

Talking Climate and Sustainability – Episode 6: Stewarding now for the future

MATT SCOTT: And I think for me, that's that concept of stewardship and what does that mean, to be able to manage both now and for the future, and to take action today that can make a real difference to the economy-wide transition.

SPEAKER: You're listening to Talking Climate and Sustainability, a podcast series from Willis Towers Watson where we explore why climate change and building a sustainable future is a responsibility we all share. From the complexity of shaping an effective ESG strategy to achieving an orderly transition to a sustainable, low carbon, climate resilient economy, organizations across the public and private sectors are grappling with the challenges of climate change and creating a more sustainable future for communities and society.

LYDIA MESSLING: Hello, and welcome to our climate and sustainability podcast. Now, this time, we've got something a little bit different for you. In these next few episodes, we thought we'd chat some more about the themes that emerged at our Climate Risk and Financial Stewardship Summit back in May 2021, where we heard from industry-leading experts on the changes and challenges in stewarding the transition to a climate-resilient economy. There is so much more to explore. And so we hope you enjoy the perspectives and insights from Willis Towers Watson's thought leaders as they further unpack climate risk, resilience, and sustainability and what organizations need to be thinking about.

Hello and welcome to our *Talking Climate and Sustainability* podcast. I'm Lydia Messling, your podcast host. And this week I have 'the' Matt Scott joining me. Matt, hi. How are you doing?

MATT SCOTT: I'm very well, Lydia. It's great to be here. Thanks for having me on.

LYDIA MESSLING: Thanks, Matt. Now, you're now a senior director in the Climate and Resilience hub here at Willis Towers Watson, but your journey to here is rather varied and quite interesting. So just give us a little recap on the life of Matt Scott thus far.

MATT SCOTT: The life of Matt Scott thus far, it's a great question. I'm not sure how long we have, but yeah, it's been a bit of a winding path, but a really exciting one. I guess I tend to think of my pre Willis Towers Watson career-- I've been here for about eight months-- in three different chapters. So initially, I started actually, did a physics degree and then worked in an environmental science company, not far from Oxford, actually, and spinning out new environmental technologies, and I guess learning a little bit about the climate in my initial sort of chapter of my career.

And then the second chapter, I had the great opportunity then to head off to Silicon Valley, so did an MBA at Stanford Business School, which was a massively transformative experience for me. I think I went in as a sort of scientist, came out more as an entrepreneur. So as you do in Silicon Valley, I set up a business to look to solve the global problem of kerosene lighting.

So there is about 1.6 billion people in the world who, at that point, nearly 20 years ago, lacked access to electricity. And it's actually a Stanford class that brought together engineers, and MBAs, and designers of what we could do about that big global problem. And we decided to set up a business.

So I went off to India for quite a number of years and was effectively a green entrepreneur, a social entrepreneur looking to bring light to off-grid villages. And actually, kerosene lighting is a huge challenge. I think that a child breathing in the light of a kerosene lamp breathes in something like the equivalent of two packets of cigarettes every evening. So it's certainly something that I felt really passionate about. And it was probably my experiences of being a green entrepreneur and trying to raise money for my own venture that then got me interested in the sort of third chapter of my career, which is what could be done to create a greener financial system.

So I spent one or two years actually in sort of impact investing, but then through a range of sort of fortuitous opportunities, I found myself at the Bank of England, where I spent close to a decade or so looking at ways to-- what central banks could do to address the risks of climate change. I'm happy to talk more to that. So effectively, I had the pleasure of leading a report on the impacts of climate change in the insurance sector that laid out the physical transition liability risks framework that has become quite familiar, and then also worked quite closely with Governor Carney and others at the bank around things like TCFD and the Network for Greening the Financial System.

So that was a bit of a detour into a sort of 10 years of policy and regulation, but it's been massively exciting, I think, in some ways, even more entrepreneurial than some of my experiences in India. We now have over 90 central banks working together to green the financial system. And so much progress has been made. And I think it was on the back of that, and also helping to lead the UK's green finance strategy on some comments from the Bank of England, that I just felt it was time to come back to the private sector and to join Willis Towers Watson, which again, is a really exciting 18 months in the Climate and Resilience hub, so yeah, delighted to share some more thoughts on that too.

LYDIA MESSLING: So that's a really interesting segue through quite a few different things, from your science background, then moving into green entrepreneurship. But then to step from those into the things that you were doing at the Bank of England, how did that your past experience sort of shape and influence what it is you then went on to do at the Bank of England?

MATT SCOTT: So great question, Lydia. I think there is probably a few aspects to how my experience helped. I think to some extent, I think the climate challenge that we're facing does lie at the intersection of the climate energy system and also the economy. So I think having sort of has some experience of the science, also some experience in the energy sector, and then also obviously the bank's focus around the economy, being able to understand those different aspects I think was quite helpful.

When I joined financial regulation, there was already a movement towards financial regulation becoming more forward looking, and what's known as judgment-based supervision. So for example, my first role was actually looking at the sustainability of

business models, particularly in the insurance sector. And I think it was therefore really that focus around sort of sustainability.

At that point, it was just quite a narrow financial focus. So were firms making enough money to pay their future dividends? But obviously, I think that sustainability aspect has now broadened to consider the impacts of climate risk. And I think it was quite natural, actually, in some ways, for that to begin in the PRA's insurance division, because insurance is already on the front line of climate risk. So to consider what the impact of climate change could be from a sort of emerging-risk perspective was a natural place, then, to begin to look at the physical transition and liability risks that form the framework for the report that was published in 2015.

LYDIA MESSLING: And so from green entrepreneurship to Bank of England, with regulation and things like that, now Willis Towers Watson-- what is it about being with us that appealed to you?

MATT SCOTT: Many different things. I think, in particular, the combination of the firm's work across people, capital, and risk, because I think, throughout my journey both as a sort of entrepreneur, and then also in central banking, I think I've begun to realize that, again, to solve the big systemic challenge of climate, we really need to integrate climate risk. Obviously, that speaks to a lot of the work that I can talk more to in terms of what financial regulators are now doing to integrate climate risk. And they need to quantify those risks.

Also, we need capital to move. So we need to fund the solutions of the future, reallocate capital in line with a Paris-aligned economy. And then, I think, ultimately, it also comes down to people. You know, we need people to engage on this. And I think so much of the significant shifts that I've seen throughout my career really come down to, a lot of the time, individual leadership, and people choosing to make a difference and to show leadership. So I think that combination of being able to work at the intersection of risk, people, and capital is something I think the firm is uniquely placed to offer. And indeed, our very purpose of creating clarity and confidence today for a more sustainable future, I think, speaks so much to what we need to fully address the climate challenge.

LYDIA MESSLING: That's great. That's the right answer, Matt. You can stay. We'll keep you. And so what's the next challenge for you here, then? What is it you're focusing your efforts on in particular at the moment?

MATT SCOTT: Yeah, so there is a number of things that I'm working on. And it's been a real delight to do that with many colleagues like you, Lydia, across the Climate and Resilience Hub, which I think we're now close to 100 people, but then also, again, across the whole firm, across experts that we have around people, capital, and risk. And I think one of the things that I talk often about in terms of how central banks' and financial regulators' thinking has evolved in this area of what the role can be to address climate risk, is that, really, in my view, there has been sort of two inflection points on that journey.

The first one is that climate is a financial risk. And therefore, we need to integrate it like any other risk. And I think that really speaks to the physical transition liability risk framework.

But then interestingly, I think there is a recognition now, even including the Financial Stability Board and many members of the Network for Greening the Financial System, which is this community of the willing of central banks that now totals over 90 members, that climate also has distinctive characteristics, in that it's far reaching. It's systemic. It's foreseeable.

So we know some combination of these physical or transition risks are coming down the line. And also, perhaps importantly, it's clearly for action today. So it's really actions over the next few years, and particularly over the next decades that will determine the future financial risks that we face.

So I think with climate, we're seeing the need not only to manage the risks of today and over the next few years, but also to find a way to manage future financial risks. And to do that, we need to steward an orderly transition to a net-zero and climate-resilient future. And I think for me, though, it's that concept of stewardship and what does that mean, to be able to manage both now and for the future, and to take action today that can make a real difference to the economy-wide transition.

And that's one of the reasons, for example, a few months ago, that we held a big summit, as you know, Lydia, to convene lots of different actors, both financial institutions, pension funds, banks, insurers, as well as policy makers and regulators, to talk about both climate risk and this notion of financial stewardship. How do we manage now and for the future?

So I think that's something that is really interesting to me, because again, I think it speaks to this combination that we need of being able to look at the long-term risks and the analytics we need around that, but then also ways that we need to mobilize capital and ensure that current commitments around net zero, which are extremely welcome and that we've made ourselves, are really targeted and harnessed towards driving outcomes in the real economy. And I think that, for me, sort of speaks to some of my previous experiences as a green entrepreneur, that we need money flowing into the solutions, that we need to address the climate challenge, as much as we obviously also need to be thinking about decarbonizing portfolios and reducing investments, perhaps in areas where there is considerable transition risk.

LYDIA MESSLING: So yeah, one of the things that you talk about is that sort of good stewardship, or meeting net zero isn't just about decarbonizing portfolios, that it's more than that. So can you tell me a little bit more about how stewardship, what that actually looks like, and how that is different to just being a really good investor or placing money in the right place for what looks good for you and for your organization? What is it about stewardship that is a bit more beyond that?

MATT SCOTT: Yeah, I think it's a number of things. I think for me, coming out of the Climate Risk and Financial Stewardship Summit, I think there were three real takeaways around what good stewardship can look like and what effective stewardship can look

like. And I mean that in the sort of the broadest sense of this notion of needing to manage the future risks today and to an orderly transition towards a net-zero and resilient, climate-resilient economy.

I think the first one is sort of fundamentally-- and this is where a lot of the Bank of England's work started, is the need to properly price and assess climate risk. So we know the current pricing doesn't necessarily fully reflect a mixture of climate-related factors. And to get the efficient allocation of capital, then, we really need to integrate climate risk effectively.

So for example, some of the great work that our Climate Transition Analytics team do here in the Climate Resilience Hub is just highlighting the differences, for example, between carbon intensity and the underlying value at risk from the transition to a low-carbon future. And so in some industries, a carbon price may be passed on. It doesn't necessarily pass through to consumers.

So there might be lower transition risk. And obviously, where individual firms are on the cost curve is also really important to consider when you're thinking about the actual value at risk from the transition. So I think, firstly, really important to price risk effectively, including climate factors. And through that, we can then have the efficient allocation of capital.

I think the second thing for me that really stuck out from the conference was this, again, this notion of needing to channel the great momentum that we have around net-zero commitments to things that are going to drive outcomes in the real economy. And I think one of the panelists had this phrase of the fact that a net-zero portfolio isn't necessarily the same thing as a portfolio designed to create a net-zero economy. You know, so within that, we need to think about, again, allocation to climate solutions, ways that firms are engaging, and innovating, and working with policy makers and regulators to try and create a more sustainable future. So I think it's a broader set of activities, as well as thinking through how to reduce the emissions of a portfolio, which obviously is really important too. So I think it's very much inclusive of, but beyond just a very narrow focus on target setting.

And then I think the third thing is, again, this sense of needing to consider mindsets as well as metrics, because obviously, the systemic risks that we're facing will be determined not by any emissions of an individual portfolio, but by the global emissions that we face. And therefore, we need to be thinking about what we can do to move the system as a whole towards a net-zero and climate-resilient economy. And I think that speaks to the role that we can all play and the agency that we all have to make a contribution to towards the systemic challenge that we face.

LYDIA MESSLING: So I like that, Matt. You've got how do you quantify risk and well in ways that actually can facilitate wise decision making and then make decisions off the back of that that have a real-world mindset-- impact. And then we have this thing around this mindset and how there is something more that needs to change in order to unlock all of these benefits.

What sorts of things have you seen recently change that you think we're beginning to see a change in mindset? Or do you think we're not quite seeing that yet? Where are your thoughts on that?

MATT SCOTT: Yeah, I think there is definitely change happening. I think we probably all experience that. I think it's probably driven from a climate perspective, obviously, from some of the quite tragic events that we're seeing evolve as the three, wildfires storms, floods are the things. I think the manifestation of the physical risks is becoming more evidence for everybody.

I think also, I think in my own journey, I've sort of experienced how having a little bit of a more developed understanding of the climate science can also be really, really helpful just so it brings home just the time scale in which we have to make a difference and the size and scale of the risks that we face. For instance, I remember the first meeting of the Network for Greening the Financial System.

At that time, there were, I think, 10 or 12 founding members of central banks and supervisors back in 2018. And we opened the conference, actually, with a brilliant climate scientist that really laid out how unprecedented some of the changes we're seeing are in, not only tens of thousands of years, but as you know, Lydia, for potentially millions of years, in terms of the level of atmospheric concentration of CO₂ and greenhouse gas in the atmosphere.

And I think understanding the time scale by which we need to then navigate down towards net zero and a halving of emissions over the next decades, I think can also really help to change people's views in a way of just the fact that climate change is very significant. It's relevant to everybody and to the financial system as a whole in terms of being a financial issue. And then also it's something that we need action on today.

And again, I think that brings me back a little bit to sort of the importance of this sort of second inflection point that is happening, but perhaps isn't as widespread as the first, that climate is not only a financial risk, but it does have these distinct characteristics. You know, it's different to other issues that we face, because it is so far reaching. It is also foreseeable. And it's for action today. And I think people-- as people understand that and begin to work together to address it, I think we're seeing really significant global progress to do that.

But obviously, finding out where responsibility sits for these things, between the need clearly for very strong government-led action, but also the fact that, really, everybody needs to be part of this journey, because we're all facing the risks of the future-- a world that is 3 or 4 degrees is potentially everybody's risk, not just the risk of others. So I think the work that's being done to extend time horizons out to 2050 and beyond, for example, through climate stress tests, again, is an opportunity not only to size the risks of climate change, but as my former boss Sarah Breeden talks eloquently about, also to prompt discussions of the role that we can all play and the financial sector can play to steward the transition.

LYDIA MESSLING: Right, exactly. And so then, you mentioned earlier about having sort of good stewardship, and what that looks like, and effective stewardship. And you've

also said that what stewardship might look like for individuals is different. But this idea of, like, collective stewardship, all together working to bring about a climate-resilient economy, how do we go about defining what good stewardship looks like to realize that climate-resilient economy?

MATT SCOTT: It's still evolving. I think we-- because, again, we're facing a type of risk that we've never had to quite manage before, one that needs collective action today to manage a future financial risk. So exactly what that looks like, I think, is still things that are developing.

I know it's an area that we, across the firm, as a whole are developing a whole range of different approaches in terms of the best way to do that, so whether it be helping to create a more resilient future through the Coalition on Climate Resilience Investments that we help to share, whether it's the work that we're doing around climate transition pathways to help assess and make sure we have robust transition plans for companies in the real economy, whether it's around series of products that we're looking to make available that help to factor in transition risk and forward-looking and financial metrics. So I think that we really are in a verge of a whole set of innovation that's required to help us navigate the transition ahead, and to reduce these future financial risks, and take the action today we need to do that.

I think also, we haven't really touched too much on the people side of things, but even the importance, for example, of governance incentives and embedding climate metrics into executive compensation, things like that, that are so important for us to help to, again, bring everybody with us within our organizations. And so I think there is a whole range of things. I would really highlight the sessions that took place back in May as a way for people to dive deeper into all of those topics. So there was a fabulous session around the pricing climate risk effectively at the summits.

There is also one around governance culture incentives that colleagues led that I think was really insightful. And I know that colleagues are also leading a forthcoming seminar in-- a webinar in September and the role that HR can play, for example, to be central to the climate challenge. So again, I think we are really in a wave of innovation to be able to address these complex, emerging, and in terms of climate change, I guess, very present risks that we need to face, so a whole range of different things that we're doing across the firm to help our clients navigate this.

LYDIA MESSLING: And so I'm going to be rather cruel now in asking this question, Matt. I'm going to ask you to choose to choose one thing. But you know, we're talking about the different tools and things that are becoming available to help us be effective and good stewards. And you also touched on mindset. And you do need to have the right mindset to know that you need to use those tools and the decisions, then, that you make off the back of what those tools and analytics can show you. So if there was one type of mindset that you could change, or is there one particular way of thinking that you think presents the biggest barrier to achieving good and effective stewardship, what would that be?

MATT SCOTT: Wow, one-- always hard to narrow it down to one thing, isn't it, Lydia? It's a great question. I think one of the things that is going to be important, particularly as we navigate the need for real economy impact, and to drive the economy as a whole

towards net zero, so again, this sort of sense that it's really global emissions that are going to determine the systemic risks that we face, is having a system perspective.

So basically, if we are to address the systemic risks, we need to think about what it is that we can do to help contribute towards the system as a whole moving towards net zero. And I know that's a real challenge, because we naturally think through the mindset of addressing our individual issues within our individual organizations, and perhaps our own organizational challenges. So I think finding ways that we can collectively work together and collaborate to deal with these system issues and to help to address the systemic risk, I think, is a slightly new way of thinking compared to the, perhaps, how we've had to manage risks before.

So I think, again, that probably speaks to understanding the interconnectedness of different disciplines, bringing together climate science with economics, with financial risk analysis, something that we're doing through our investments in the Willis Research Network, for example, that have been built up over 10 to 15 years, so engaging with the academic community to bring in those insights. And then again, I think across the firm as a whole, one of the things that really excites me of being part of the Climate Resilience Hub is to really be thinking about this problem through the lens of people, capital, and risks, because I think to respond strategically to the challenge ahead, it really does require thinking across each of those disciplines to form a strategic response. So I think that's the thing I would probably highlight, yeah, the need to be thinking about this from a systemic perspective and be thinking about how we can collaborate and work together to address the challenge that we're all facing.

LYDIA MESSLING: That's brilliant. That was a good one to choose, Matt. Well, thank you so much for joining us and for sharing your thoughts, and particularly on stewardship, such a fascinating project. But thanks for joining us, Matt.

MATT SCOTT: Thanks, Lydia-- great working together in the Climate Resilience Hub, and many thanks for having me.

LYDIA MESSLING: And many thanks to you all listening. And we hope you enjoyed it and will join us again and next time on the *Talking Climate and Sustainability* podcast.

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