Expert Group / Technical Criteria (March 2020)▶ Basis for further measures such as Disclosures and Green Bond Standard
Inclusion of ESG Aspects into Financial Market Regulation	<ul style="list-style-type: none">▶ Sustainable Finance Disclosure Regulation (9 December 2019) and draft RTS on SFDR▶ ESMA Strategy on Sustainable Finance (6 February 2020)▶ Integration of ESG risks and factors in MiFID II and IDD (Draft Delegated Acts, 8 June 2020)
Inclusion of ESG Risks in Prudent Supervision	<ul style="list-style-type: none">▶ Integration of ESG risks into ORSA, stress testing and risk management▶ Opinion on Sustainability in SII▶ Consultation on Stress Testing
Disclosure & Long Term Value	<ul style="list-style-type: none">▶ Non-financial Reporting Directive (NFRD): Consultation for a revision of NFRD▶ ESAs reports on undue short-term pressure from the financial sector on corporations





Proposed approach to building out your climate risk strategy

EY

Building a better
working world

EY

Phase 1 - Understanding where you are

The first phase of developing an appropriate strategy is a review and analysis of the current maturity of your organisation with respect to climate change

Climate change maturity assessment process

1

Review and analysis of current state

Potential activities

- Agree scope of review
- High level interviews with key stakeholders
- Comprehensive information request designed to facilitate review
- Walkthrough of any established processes with process owners
- Desktop review of documentation

2

Maturity model

- Example maturity model below

	Basic	Strategic	Pioneering
Governance	<ul style="list-style-type: none">• No formal governance responsibilities in place• High level comments around board ownership of sustainability• SMF function	<ul style="list-style-type: none">• Governance formalised and documented• MI and reporting processes being established• Board and senior management aware of key risks	<ul style="list-style-type: none">• Regular item at Board and other relevant committees• Clear ownership of relevant topics and issues• Evidence of clear oversight of risk mgt and controls, including established MI and scenarios
Regulation	<ul style="list-style-type: none">• Some awareness of developments around ESG, sustainable finance and climate requirements• No plans in place to meet reporting requirements• Limited visibility/awareness at senior level	<ul style="list-style-type: none">• Aware of significant movement in a number of areas• Some plans in place to meet elements of regulation• Overall still reactive to developments as they emerge	<ul style="list-style-type: none">• Good progress on Financial Stability Board's recommendations on climate related financial disclosures• On front foot with UK, EU and global initiatives• Prepared to support clients with changing needs
Strategy	<ul style="list-style-type: none">• Lack of clear strategy on climate and ESG• Senior management focus on short term• Lip service paid to values and behaviours	<ul style="list-style-type: none">• Clear strategic intent around supporting Paris agreement• Sponsorship and engagement driven from top down• Some progress on implementation	<ul style="list-style-type: none">• Strategy execution underway and clarity on direction• Commitment to net zero• Organisation consistently walks the walk• Stakeholders take pride in association with brand
Products	<ul style="list-style-type: none">• Limited sustainable funds, with no clear strategy on developing next generation investments• Challenging to find information on fund strategies• No policy or reporting on stewardship and engagement	<ul style="list-style-type: none">• Starting to develop climate aware investments• Recognise need to integrate ESG but not implemented• Stewardship and engagement activities led by asset manager with limited direction from owner	<ul style="list-style-type: none">• Range of purposeful investment strategies• ESG themes run through all investment decisions• External reporting on impact and stewardship• Personalised customer communications on themes
Risk	<ul style="list-style-type: none">• Climate risk classified as reputational and poor understanding of capital market implications• Reliance on asset manager PRI status to cover ESG• Regulatory driven scenario analysis only	<ul style="list-style-type: none">• Climate risk recognised on risk register with some carbon footprinting and risk quantification• Not linked to broader sustainability agenda• ESG risks not included in ORSA or risk framework	<ul style="list-style-type: none">• Regular forward looking assessment of risk, value at risk as well as footprinting• Risk appetite articulated and exposure monitored• Embedded in risk management framework and ORSA
Operations	<ul style="list-style-type: none">• No comprehensive environmental policy• Limited reporting and no accountability• Lags behind peers on most environmental metrics	<ul style="list-style-type: none">• Environmental policy in place• Senior management accountability and vision• Some progress on efficiency but not science based	<ul style="list-style-type: none">• On track for meeting ambitious science based goals• Rigorous measurement and reporting• Active participant in collaborative industry initiatives
Stakeholders	<ul style="list-style-type: none">• Roles purely functional• Culture focused on finances, limited broader stakeholder and customer perspectives• Limited CSR efforts and risk of greenwashing	<ul style="list-style-type: none">• Some value based elements to reward• Company engages meaningfully with external stakeholders• Some staff engagement with purpose	<ul style="list-style-type: none">• Climate goals embedded in staff goals and reward• Real pride at working for company• Comprehensive climate reporting to shareholders and customers

3

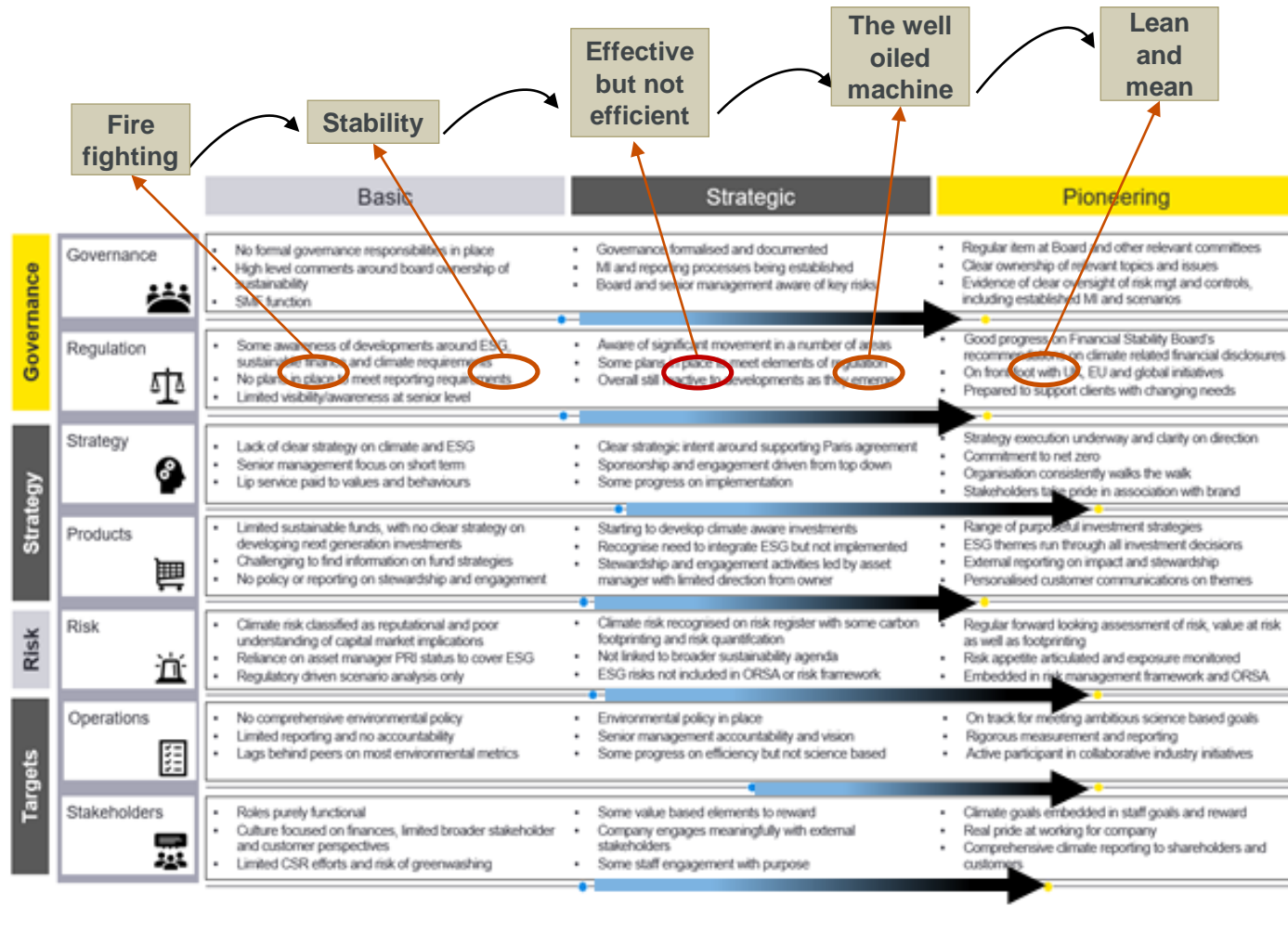
Reporting output

- Structured reporting of your organisations maturity relative to peers, regulatory expectations and future direction of travel.
- Identification of any areas of strength and weakness to support development of options and recommendations, including quick wins

Phase 2 – Options and recommendations

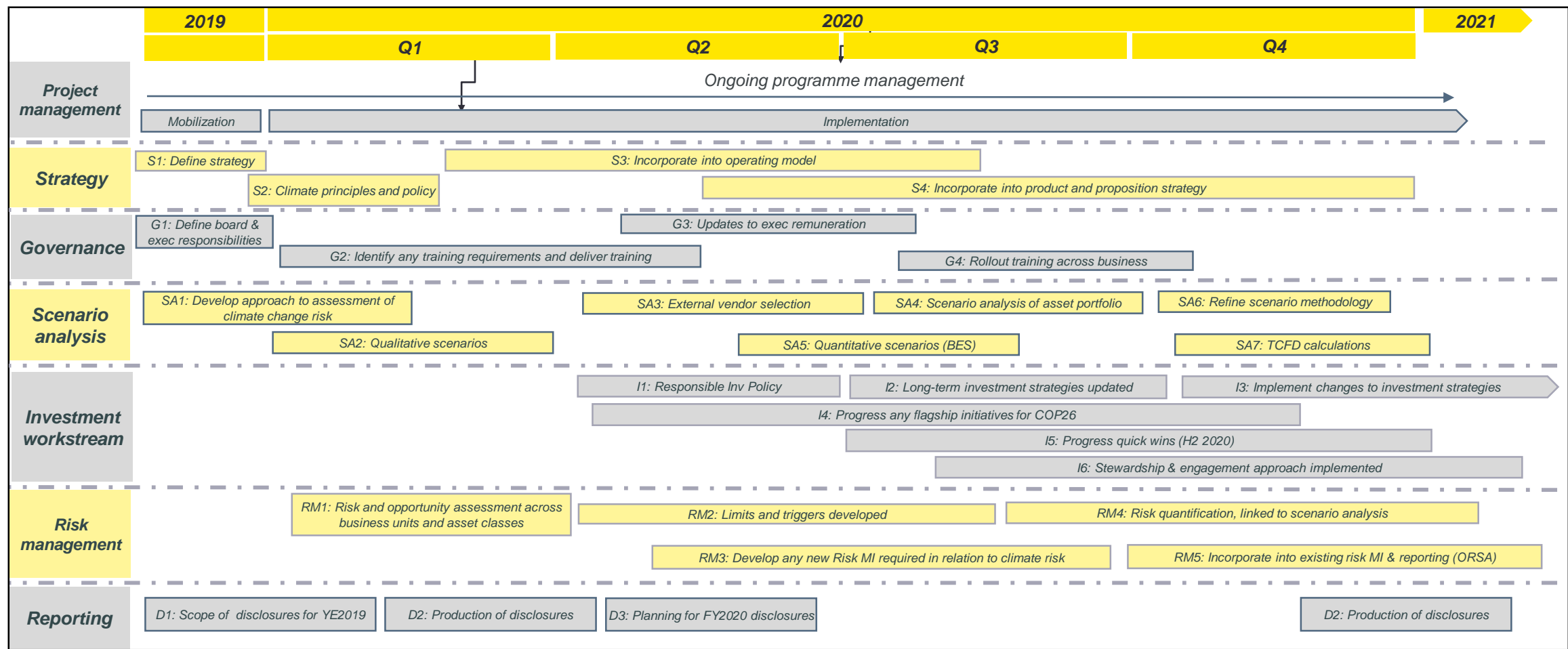
- The current state assessment is combined with quantitative risk analysis to feed into Phase 2.
- The maturity assessment allows you to understand where you are today, where you want to be and the scale of any gaps that need addressing.


Phase 2 - Develop options and recommendations



- ▶ Its important to understand where you are and determine the scale of your ambition clearly at outset.
- ▶ You can then choose where and how to develop climate change capability based on an assessment of prioritised requirements and benefits.
- ▶ An action plan can then be used to drive the business forward: addressing gaps in the short term to avoid unnecessary regulatory scrutiny, and in the longer term to deliver competitive advantage.
- ▶ Undertaking this can also help to evidence to the regulator that there is appropriate management focus and activity on climate change

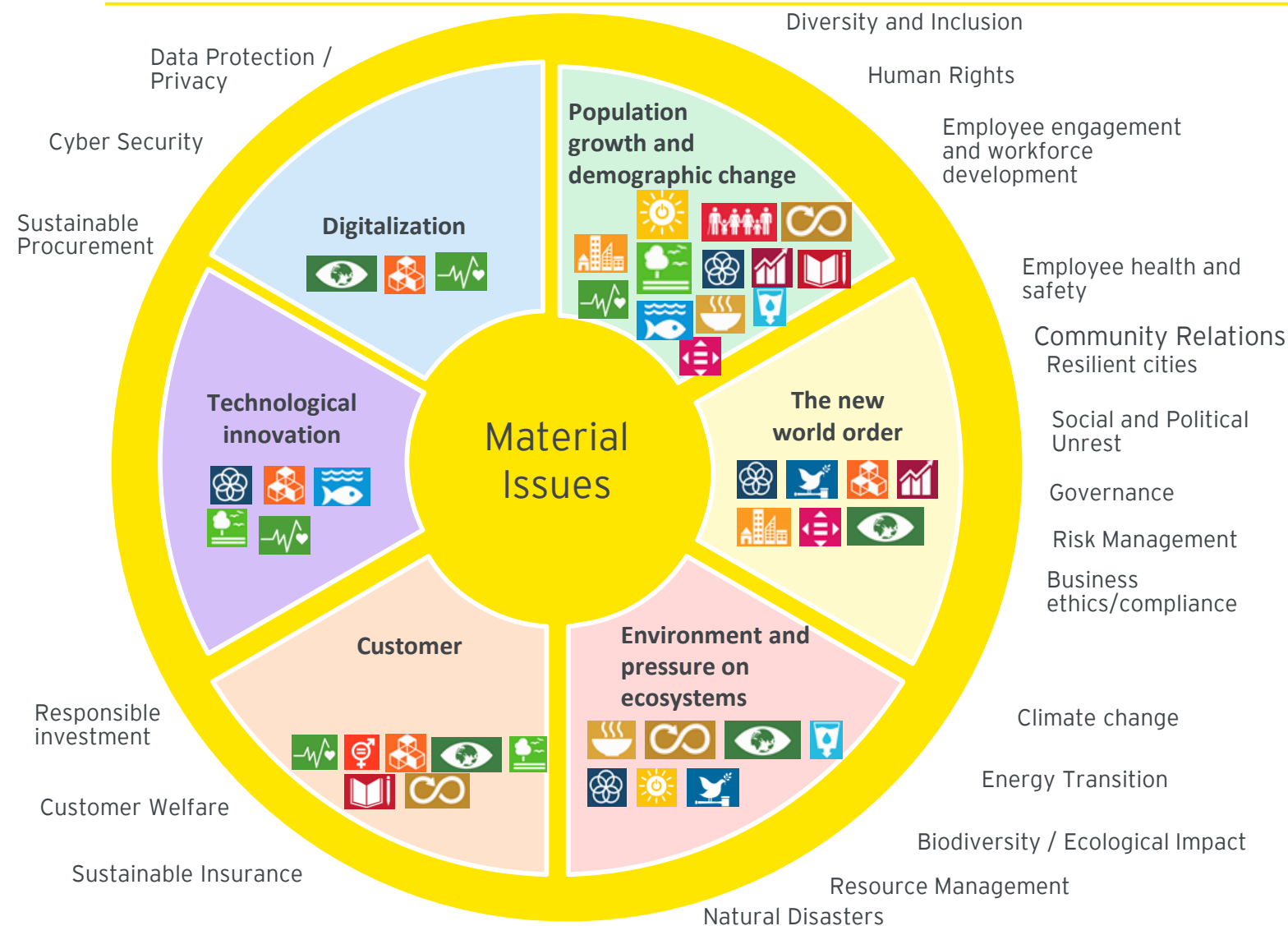
Phase 3 - A structured delivery plan





Deep dive into the
contents of a climate
risk strategy: SDGs and
“net-zero”

Mapping the megatrends with the SDGs



Materiality assessment - importance to stakeholders



Physical risks are emerging more quickly than anticipated... driving enhanced transition risks as society races to zero



Climate-driven changes to the earth are happening faster than we thought

Oceans heating



Sea level rising



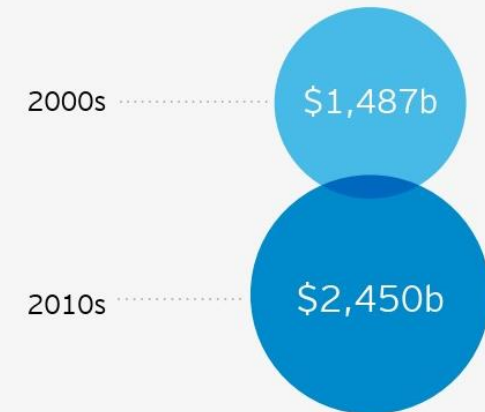
Himalayan glaciers melting



Greenland ice cap melting



Extreme weather is becoming more frequent and costly

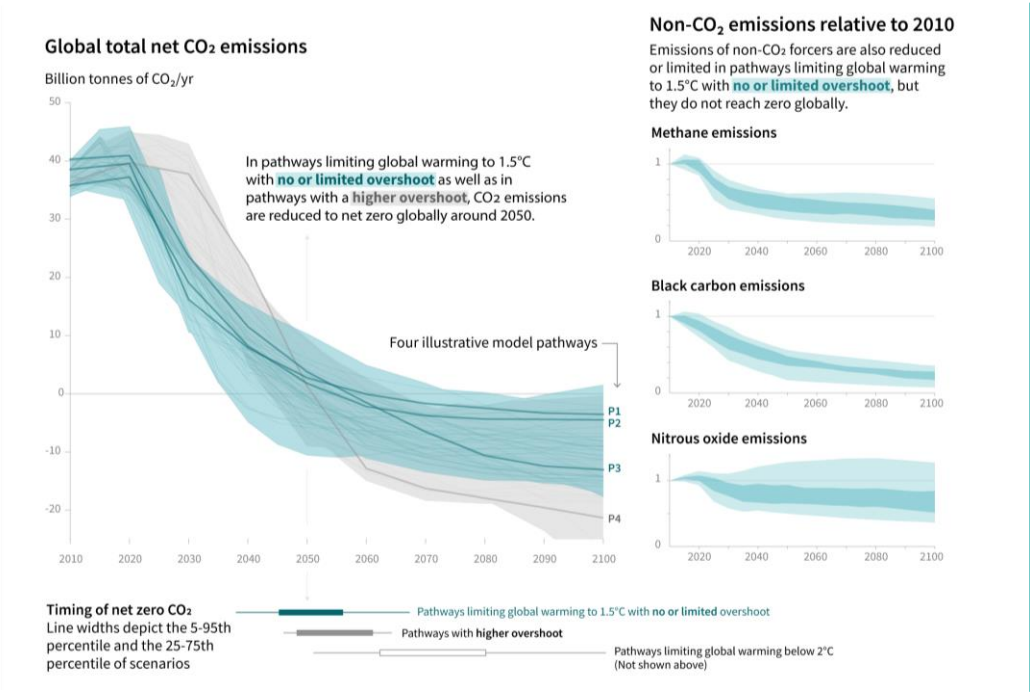


Source: Weather, Climate & Catastrophe Insight 2019 Annual Report, Aon

Source: EY Megatrends 2020

Net zero objectives - derivation and implications of failure

Global emissions pathway characteristics (IPCC)



From emissions pathways to portfolio alignment

A range of techniques, which continue to evolve rapidly, are available to assess the alignment of both corporates and portfolios against climate pathways.

Key themes

- Data normalisation
- Relevance of company targets
- Scenario alignment

The 2050 net zero objective is detailed in the IPCC’s Special Report on 1.5°C of warming that details the additional risks associated with 2°C warming.

1	1.7 billion more people face heatwaves annually.	4	Coral reefs that support marine environments around the world decline as much as 99 percent
2	Sea levels rise by an additional 10cm.	5	Global fishery catches could decline by another 1.5 million tonnes
3	Several hundred million more people exposed to climate-related risks and poverty.	6	Drastic increase in drought risk for the Mediterranean region

Metrics and targets

There are a number of metrics that are likely to be required to assess progress towards net zero across asset portfolios.

Financed emissions - *Tracking position*

Key metric for:

- Assessing position today
- Tracking progress against targets

Management Quality - *Commitment and capability*

Key metric for assessing:

- Commitment of firm to net zero
- Capability of firm to change

Paris Alignment - *Trajectory*

Key metric for assessing:

- Direction of firm against net zero
- Adequacy of trajectory

Theme		Requirements	Supporting analysis
1	GHG emissions and targets	<ul style="list-style-type: none"> • Usage of sector relevant emissions sources • Alignment with an accepted climate scenario such as the IEA 	<ul style="list-style-type: none"> • Climate Action 100+ • Transition Pathway Initiative (TPI) • Carbon Tracker Initiative (CTI)
2	Implementation strategy	<ul style="list-style-type: none"> • Business changes to operationalise the GHG reduction targets 	<ul style="list-style-type: none"> • Climate Action 100+
3	Climate policy engagement (lobbying)	<ul style="list-style-type: none"> • Disclosure of approach to engagement on government policy • Industry group/trade association membership 	<ul style="list-style-type: none"> • Climate Action 100+ • InfluenceMap
4	Capital stock alignment	<ul style="list-style-type: none"> • R&D expenditure • Methodology for alignment of major Capex 	<ul style="list-style-type: none"> • Climate Action 100+ • Carbon Tracker Initiative (CTI) • 2 Degrees Investing Initiative (2DII)
5	Management quality	<ul style="list-style-type: none"> • Board capability and oversight • Executive remuneration 	<ul style="list-style-type: none"> • Climate Action 100+ • Transition Pathway Initiative (TPI)
6	Reporting	<ul style="list-style-type: none"> • TCFD alignment 	<ul style="list-style-type: none"> • Climate Action 100+ • EY TCFD Barometer

Net-zero - illustrative actions to remain within net zero risk appetite

Company level - ABC Ltd (Automotive)		
Dimension	Rating	Comment
Physical		Supply chain
Transition		Good EV progress
Risk Rating		Medium
Alignment		Some deficiencies
Climate Score	65/100	Consider action



Fund level - e.g. with-profits		
Dimension	Rating	Comment
Physical		Mix of factors
Transition		12% high risk
Risk Rating		Medium
Alignment		Need to accelerate
Climate Score	45/100	Take action



Balance sheet level		
Dimension	Rating	Comment
Physical		Real estate
Transition		8% high risk
Risk Rating		Medium
Alignment		Option to accelerate
Climate Score	51/100	Consider action

Potential actions

- ▶ Set tolerances and limits
- ▶ Understand drivers for rating
- ▶ Investment decisions - buy, sell, hold
- ▶ Stewardship activity and escalations

Potential actions

- ▶ Fund glide paths
- ▶ Fund level tolerances and limits
- ▶ Identify concentrations and hot spots
- ▶ Investment management agreements

Potential actions

- ▶ Aggregation methodology and risk appetite
- ▶ Methodology review
- ▶ Reporting

A photograph of a penguin standing on a white, snow-covered ice shelf. The shelf is melting, with jagged, blue-tinged ice edges hanging over a dark blue ocean. The sky is a deep blue with some light clouds. A large yellow rectangle is overlaid on the left side of the image.

What does the future
hold for climate risk?

A busy summer for climate scenarios

DISORDERLY TRANSITION

Action that is late, disruptive and unanticipated, but sufficient to meet climate goals. High transition risk.

ORDERLY TRANSITION

We start reducing emissions now in a measured way to meet climate goals. **Early, ambitious actions taken. Net zero achieved by 2070, 67% chance temperatures limited to below 2°C.**

HOT HOUSE

Limited action leads to a hot house world with significant global warming - **physical risks are maximised**. Global GDP decreases significantly post 2050 as physical risk overwhelms society.

2020 - A BUSY SUMMER FOR CLIMATE SCENARIOS

Multiple climate scenario papers were published from regulatory bodies, analysts, professional organisations and others.

Observations

1. *The energy transition is now underway, with pace driving temperature outcomes*
2. *The high level of physical risk is poorly understood and likely to be understated*
3. *Net zero is now the clarion call, driven by the enhanced risk of 2°C*

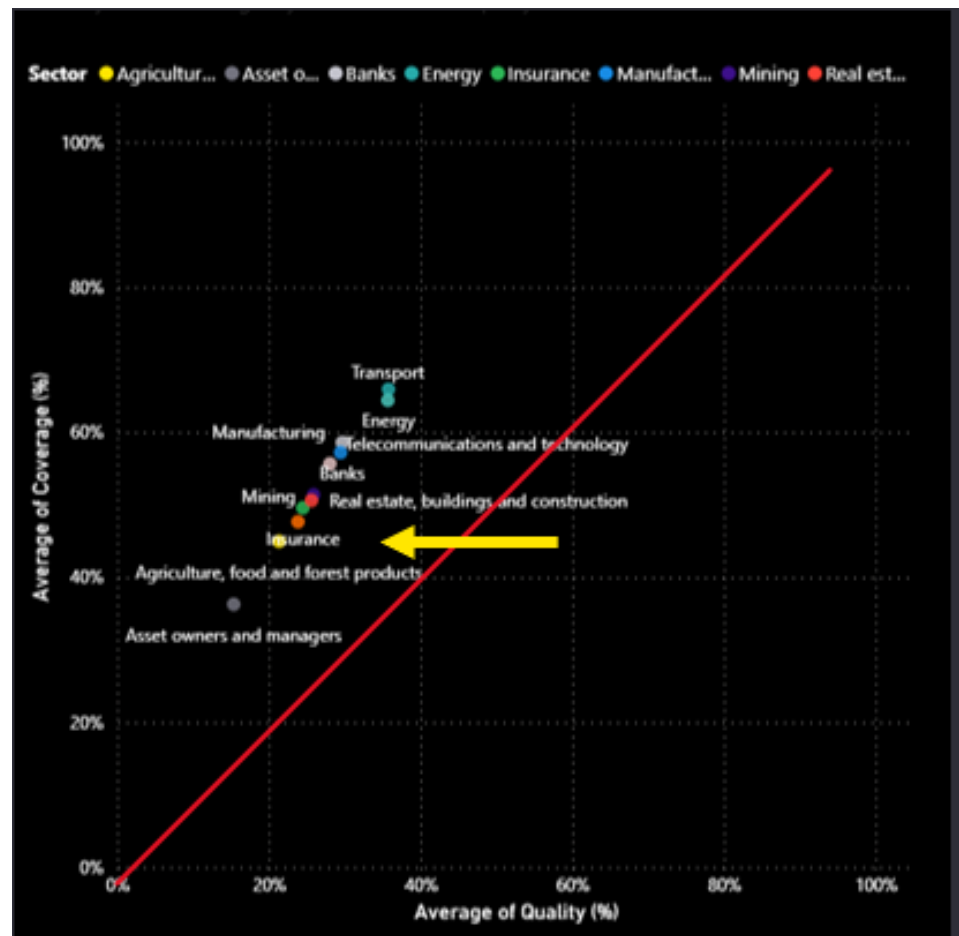


Implications

1. *Business as usual doesn't exist, we are experiencing climate risks today*
2. *Firms must go beyond climate 'what ifs' to identify likely outcomes and plan appropriately*
3. *FS firms are now all moving but leaders are accelerating harder*

Room for improvement in the quality and coverage of TCFD disclosures

Quality and coverage by sector and company



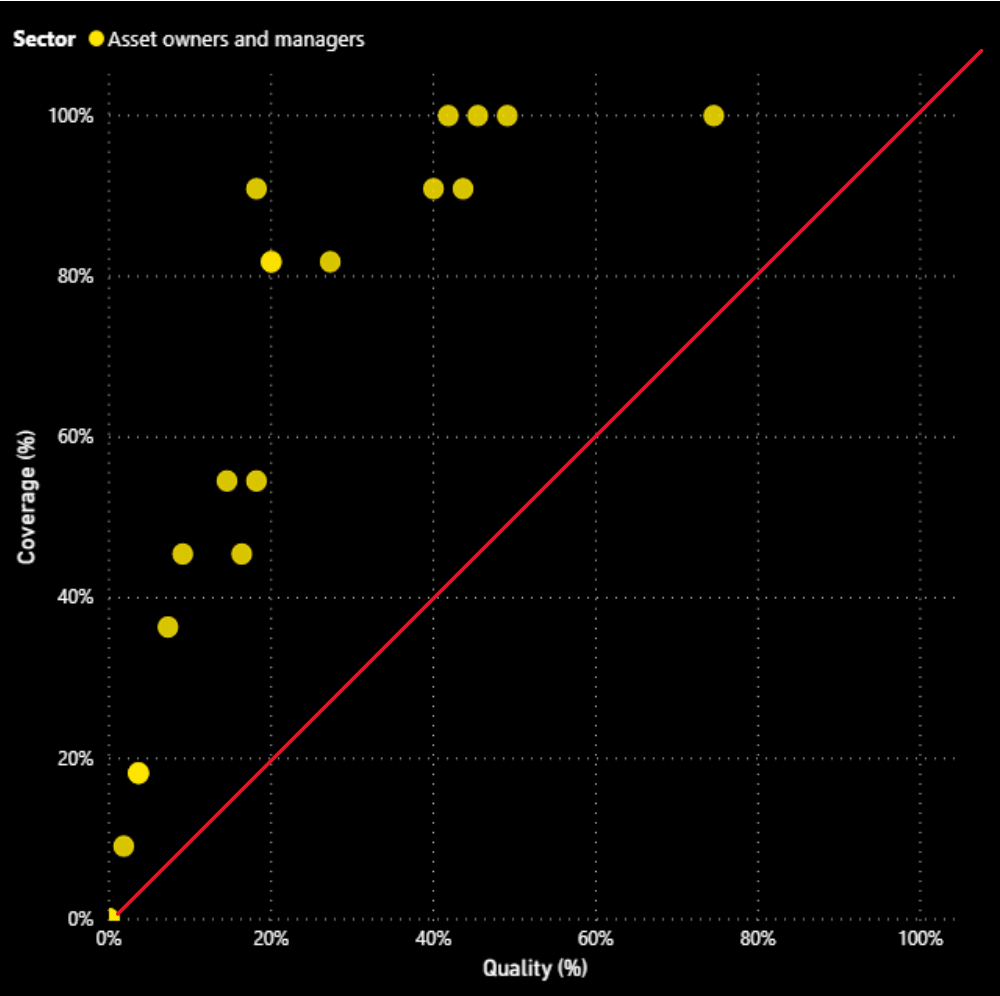
Quality per pillar by sector and company



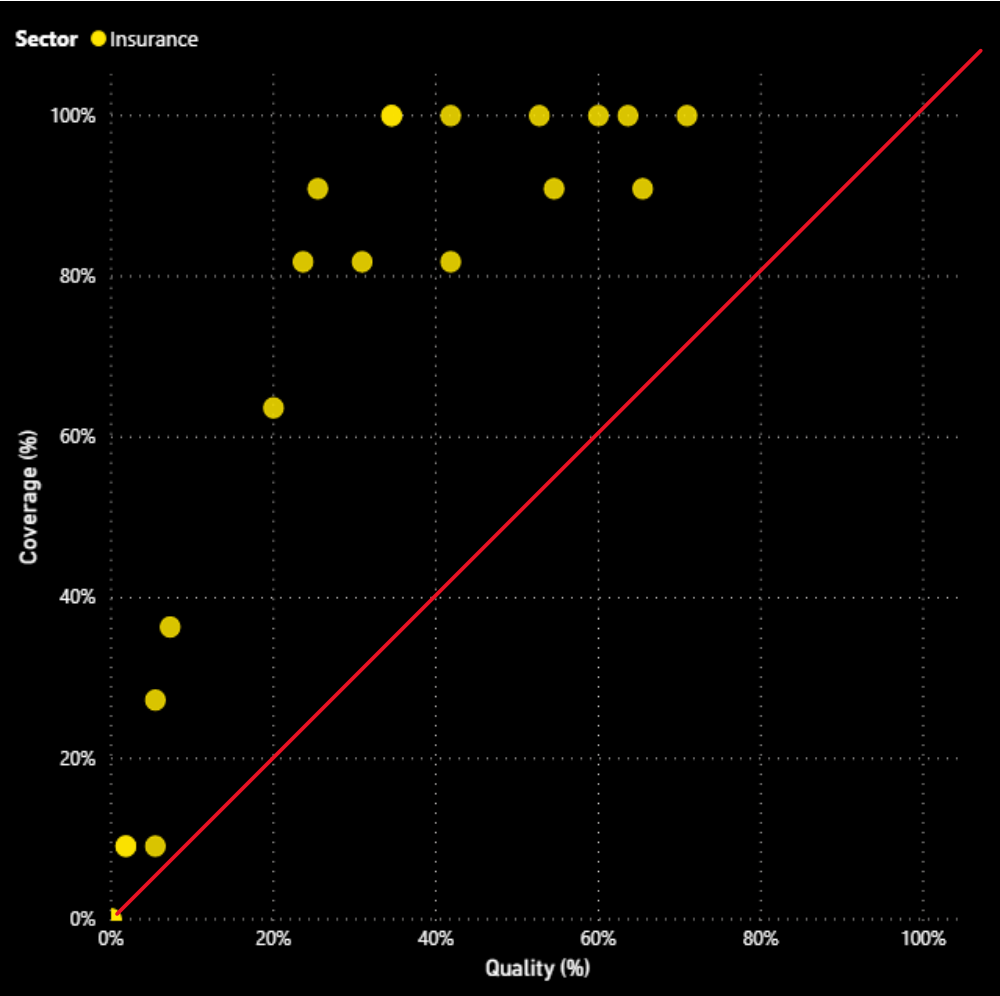
Source: EY Global Climate Risk Disclosure Barometer 2020

Insurers and asset managers performance by company

Asset managers



Insurers



A number of themes are expected to emerge

Arctic oil exploration



Biodiversity



Build Back Better



Deep-water drilling



Tar sands



Significant activity within the profession with respect to climate risk

Sustainable Finance Community Update

An IFoA Resource & Environment Board initiative

13th December 2019

This week's updates at a glance:

- [UN-backed report finds high carbon emitters likely to lose half their value](#)
- [European Green Deal Launched](#)
- [Governments planning to produce 120% more fossil fuels than consistent with 1.5°C](#)
- [Record number of institutional investors urge governments to tackle global climate crisis](#)
- [EU's Sustainable Finance Taxonomy set for re-write after rejection](#)
- [ONS review the growth of UK economy and carbon emissions](#)
- [International alliance embarks on sustainability legal impact review](#)
- [The Actuary: approaches to measure climate-related risks](#)

What we're reading...

- [Impacts of the Inevitable Policy Response on Equity Markets](#)
- [The Fossil Fuel Production Gap](#)
- [Business and trade association influence on the EU's sustainable finance taxonomy](#)

Tune in

SIGN UP!

A woman with blonde hair tied back, wearing a red patterned top, is speaking into a microphone. She is gesturing with her left hand. In the background, several people are seated, listening. The setting appears to be a conference or meeting room with large windows and modern decor.

Questions and comments

EY | Assurance | Tax | Strategy and Transactions | Consulting

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