

Stewarding the economy-wide transition to climate resilience, now and for the future



Following the Climate Risk & Financial Stewardship summit, Matt Scott, senior director in the Climate & Resilience Hub, shares his reflections on what effective climate stewardship means for the finance sector.

Climate Stewardship

Close to a decade ago, I had the pleasure of working with colleagues at the Bank of England to begin to examine the [impact of climate change on the UK insurance sector](#), leading to the formative physical, transition and liability framework for climate related financial risks. At that time, it was hard to imagine how quickly climate considerations would enter the mainstream – that we would be on a pathway to [mandatory climate disclosure across G7 countries](#), that more than 90 Central Banks and Supervisors would be working together to [Green the Financial System](#) and that institutions representing nearly [\\$70 trillion of assets](#) would have announced Net Zero targets.

At Willis Towers Watson's inaugural [Climate Risk & Stewardship Summit](#) in May this year, over 3,000 attendees across 3 days explored what is now needed for banks, insurers, pension schemes and other investors, supported by their financial regulators, Central Banks and Governments, to fully respond to the climate challenge and a rapidly evolving policy and regulatory landscape.

A key theme throughout these three days was the notion of 'stewardship' - the need for the financial institutions to play a strategic role, not only managing short-term risks to their own portfolios, but also playing their part in responding to the systemic climate challenge by actively stewarding the transition to a Net Zero and climate resilient economy.

While many financial firms are now embracing this stewardship role, putting this into practice can be challenging. What 'good stewardship' – and Net Zero

– means for banks, insurers and investors, is still evolving – and it can sometimes be hard to keep up with a proliferation of initiatives, approaches and requirements. Managing the risks of today is a challenge in itself; taking action today to manage future risks can be even harder.

Of the many insights shared at the Summit, three aspects particularly resonated for me as being important for effective climate stewardship:

- 1. Pricing climate risk effectively:** asset prices do not yet accurately reflect climate-related financial risks and opportunities. Effective stewards are developing and embedding the models, methods and metrics to better reflect climate factors in their investment decisions, and, in so doing, supporting the efficient allocation of capital and an orderly transition.
- 2. Real economy impact:** it is global, not portfolio emissions, that will determine the size and scale of the system-wide risks that we all collectively face; effective stewardship involves delivering Net Zero commitments in a way that channels capital to making a difference in the real economy, for example, through investment, engagement, collaboration and innovation.
- 3. Mindsets as well as metrics:** effective stewardship is more than developing climate analytics and meeting regulatory requirements, as important as these are. Building the right culture, governance and incentives is also paramount; ultimately it is an organisation's people who are the enablers and advocates – the stewards – of climate strategy.



1. Pricing climate risk effectively

Further to Mark Carney's seminal speech in 2015, [Breaking the Tragedy of the Horizon](#), the pricing of climate risk, supported by enhanced climate disclosure, is integral to the effective functioning of financial markets, and the efficient allocation of capital. A core focus of the summit was exploring the models, methods and metrics needed to do this, finding the balance between macro, top-down and micro, bottom up approaches.

By way of example, analysis by WTW's Climate Transition Analytics (CTA) team [presented](#) on Day 2 of the conference clearly illustrated the differences between financial metrics, such as climate value at risk, and climate metrics, such as carbon intensity. Carbon-related metrics [do not necessarily translate](#) into underlying financial impact in ways that you might first expect. For example, in some industries – those with an inelastic demand or those that are regulated – an additional carbon price can be passed through to consumers via higher prices, with little impact on asset valuation. In other cases, particularly where low-carbon alternatives are readily available, relatively small carbon prices could have a significant impact.

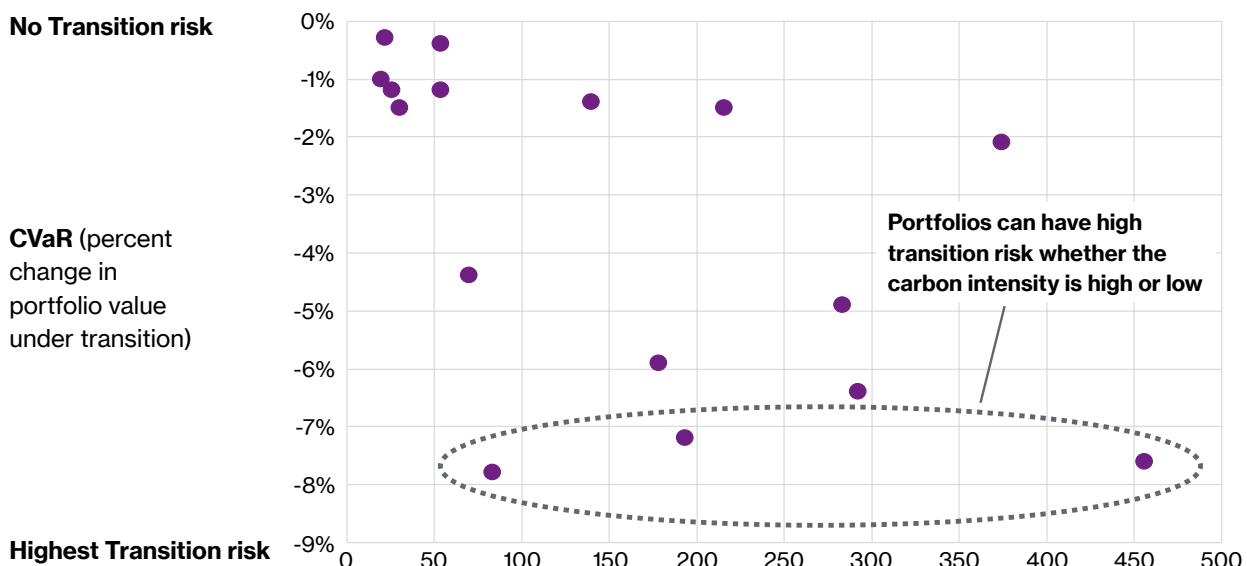
The recent move to [forward looking metrics](#), such as Implied Temperature Rating (ITR), provides a helpful way of taking a more dynamic view of future carbon emissions and can be a [powerful communications device](#). At the

same time, it's important not to conflate these metrics with measures of financial risk. A warming potential score provides little indication of the financial impact of physical risks to an investment portfolio. And for reasons explained above, where metrics are carbon based – even if they are forward looking – they do not necessarily translate into the financial impact on asset prices of a 'well below 2C' transition.

The effective pricing of climate risk – and financial risk metrics – remain core to the efficient allocation of capital and an orderly transition. To support our clients, and financial markets more broadly, to better integrate climate risk we are working on making new financial products available to asset owners. These will move beyond carbon to emphasise forward looking financial climate metrics. Doing this can help investors, such as pension schemes, play a more active stewardship role and capture pricing opportunities presented by the transition to a Net Zero future.

As highlighted at a roundtable with leading legal experts, academics and practitioners, care also needs to be taken not to lose sight of climate liability risks. Experts and practitioners alike agreed this third category is only increasing in importance, particularly in relation to [Directors' duties](#) and the far-reaching, and foreseeable, nature of climate risk.

Figure 1: Carbon intensity vs. Climate Value at Risk (for a sample of European investment portfolios – January 2021)



Source: WTW analysis (for 'well below 2C' scenario), FactSet. For more detailed presentation, see [presentation from Climate Risk and Financial Stewardship summit](#)



2. Delivering Net Zero targets through real economy impact

The momentum behind Net Zero commitments was welcomed by many Summit participants. We are proud to have announced our own, including for our **operational emissions** and our **discretionary investment portfolios**.

In discussions on Net Zero, a clear message from conference participants was the need to keep our collective eye on the prize; achieving Net Zero in the real economy. It is total global emissions, not those within individual portfolios, that will ultimately determine the size, scale, and potential irreversibility of systemic climate risks.

In the words of one asset manager, Deirdre Cooper from Ninety One: “We need portfolios that will help to drive a Net Zero world, rather than Net Zero portfolios – they are two very different things.”

The Minister for Pensions, Guy Opperman reiterated this message: “I am so passionate that we should not be going down the path of divestment. We need to ensure that organisations are helping the likes of Shell, BP and others to navigate themselves from an oil and gas provider to a clean energy provider.”

To ensure the momentum behind ‘Net Zero Finance’ makes a real-world difference, we need to work beyond solely “decarbonising” portfolios. Effective stewards are also:

- a. Investing in Climate Solutions** – including, but not limited to those in ‘low carbon’ sectors. Investments in adaptation and resilience are also important, as well as supporting innovation in **carbon intensive, hard to abate sectors** and **providing transition finance**, particularly in emerging economies;
- b. Engaging with companies**, often alongside other investors in collaborative initiatives, such as **Climate Action 100+**, to encourage, assess and ensure delivery of company specific Net Zero transition plans in the real economy.

- c. Working with regulators and policymakers** to encourage ambitious public policy to accelerate the transition, support adaptation and resilience and charter the path to a Net Zero economy and a green financial system;
- d. Pursuing innovation in green financial products and services**, for example, to better price, hedge and manage climate risk or accelerate flows of capital into Paris-aligned investments.

To better deliver their emerging stewardship responsibilities, the summit highlighted the practical actions being taken by financial institutions to drive Net Zero and climate resilient outcomes in the real economy.

For example, the opening panel showcased the progress being made through innovative, cross-sector partnerships, such as the **Coalition on Climate Resilient Investment** (CCRI). A flagship initiative of CoP26 in Glasgow, CCRI brings together many different public and private sector actors to better integrate physical climate risk into investment decision making, supporting more climate resilient economies and communities across the world.

And on transition, the pressing need to measure and monitor progress against Net Zero transition plans is also driving innovation. For example, the recent launch of **Climate Transition Pathway** (CTP) accreditation provides a consistent and robust approach for identifying which organisations have robust transition plans aligned with the Paris Agreement. In so doing, CTP provides a mechanism for a rigorous, engaged approach for financial institutions to continue to provide access to capital while stewarding an economy-wide transition.

3. Mindsets as well as metrics

Underlying the need to price climate risk and actively steward the transition to reduce risks in the real economy is an equally important shift in mindset. Stewardship begins with the individual.

As Alastair Wood, Senior Director, Talent and Rewards, said: “An organisation might have a great climate strategy, but **people are the advocates and enablers of climate strategy**. It needs to be clear and well-articulated, and employees need to understand it and be actively engaged. Listening, incentives, skills and inspiration – these will be the people pillars of creating a strong climate-positive culture and engage employees in their journey towards Net Zero and climate resilience.”

In a recent WTW survey, participants highlighted the critical human dimension of galvanising climate action, and the role for people professionals to inspire, incentivise, upskill and engage with employees to drive towards Net Zero goals. This includes finding ways to listen to employees, integrate **climate-related metrics** into executive compensation as well as developing a comprehensive, firm-wide approach, endorsed and monitored by the Board.

The critical role of HR in responding to the climate challenge continues to be high on our agenda as we **bring together climate experts and practitioners**.

Conclusion

In recent years, climate has become a strategic and financial imperative. Having helped to shape the policy and regulatory landscape, it is a pleasure to work with colleagues across Willis Towers Watson and our Climate and Resilience Hub to help our clients implement the system-wide and structural changes now rapidly underway.

People, Risk and Capital are central to addressing the climate challenge. By pricing climate risk effectively, allocating capital efficiently and empowering people to become the enablers and advocates of climate strategy, we can all become stewards of a Net Zero and climate resilient future.



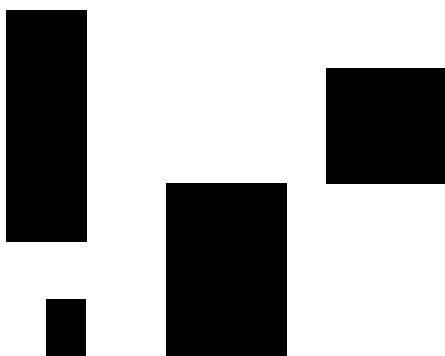
Matt Scott

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Matt Scott brings more than two decades of experience at the intersection of climate, finance and sustainable business. At the Bank of England, he created the formative physical, transition and liability framework for climate related financial risks and led the Bank's Climate Hub under Executive Director Sarah Breeden. He also supported the creation of the Central Bank and Supervisors Network for Greening the Financial System (NGFS). In 2018 he was seconded to Government, where he led the development and launch of the UK's Green Finance Strategy which set expectations for mainstream TCFD disclosure by 2022.

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