Risk managers *navigate* transition risks on the road to net-zero

Customer and Broker webinar summary

November 14, 2023

Transitioning to a low-carbon economy is a complex process, involving many stakeholders, with risk managers playing a critical role in helping their organizations meet net-zero targets while reducing greenhouse gas emissions throughout their value chains, and at the same time managing the immediate effects of climate change (increased frequency and severity of natural hazard events).

That's the consensus of a panel of experts who discussed the challenges of managing climate-related transition risks during a webinar hosted by Zurich Commercial Insurance. Such work is not easy, they pointed out, but it is achievable with the right approach. And, risk managers have a big part to play in getting the work done.

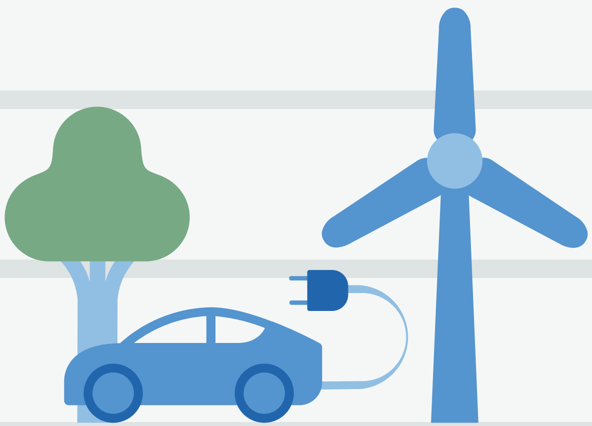
"Risk and insurance managers are particularly well-positioned because of their knowledge of their companies and positions they have within their organizations," said the webinar host **Ron Davis**, Global Head of Customer Management, Zurich Commercial Insurance.

A report "Accelerating the Climate Transition" published by Zurich Insurance in September 2023, shows that there is substantial interest in physical, operational and transitional climate risks. A survey of nearly 700 sustainability executives and others in senior leadership at large companies in heavy manufacturing, consumer goods, energy, transportation, agriculture and other industries revealed that many are addressing the risks and opportunities of transitioning to a lower-carbon environment.

The report notes that, depending on the sector, transition planning has been uneven, according to **John Scott**, Zurich's Head of Sustainability Risk. "Finance and energy seem to be pushing ahead pretty hard with the delivery of their transition plans in the short term," he said, while businesses in other sectors, such as transportation, which is heavily reliant on fossil fuels, are not as far along.

The cost of capital, an absence of technological solutions and regulatory challenges were the barriers to transitioning most frequently cited in the survey, Scott said. Regarding mapping and tracking emissions, lack of clear and credible data was a concern.

The survey also showed that there is a focus on climate-related resilience and adaptation measures even as transition work is ongoing. Companies across all sectors have concerns about supply chain risk, for example, "as they navigate the transition to net-zero," Scott said.



Green guidance

The European Union's Green Deal aims to make climate neutrality a reality by 2050 and introduces a number of policies that businesses have to consider as they transition to a net-zero environment. In other countries and regions, efforts are progressing to incentivize the shift to lower carbon economies, including the USA through the introduction of the Inflation Reduction Act (IRA).

"The breadcrumbs of how we are going to get there are summarized through the EU's perspective," **Shane O'Reilly**, Managing Director at KPMG Sustainable Futures, said of the Green Deal. It focuses not only on the environmental side of transitioning, but on social factors as well, he added.

But moving to a low-carbon economy will likely come at a price, O'Reilly said, and not just in terms of the cost of transitioning. Without adequate counter measures, the effort could cost jobs and have an impact on the prosperity in some cases. "We can't lose sight of the social factors," he said. "A just transition means that no person gets left behind."

Getting to net-zero requires governments to "bring the public along on this journey," O'Reilly said. That can be done through green jobs initiatives, retraining and upskilling programs and other moves that help ensure that the social aspect of transitioning is not ignored, he added.

"Risk managers need to know that we are shifting from a voluntary to a mandatory ESG reporting requirement," O'Reilly said. Although the pace and way this is happening is not the same in all countries or regions, the sense of direction amongst policymakers and in business is that some sort of carbon emissions disclosure is inevitable and will be required in many jurisdictions, And, just as important, there is an effort to mainstream sustainability into normal risk management practices, he added.

Change creates new exposures

Risks encountered on the road to a net-zero environment often are part of the change management process, said **Risto Schmid**, Senior Risk Engineer at Zurich Resilience Solutions. Those involved in transition work must have a detailed understanding of the process and how it applies to the entire value chain, with an awareness that the risk landscape will likely change as the organization moves towards net-zero emissions targets, he noted.

Schmid's experience as a risk engineer revealed how the transition to sustainable energy, for example, requires much different thinking than it did around seven years ago when he conducted a risk assessment at a customer's operation. In a garage, he recalled, "all I saw were petrol-powered cars and some bicycles. If I walk into a garage today, what do I see? Plenty of charging stations for electric vehicles. Not only for cars, also for bicycles. This may introduce new risks into the building if the charging stations are not professionally installed and well maintained."

Another typical example are rooftops. A few years ago they were usually only topped with gravel and grass but today they are more likely to have solar panels, Schmid said. Such changes can create new exposures. "Solar panels or other new technologies are not a problem but we need to be sure that the quality of components are the right ones," he, added, while ensuring that the contractors who installed the panels were experienced and that proper maintenance is ensured.

Justine Kelly, Global Head of Sustainability, Commercial Insurance and Group Underwriting at Zurich, pointed out that in addition to risks related to physical impacts of climate change, there are a number of additional transition-related risk categories, defined in the Task Force on Climate-Related Financial Disclosures framework.

Among them, risks arise from policy actions aimed at constraining actions that contribute to the adverse effects of climate change, she said. Bans on technologies such as internal combustion engines, for example, could mean sales of companies supplying parts for such engines are heavily impacted or ceased.

And, as the world moves away from carbon intensive activities, there is a risk that assets could be stranded if they can't be adapted to a low-carbon model, Kelly said.

There are legal risks as well, Kelly said, as companies' exposure to litigation could increase if they run foul of a growing number of sustainability and carbon disclosure mandates such as the EU's Corporate Sustainability Reporting Directive, or the Corporate Sustainability Due Diligence Directive (CSDDD).

New technology in the transition process introduces risks, Kelly said. "We're all aware as technology quickly evolves, we also see generally higher risks that something might go wrong," she added.

There are also market risks, which are posed by factors such as volatile costs of low-carbon raw materials and changing consumer behavior, as well as reputational risk which is a consequence of raised expectations by consumers and other stakeholders about companies' actions matching their words when addressing environmental and social issues, Kelly said.

"The level of transition risk differs according to market and industry," she said. "We need to think about the risk landscape of each individual company."

The risk management approach

Risk managers have to take a holistic view of transition risk in order to manage it properly, Schmid said.

"The most important thing is that the risk manager has a solid understanding of the business," he said. "This obviously includes the whole value chain, goes down to the suppliers who deliver raw materials on all components, the different factories, the interconnection of the factories and, finally, the distribution of the product into the market."

Drawing insights from available data to manage transition risks is important, but is not as easy as it is for data-rich physical risks, Kelly said. Insurers, who are involved in multiple sectors related to transition risks, play a key role in providing insights drawn from their data sources and "that's valuable in our customer discussions," she added.

Risk managers have access to data around their organizations' operations that is valuable in making decisions on transition strategies, according to Schmid. "A sustainability database strategy should be developed," he said.

Zurich and other insurers use modeling to run climate risk scenario analyses that help generate a long-term view of risks and opportunities associated with climate change. "It doesn't give us absolute answers," according to Kelly, "but it informs our decision-making and it makes sure that we can have a strategic response to potential impacts."

Getting buy-in from all relevant stakeholders is a challenge in most companies when addressing climate-related risks and transition planning, the experts agreed.

Schmid praised the approach of a risk manager who worked with his company's sustainability manager to set up a workshop to cover reporting requirements outlined by the Task Force on Climate-Related Financial Disclosures. After inviting 19 functions within the company to attend, they were able to secure buy-in from different stakeholders on what needed to be done address the risks identified, through site-specific adaptation measures.

Support from insurers

Among the different ways insurers can support their customers as they move towards a net-zero operation, the most obvious is providing insurance cover enabling companies to operate and invest in their transition as they manage or move to new business models or deploy new technologies at scale for instance. Insurers also play a key role in supporting risk management by providing data, insights and expertise as companies look at adaptation to and mitigation of climate related risk, as well as rebuilding with more resilience should an event or disaster occur, according to Kelly.

In addition, insurers can use their experience and understanding of various sectors as well as interconnectedness of sectors and industries to share insights relevant to the transition to net zero with customers, as well as provide input to policy discussions and advice industry associations or similar, she said, adding Zurich's "Accelerating the Climate Transition" report as an example of how such expertise can be put to use.

Zurich takes a risk-based approach to assess the specific risks its customers face and how they are managed, Kelly pointed out. "We are continuing to build knowledge and loss data, especially in emerging technologies," she added, and "provide expertise, insights and capacity where we can."

O'Reilly pointed out that underwriters focus on supporting their customers in building resilience to physical risks through adaptation. They can provide insights from modeling both before and after a severe weather-related event, informing potential coverage changes and the benefits of strengthening resilience in rebuilding.

Insurers are able to provide innovative coverage options, O'Reilly said. Depending on the needs of individual customers, that could include risk transfer solutions such as protection against business interruption, other non-physical-damage losses, the cascading effects and interdependencies of hazards, and critical infrastructure failures.

Schmid likened insurer support to the experience of driving a car. Looking into the rearview mirror reveals claims data, which shows how organizations reacted to losses and might be able to avoid similar incidents, he said. Through the windshield, the driver sees current exposures and the GPS represents the long-term journey on the road to the net-zero transition, "with the data you enter changing as the trip progresses," he said.

"All the passengers, at the end of the day want to get from A to B," Schmid said. "It is our task as insurers to support them through our risk management expertise, data and tools on a safe journey."

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