UNDERSTANDING CLIMATE RISK IN NEW ZEALAND'S BUSINESS COMMUNITY

BDO

Aotearoa became the first country in the world to make climate-related risk disclosures mandatory in the financial sector. Though the legislation currently only applies to around 200 of New Zealand's largest finance firms, it is expected that these requirements will soon trickle down to the wider SME community.

The law requires affected businesses to disclose information about the risks and opportunities climate change presents, thereby making environmental sustainability a central pillar of business decision making.

The finer details of the requirements have now been developed by the XRB in line with the recommendations of the Task Force on Climate-related Disclosures (TCFD), and reporting becomes mandatory from FY23.

There are a number of actions affected businesses, as well as other organisations that want to improve their understanding of climate risk, can take to prepare.

We've created this handy framework to help you understand and mitigate your climate risks.

UNDERSTANDING CLIMATE RISKS FRAMEWORK

1. UNDERSTAND WHAT CLIMATE RISK MEANS TO YOUR BUSINESS
2. UNDERSTAND THE OPPORTUNITIES PRESENTED BY CLIMATE RISKS
3. UNDERTAKE A GAP ANALYSIS AGAINST THE 11 TCFD RECOMMENDATIONS
4. SET TARGETS AND DEFINE ACCOUNTABILITY
5. DEVELOP AND IMPLEMENT A PLAN TO MEET YOUR TARGETS AND MAKE CLIMATE CHANGE A STANDING AGENDA AT YOUR BOARD
6. REGULARLY REVIEW PROGRESS AND UPDATE YOUR STRATEGY AS REQUIRED

1. UNDERSTAND WHAT CLIMATE RISK MEANS

Many businesses have a limited understanding of what climate risk really means for their organisation. Climate risks are complex and long term, and require a different approach to other types of risk businesses usually face.

The TCFD considers there to be two types of climate-related risks:

TRANSITION RISKS – **these are the risks associated with transitioning to a low-carbon economy. These include:**

- policies attempting to curb the emission of greenhouse gasses by the business community
- potential litigation arising from businesses failing to mitigate the impacts of climate change
- changing consumer habits leading to a shift in demand for certain products and services
- new technologies that support the transition to a low-carbon economy, which are likely to disrupt markets, creating both winners and losers
- damage to organisational reputation when a business is perceived to be making climate change worse

The financial impacts of transition risks include increased costs of complying with government policy (particularly the increasing costs of carbon credits in the New Zealand Emissions Trading Scheme), more difficulty in securing funding from investors wary of environmental risk, reduced revenue when customers seek greener products than those you can deliver, and potential regulatory fines if you do not comply with government policy.

PHYSICAL RISKS – **these involve acute risks (such as extreme weather events) and chronic risks (new climate patterns).**

Examples of acute risks include flooding, cyclones and droughts. Examples of chronic risks include rising sea levels and increased temperatures.

The financial impacts of physical risks include damaged infrastructure and assets owned by businesses, disrupted supply chains, increased prices for raw materials, and higher insurance costs.

Identifying which of the above risks your business is susceptible to is the first step to understanding how climate change is going to impact your organisation moving forward. This may require detailed scenario analysis so that you can plan based on different degrees of global warming.

2. UNDERSTAND THE OPPORTUNITIES PRESENTED BY CLIMATE RISKS

It's important to note (and it can be easy for businesses to forget this) that climate risk does not always have to be negative. Our BDO colleagues in the US recently ran a mid-market CFO survey, which indicated that nearly two-thirds of CFOs believe focussing on ESG will improve their long-term financial performance.

There are many business opportunities arising from climate change. These include but are not limited to:

- **Improved efficiency** – for example by reducing energy costs through transitioning to renewable energy, or by participating in the circular economy so that less product goes to waste
- **Competitive advantage** – those businesses that can show they are taking climate change seriously will win the hearts and minds (and dollars) of climate-conscious consumers
- **Diversified products and services** – by providing offerings that help solve the climate crisis instead of contributing to it
- **Increased collaboration** – working with local communities, government bodies, entrepreneurs and emerging markets collaboratively on projects that help solve the climate crisis

Identifying where you can take advantage of opportunities will help to make you a more resilient organisation.

3. UNDERTAKE A GAP ANALYSIS AGAINST THE TCFD RECOMMENDATIONS

Once you've understood the different risks and opportunities presented by climate change, you can undertake a formal gap analysis (comparing current performance versus expected performance) against the TCFD's 11 recommendations. These cover four key areas (see below). Once you've undertaken your gap analysis, benchmark it against others in your industry to see how you're faring.

RECOMMENDATIONS AND SUPPORTING RECOMMENDED DISCLOSURES

GOVERNANCE	STRATEGY	RISK MANAGEMENT	METRICS AND TARGETS
Disclose the organization's governance around climaterelated risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
RECOMMENDED DISCLOSURES	**RECOMMENDED DISCLOSURES**	**RECOMMENDED DISCLOSURES**	**RECOMMENDED DISCLOSURES**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climaterelated risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climaterelated risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Recommendations of the Task Force on Climate-related Financial Disclosures, pg. 14

4. SET TARGETS AND DEFINE ACCOUNTABILITY

Once you know where you're at and where you want to be, you can start introducing some KPIs and targets for various areas of your climate change strategy, as well as working out clearly who in your organisation is responsible for meeting each target.

5. DEVELOP AND IMPLEMENT A PLAN TO MEET YOUR TARGETS AND MAKE CLIMATE CHANGE A STANDING AGENDA AT YOUR BOARD

Work with every department in your business to create a plan to address climate change risks and harness any opportunities you have identified from your gap analysis.

To do this, you need to get all of your senior leaders and board talking about climate change regularly so they can better understand how it impacts the different areas of your business. Mapping your stakeholders and assessing how sympathetic they are to implementing climate change measures as well as their general understanding of environmental issues will help you know where you need to focus most of your education efforts.

It's also important to make sure you have effective and regular data gathering processes for all of the climate risks and opportunities identified so that your board can make the best decisions possible.

6. REGULARLY REVIEW PROGRESS AND UPDATE YOUR STRATEGY AS REQUIRED

Make your climate disclosures part of your main financial reports, and ensure you have plans to increase the quality of your reports as you move forward.

Remember that mandatory disclosure isn't just about reporting on your climate risks but also having rich enough data to make better decisions and ultimately improve your organisation's environmental impact. Make sure you're frequently reviewing your strategy to improve your carbon practices – this is not just about mitigating the worst risks but harnessing the opportunities that strong climate change policies can provide.

If you need help with moving your business' sustainability journey along and don't know where to start, BDO can help. Contact your local office today.

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