

New climate risk report will help businesses assess impact of global warming

February 23 2022, by Laura Singleton



Credit: Imperial College London

A new climate risk "taxonomy" released today is the first framework of its kind to classify the risks of climate change to firms.

Created by the Centre for Climate Finance & Investment (CCFI) at the Business School, the [new taxonomy](#) will enable lenders, investors, and regulators to better assess the climate and natural capital risks that may affect their organization.

The report makes the first attempt to codify natural capital risks, which would not normally appear in more traditional risk or credit analysis, into an organized taxonomy. It is also the first attempt to capture a broad range of physical and transitional climate risks that can affect a company's financial profile.

The report groups the three traditional climate risks facing companies and adds an extra category as follows:

- Physical risks, both acute and chronic such as water and heat stress and rising sea levels
- Transition risks related to adaptation—how to adapt coastal infrastructure to physical risk impacts
- Transition risks related to mitigation, ranging from regulatory compliance risks to reputational and litigation risks
- Natural capital risks—those that reflect depletion of both renewable and non-renewable resources that are themselves affected by climate risk factors

The first three risk categories represent traditional approaches to climate [risk assessment](#), and the report attempts to organize these to the level of financial impacts at the firm level, including the potential impact on margins, cash flows, leverage ratios and asset valuations.

The fourth category represents a new risk assessment category— the first attempt to codify such risks into an organized framework. This constitutes risks from natural events that may be accelerated as a result of some form of natural capital depletion or disruption, particularly in

the area of water availability.

The four major indicators chosen—subsidy loss risks, depletion risks, boundary condition risks and geopolitical risks, are becoming an increasingly important policy goal for both the public and private sectors.

Bob Buhr, honorary research fellow at the Centre for Climate Finance & Investment at Imperial College Business School and lead author of the report said: "Climate change is certain to have broad impacts on companies in affected industries, not least on their credit profiles and share prices. Yet this knowledge is useless to lenders and investors unless these risks can be further granulated in terms of their scope, timing and likelihood and their potential financial impacts."

The taxonomy is intended to be a framework that will help stakeholders to identify climate risks before they have impacts on asset utilization, stranded assets, reduced income and margins, or other financial measures.

"Without speaking directly to the risks arising from climate change from an investor's or lender's perspective, we cannot assess the extent to which a particular firm or corporate sector is exposed to climate impacts, which are becoming increasingly secular in terms of their potential financial impacts," said Mr Buhr.

Michael Wilkins, executive director and professor of practice at the Centre for Climate Finance & Investment at Imperial College Business School, added: "A climate risk taxonomy should be organized according to increasing granulation of different types of risks and levels of potential materiality at the firm level. The EU's Green Taxonomy is a useful tool as an investment opportunity set. However, it is limited in its potential utility as a risk monitor, due in part to its focus on industrial

sectors, rather than firms, and because it generally doesn't assess the costs associated with the transition it seeks to encourage."

Increased concerns among lenders, investors and regulators over climate risks have pointed to the need for a more rigorous assessment, which led to the Business School developing a comprehensive taxonomy that goes further than any other research done to date.

"This taxonomy is intended to supplement, not replace, traditional financial analysis, which is useful for situations with more determinate horizons," added Mr Buhr. "At the same time, this [taxonomy](#) should be considered integral, as the financial impacts of climate change become more evident and increasingly systemic."

The full report, "What is [climate](#) financial risk? A [field guide](#) for investors, lenders, and regulators," is available to [download](#) from the Imperial College Business School website.

Provided by Imperial College London

Citation: New climate risk report will help businesses assess impact of global warming (2022, February 23) retrieved 10 July 2024 from <https://phys.org/news/2022-02-climate-businesses-impact-global.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.