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# RESILIENCE

Climate Change Transition Risk – Interactive Scenario Game
(GARP's Climate Risk Symposium) – November 2020

# **GARP's Climate Risk Symposium:** Interactive Scenario Game

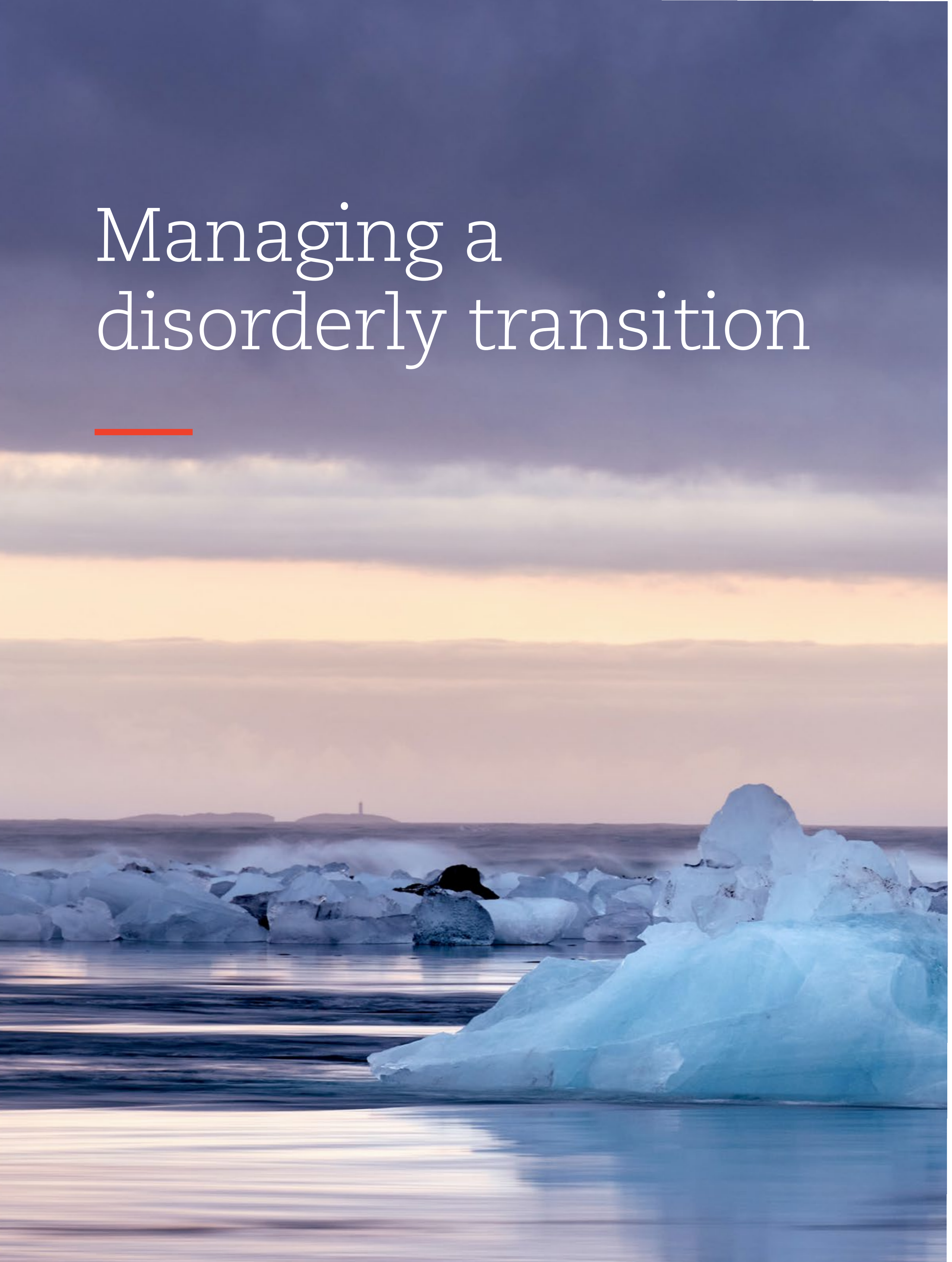
## Dealing with the dilemmas triggered by the transition to a low carbon economy

Life is all about choices, as board members and risk management professionals know only too well. When it comes to moving towards a low carbon economy, difficult decisions can become thorny dilemmas with significant commercial, ethical and reputational implications - short term and in the decades ahead.

Aware of the challenges, 1,130 global risk professionals attended a virtual climate risk symposium entitled "Climate Change Transition Risk – Interactive Scenario Game." The audience played the role of the board of a fictional company, voting on critical boardroom decisions set out in a hypothetical yet credible scenario, taken at various points over the next ten years. As there are no right or wrong answers, it was instructive to think about the trade-offs.

Expert panellists from Clyde & Co, the Global Association of Risk Professionals (GARP), Chapter Zero (the Directors' Climate Forum), Willis Towers Watson and UBS Asset Management gave their insight into the issues and the decision-making process, as well as the fictional outcomes of those "decisions".

Explaining the rationale for this innovative interactive approach, event Chair Jo Paisley, Co-President of the GARP Risk Institute, a leading provider of climate financial risk education (climate.garp.org), said, "One of the issues that makes climate change so difficult is that we don't know what the future will look like, which is why scenarios are so important." The idea was that by immersing the audience in a convincingly "real" example, the issues were brought to life and the immediacy of the need for action was brought home, empowering attendees to tackle similar questions on policy, legal, technological, market and reputational risk at their own organisations.



# Managing a disorderly transition

To set the scene, the audience was asked their opinions on whether, in real life, we are likely to see:

| | |
|---|---|
| An orderly transition to a low carbon economy, informed by early policy action; | 13.10% |
| A disorderly transition created by policy action being taken relatively late; or | 81.60% |
| A “hot house world” where no (or minimal) additional policy action is taken. | 5.30% |

The poll findings are based on 526 responses

Most agreed that a disorderly transition is the most likely, and that was the environment in which the hypothetical event scenario played out. The fictional company (called “OurCo”) was a global consumer goods business with a distribution arm.

Its complex supply chain put the spotlight on whether its carbon emissions were Scope 1, 2 or 3 – i.e. directly created by its activities and within its own control such as vehicle fleet fuel consumption (scope 1), indirectly created, via its electricity use (scope 2), or business travel or procurement, for example (scope 3).

Ahead of its next board meeting in January 2021, it had drafted its first TCFD (Taskforce on Climate-Related

Financial Disclosures) report. The TCFD was established to improve and increase reporting of climate-related financial information, however OurCo’s report had provided only superficial analysis and lacked data. Also at issue was that, unlike many competitors, the company had not yet agreed on a commitment to net zero.

# Challenge 1: To commit or not to commit?

The audience/board was asked to vote on:

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|---|---|
| Whether to commit to net zero by 2050 in the Annual Report and then develop a plan to deliver it; or | 42.30% |
| To publish the TCFD report and indicate that a net zero target would be published within a year, having developed a delivery strategy? | 57.70% |

The poll findings are based on 529 responses

In the scenario, there was a negative reaction to OurCo's perceived lack of leadership on this issue, irrespective of which option was chosen. Critical media coverage cited employees' disappointment and shareholders tabled (and passed) a non-binding resolution at the AGM, requiring a net zero target date of before 2050, with an implementation plan and clear milestones.

Commenting on the scenario, panellist Nigel Brook, Partner at Clyde & Co, urged caution, pointing out that if companies make a promise without feasibility studies and a strategy in place, there could be major ramifications from a legal as well as reputational standpoint.

However, it was also made clear that inaction is not an option. Panellists argued that communication with stakeholders to explain the situation, outline the steps to be taken, and show progress is key, and that if companies felt that they were being outpaced by rivals, they should take swift affirmative action to re-write the narrative.

"My advice is: get on with it now," said Julie Baddeley, Founder and Chair of Steering Group, Chapter Zero. "Designing a robust plan is a lot of work and takes a lot of time."

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>
> *Julie Baddeley, Chapter Zero Founder and Chair of its Steering Group.*

# Challenge 2: Divestment or investment?

Fast-forward several years, and having published an ambitious target of net zero by 2040 in June 2021, impetus for the company's transformation project had then waned, distracted by COVID-19 and a weak climate policy environment. By the time political pressure stepped up again in 2025, many early milestones had been missed.

Since transport is a critical area in which to cut emissions, and with the cost of hydrogen fuel technology expected to fall rapidly, an opportunity had emerged for OurCo to become a state-of-the-art distribution company, making this a profit centre in its own right, while contributing significantly to net zero goals. The audience/board was asked to vote on:

| | |
|---|---|
| Whether to sell the distribution business and outsource the function to the most competitive provider in the hope that they move to carbon-neutral vehicles soon; or | 42.50% |
| Invest heavily in building a hydrogen-powered green fleet even though the technology is still not fully proven? | 57.50% |

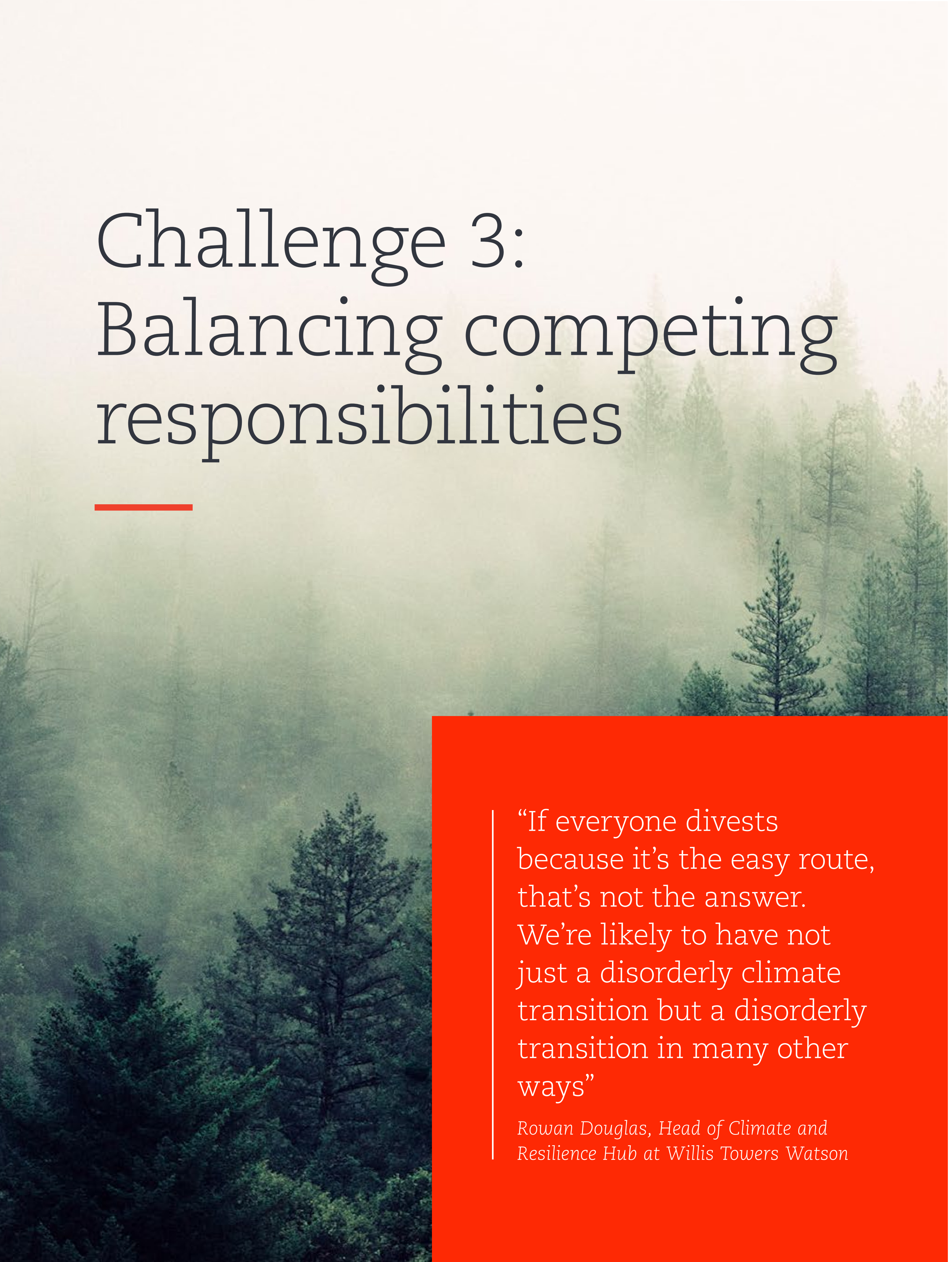
The poll findings are based on 504 responses

> "If it's strategic and the revenues are significant, then don't divest. But shareholders will also be looking at the cost of implementing the new change and the impact of that on revenue."
>
> *Nasreen Kasenally, Chief Risk Officer at UBS Asset Management*

Panellists agreed that any opportunity like this must be rigorously assessed and robustly explained to shareholders. Nasreen Kasenally, Chief Risk Officer at UBS Asset Management outlined the pros and cons like this: "If it's strategic and the revenues are significant, then don't divest. But shareholders will also be looking at the cost of implementing the new change and the impact of that on revenue." She added that ultimately,

"The company has to believe in what they are doing for others to believe it's a strategic pathway to net zero."

When taking big bets on unproven technologies, options available via the emerging green finance market as well as existing carbon credits could be explored, to mitigate the risk. However, the point was made that outsourcing carried its own inherent risks, since emissions costs remain on the balance sheet.



# Challenge 3: Balancing competing responsibilities

> “If everyone divests because it’s the easy route, that’s not the answer. We’re likely to have not just a disorderly climate transition but a disorderly transition in many other ways”
>
> *Rowan Douglas, Head of Climate and Resilience Hub at Willis Towers Watson*

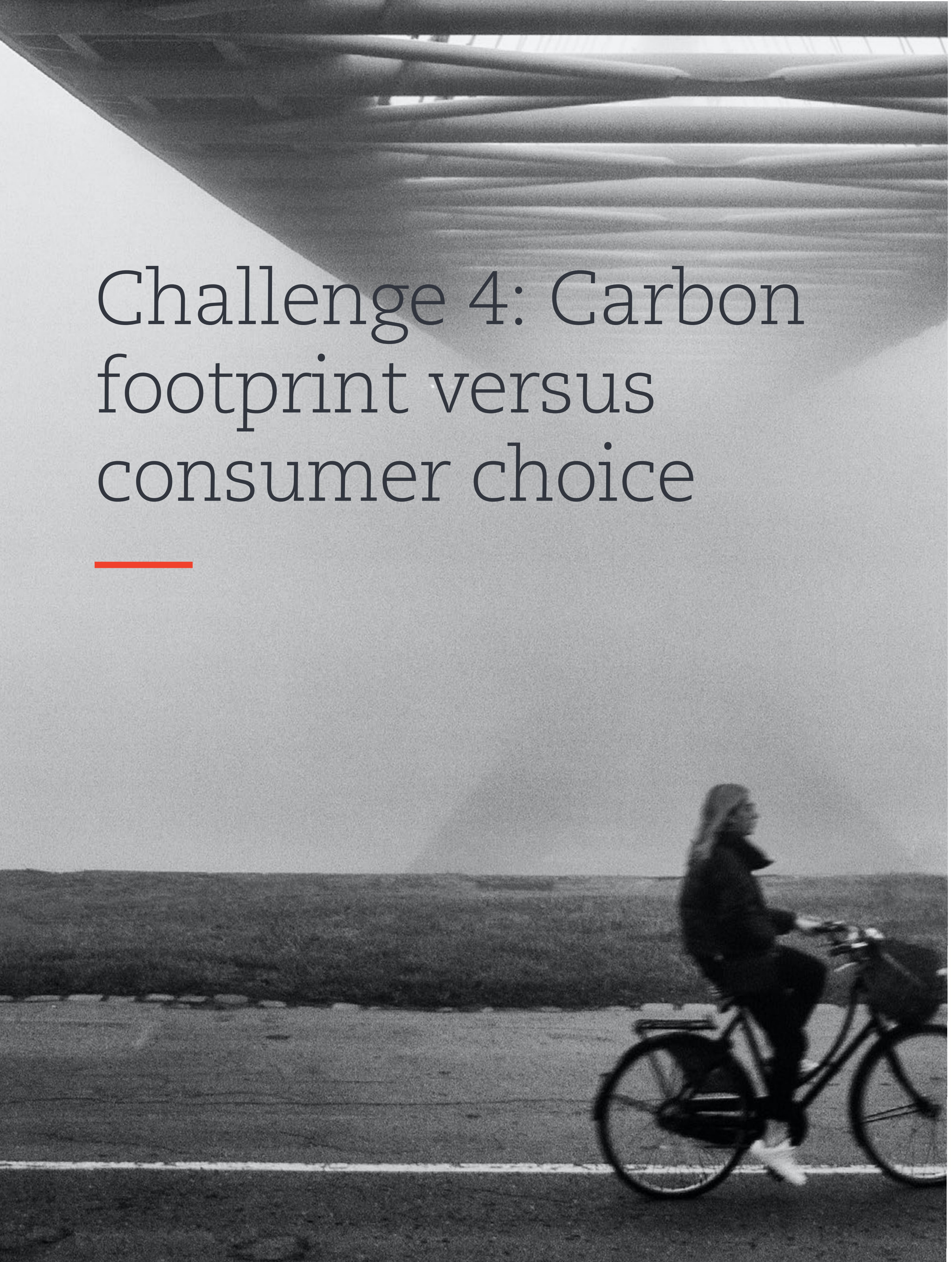
The year was now 2029, and it had become clear that in order to meet net zero in OurCo’s supply chain, it must re-tender for suppliers. A major supplier for one of the company’s main products failed to meet the expected environmental standards. In deciding whether to reappoint it, environmental considerations had to be balanced with wider responsibilities to the local workforce and community. The audience/board was asked to vote:

| | |
|---|---|
| Yes, reappoint the supplier – we recognise our responsibilities to the local workers; or | 63.70% |
| No, don’t reappoint – we don’t want to jeopardise our track record on cutting emissions | 36.30% |

The poll findings are based on 455 responses

Aligning the supply chain behind net zero targets is a huge challenge, as the panellists made clear. Having contracts aligned with codes of conduct and setting the right KPIs are essential, but it also requires understanding, engagement and support, so that suppliers can be part of the solution. This feeds into ideas around “stewardship”, in which corporations work with partners to marshal a “just” transition to net zero.

“If everyone divests because it’s the easy route, that’s not the answer. We’re likely to have not just a disorderly climate transition but a disorderly transition in many other ways,” said Rowan Douglas, Head of Climate and Resilience Hub at Willis Towers Watson. “It’s up to companies like OurCo not just to worry about its own emissions and to help its immediate supply chain, but also to support the thornier challenge of a transition for the whole economy.”



# Challenge 4: Carbon footprint versus consumer choice

By 2030, legislation had been brought in introducing mandatory product carbon labelling, but OurCo was still not on track to hit its targets, so its shortcomings were soon to become clear to customers. It lacked the data to comply quickly enough, and so either significant investment in data gathering would be required and/or some difficult choices made about the product range. The audience/board was asked to vote on:

| | |
|---|---|
| Whether to remove certain products, reducing consumer choice but enabling OurCo to hit its milestones; or | 43.50% |
| Rapidly accelerate work to reducing the carbon footprint of the whole product set, despite major increases in the cost of production? | 56.50% |

The poll findings are based on 409 responses

Panellists acknowledged that having the right data about the specific carbon footprint of their products or operations is likely to become a major issue for companies, as part of the wider drive for transparency around how climate risk is being addressed.

They also made the point that consumer behaviour is likely to be very different in ten years than it is today, and even more influenced by the green agenda, so it's important to think ahead how the business' offering – and its entire business model – may have to change.

# The challenges ahead

As Nigel Brook put it, "Forward-planning and horizon-scanning are so important: developments are happening so fast, companies need to be super agile. The board and the risk management team will require a whole new set of skills going forward."

Navigating climate risk will be a continuous process, and businesses will face unique as well as common challenges along the way – some of which will clash with other, no less critical, considerations. By taking attendees on this virtual journey now, they should be better equipped to anticipate some of the issues that may lie ahead, and help put strategies in place to take advantage of the possibilities and avoid the pitfalls the transition to net zero unearths.

To find out more about Clyde & Co and resilience visit **www.clydeco.com/resilience** where you can read our latest insights, blogs, events and you can join the resilience conversation. As a global law firm with a unique understanding of risk, Clyde & Co are well positioned to assist you to understand the legal and regulatory implications of developing new approaches to risk management.



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