BLOG SERIES - BLOG 4

Why climate priorities are essential for the global TMT sector

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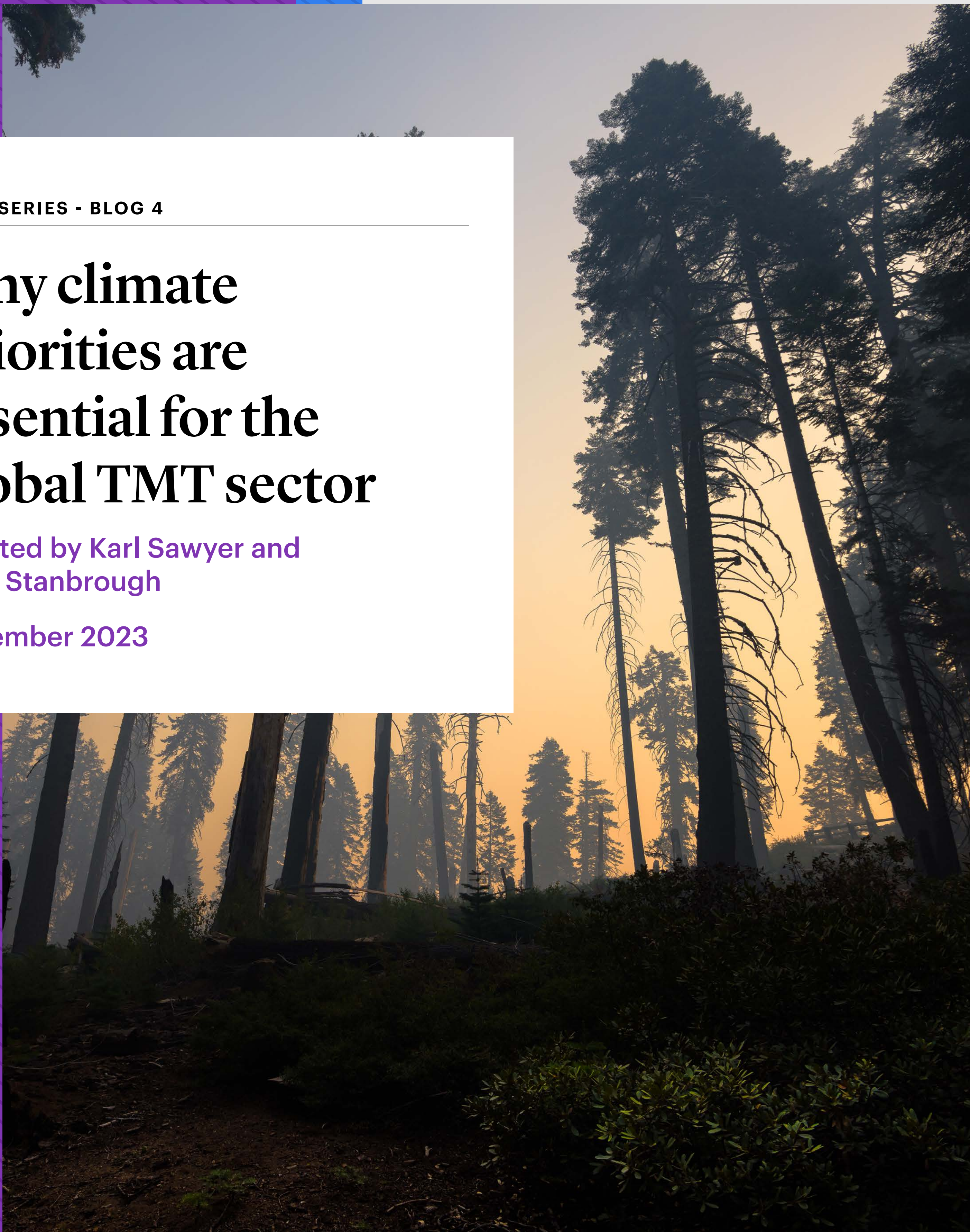


Our fourth blog in the Managing the risks and opportunities of climate change in the TMT industry series will home in on what we see as key climate priorities for the TMT industry.

Climate risks – and the opportunities associated with those risks – are in a constant state of flux. The physical impacts of climate change, shifting ESG and reputational pressures, the potential effects on the cost of capital, and the employee value proposition that will help companies thrive through transition are among the factors shaping how TMT companies will need to respond.

Taskforce on Climate-related Financial Disclosures (TCFD)

A good starting point is to become familiar with the TCFD framework and produce a TCFD report.

As outlined in our third blog, Facing up to climate-related risks and pressures, the TCFD is of growing importance as it is being embedded into regulatory reporting requirements. Such reporting is mandatory in Brazil, the European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland and the UK, where TCFD-aligned disclosures became mandatory in April 2022. The G7 nations have also openly supported mandatory reporting based on the TCFD.

At the heart of climate disclosure requirements is the need to understand whether the risks and opportunities from climate change are given sufficient prominence in the corporate governance and strategic planning. TCFD reporting focuses attention on a forward-looking view of corporate exposure to climate change exemplified by the inclusion of plans for "transitioning to the low carbon economy" into the expected strategy disclosures under the TCFD framework.

Climate disclosure – a pathway to stronger resilience

Businesses that look upon TCFD as a distracting compliance-only framework will not receive the full benefit from the effort involved. Those that look beyond the framework will enjoy resilient climate risk strategies that put businesses in a strong position to thrive in changing times.

The use of scenario analyses is particularly important in modelling future risk exposure as well as testing the resilience of an organisation's strategy. Transition and physical risk analyses need to be delivered together so that both transition and adaptation plans are co-ordinated.

Room for improvement

The Financial Stability Board (FSB) TFCD 2021 status report showed that, relative to other industries, the TMT sector had ground to make up on disclosures. Of the companies making disclosures (including reporting through 2020), around a quarter had reached the recommended level on 'strategic risks and opportunities' and the 'strategic impact of climate change including use of relevant metrics and targets', although fewer have been able to demonstrate the resilience of climate-related strategy. Progress on governance and operational risk management, however, was lagging behind. This disparity poses the question of whether climate risks (current or forward looking) are being sufficiently and accurately identified, assessed and managed. Fast forward to 2023, the percent disclosing information aligned with metrics and targets increased 67%, improving the industry picture somewhat. Please refer to the Financial Stability Board (FSB)'s 2023 report for details.

A further point flagged in the report was that sectors considered to be less carbon intensive disclose less. They noted that across all five regions, technology and media companies had significantly lower levels of disclosure compared to companies in other industries. The lowest level of reporting was on resilience of companies' strategies under different climate-related scenarios (Strategy c). Yet as technology is described as a key enabler of a transition to net zero, there is both a risk of not keeping pace, and an opportunity to accelerate and support the transition of other sectors.

The growth in net zero targets and in climate risk analysis by the financial services industry is driving an increased demand for quality disclosure data. Regulators are also increasingly mandating climate-related disclosure. This pincer movement is focusing on risk assessment and management, portfolio alignment to the 2015 Paris Climate Agreement pathways and emissions, and the use of benchmarks and indices.

WTW Insight:

Climate risk as an issue for financial institutions and why it matters to TMT

The principle regulatory areas of international co-ordination of financial institutions come from the Network for Greening the Financial System (NGFS) with regulators aligning and incorporating this into mandatory reporting.

Businesses have been voluntarily reporting their climate performance, strategy, governance, and risk management for a while (through climate frameworks and sustainability standards such as CDP (Carbon Disclosure Project), SASB (Sustainability Accounting Standards Board), GRI (Global Reporting Initiative), etc). Global climate reporting is evolving fast. The proposed Securities and Exchange Commission (SEC) rules to standardize climate-related disclosures for investors in the U.S. and the EU Taxonomy for sustainable activities build on the foundations laid by the international Financial Stability Board (FSB)'s Task Force on Climate-related Financial Disclosures (TCFD). Alongside this, international climate reporting standards continue to advance with the formation of the International Standards Sustainability Board (ISSB) towards the end of 2021, itself part of the Corporate Sustainability Reporting Directive (CSRD), an EU environmental, social and governance (ESG) standard passed late in 2022 to make corporate sustainability reporting more widespread, consistent and standardized.

One of the indirect outcomes of increased regulation is that financial institutions are now asking for similar levels of data to help inform their own investment and capital deployment decisions.

In December 2022, the Climate Financial Risk Forum (CFRF) published its third round of guides to help the financial sector develop its climate risk approach. The guides focus on three areas: the transition to net zero; scenario analysis; and climate disclosure, data and metrics. Reasons for undertaking scenario analysis varied for companies in the industry. According to the Climate Financial Risk Forum's Scenario Analysis guidance, Financial institutions are using climate scenario analysis to understand climate risks in stress testing, and in aligning investments to net zero and temperature pathways.

The report also aims to help guide the thinking of insurers and related stakeholders as they continue to develop their approaches to managing and mitigating climate risk.

Financial institutions are starting to account for their 'financed emissions' and to demonstrate progress against their net zero portfolio targets through methodologies outlined by organisations such as The Partnership for Carbon Accounting Financials (PCAF) and the Science-Based Targets Initiative.

Accounting bodies are stepping up their efforts here to incorporate climate change issues into financial reporting. The formation of the International Sustainability Standards Board (ISSB) by the International Financial Reporting Standards (IFRS) foundation will complete consolidation of the Climate Disclosure Standards Board (CDSB—an initiative of CDP) and the Value Reporting Foundation (VRF—which houses the Integrated Reporting Framework and the SASB Standards).

Climate risk and opportunity in financial products

With the rise in sustainable finance taxonomies, financial products claiming ESG, climate, green and transition credentials need to provide proof. It is likely that these criteria will get embedded into all financial products over time.

Benchmarks are also being created and used to assess companies such as the Climate Action 100+ net zero benchmark and the World Benchmarking Alliance's climate and energy benchmark. Climate Transition Pathways, the climate transition accreditation for insurance and debt markets, uses the same transition assessment methodology as the World Benchmarking Alliance - Assessing Low Carbon Transition.

Accounting for emissions in the TMT sector

As we have discussed previously, greenhouse gas (GHG) emissions are now in the cross-hairs of global regulators. A TMT company that fails to manage emissions can face both public and investor backlash and serious penalties. While technology has contributed to climate change, it is worth reminding ourselves that new and efficient technologies can help reduce net emissions going forward. Back in 2019, it was shown that readily-available technological solutions already existed for more than 70% of today's emissions.

GHG emissions are categorized into three distinct types:

- Direct fossil fuel emissions from both stationary and mobile sources, and fugitive emissions such as refrigerant leaks.
- Indirect emissions from electricity, steam and chilled water purchased by the business.
- Upstream and downstream value chain emissions, from suppliers to customers.

In 2021, researchers estimated that the information and communications technology industry was responsible for 2% to 3% of all global GHG emissions, which is similar to the emissions from airlines. But there is an increasing trend for technology companies to disclose carbon reduction targets according to a 2020 report from KPMG, The research suggests that around 70% of technology companies now disclose carbon reduction targets in their reporting.

It isn't just regulators who are turning up the heat on heavy GHG emitters. Investors and customers are also demanding better disclosure and transparency around emissions, exerting pressure on organizations across all industries to reduce them. We predict an increase in 'if you are not transparent, and if your tech is not on the green journey, we will not buy it' behaviour. The courts will also play a role in climate action.

In January 2021, the U.S. Court of Appeals for the District of Columbia vacated the Trump administration's rollback of Obama-era GHG emission standards for power plants. According to the same source, Federal procurement rules may soon require vendors to meet defined climate performance requirements and report on GHG emissions. The future will be technology dependent: President Biden has directed federal agencies "to procure carbon-pollution-free electricity and clean, zero-emission vehicles". While Biden has yet to specify a timeline, any changes in U.S. Government procurement policies could have a major impact on the purchasing of technology goods and services in the U.S. Notably, in March 2022, the U.S. Securities and Exchange Commission (SEC) proposed rules to enhance and standardize climate-related disclosures for investors. The proposed changes will require registrants to include certain disclosures in their registration statements, such as information about risks that could have a material impact on their business, results of operations or financial condition, and climate-related financial statements. The information would also include disclosure of a registrant's GHG emissions, which is a commonly used metric to assess risk exposure. For most TMT companies,value chain emissions will be material; any products that produce emissions over long time periods (for example, charging cell phones or servers that run 24/7) are included, as are the many components companies use to make and deliver their products or services.

We feel that all TMT sector stakeholders: investors, lenders, insurers, corporate customers, technology consumers, and workforces will increasingly be challenging companies with an expectation of accurate measurement and public disclosure. Regulators have also made a call for the redirection of capital towards more sustainable technologies and the organizations making them. Soon, any leading technology company not reporting carbon targets (truthfully and accurately) will be out of step with good global practice. The tech industry must lead by example and ensure that future products meets agreed (green) standards and beyond that are aggressively improving the carbon footprint.

WTW Insight:

TMT Industry action – Task Force on Climate-related Financial Disclosures (TCFD) reporting

A growing number of corporations and organizations (4,000 across 101 jurisdictions as of November 2023) have adopted TCFD principles. To minimize business disruptions, market participants such as asset owners, fund managers, and banks must manage increasingly complex and urgent climate-related risks and opportunities.

Included among the TMT organizations committed to TCFD is Verizon, who has been developing climate scenario analysis, investor engagement, gap analysis and cross-functional, collaborative report building as part of TCFD implementation since 2019. Other TMT companies that have been taking steps to align their sustainability reporting with the TCFD principles include Samsung and Salesforce.

The recommended approach to TCFD typically includes five steps:

1. Quantify baseline carbon footprint
2. Apply scenario analysis
3. Identify opportunities
4. Set targets
5. Engage and report

TCFD requires organizations to have a view of the physical impact of climate change as well as the risks and opportunities associated with transitioning into a net-zero or below-net-zero economy. With TCFD deadlines approaching, it is the opinion of WTW that a proactive risk manager would be very well-positioned to demonstrate their achievements to financial investors in building longer-term physical climate change resilience, and their capabilities in testing future risk profiles of the organisation. Catastrophe and climate risk models already widely used in the risk management domain can be utilized to form a view on how to finance the changing physical risk profile of an organization most efficiently. These can also be used for future planning by calibrating these 'current climate' baseline catastrophe risk models to the expected impact of climate change for given scenarios and time horizons.

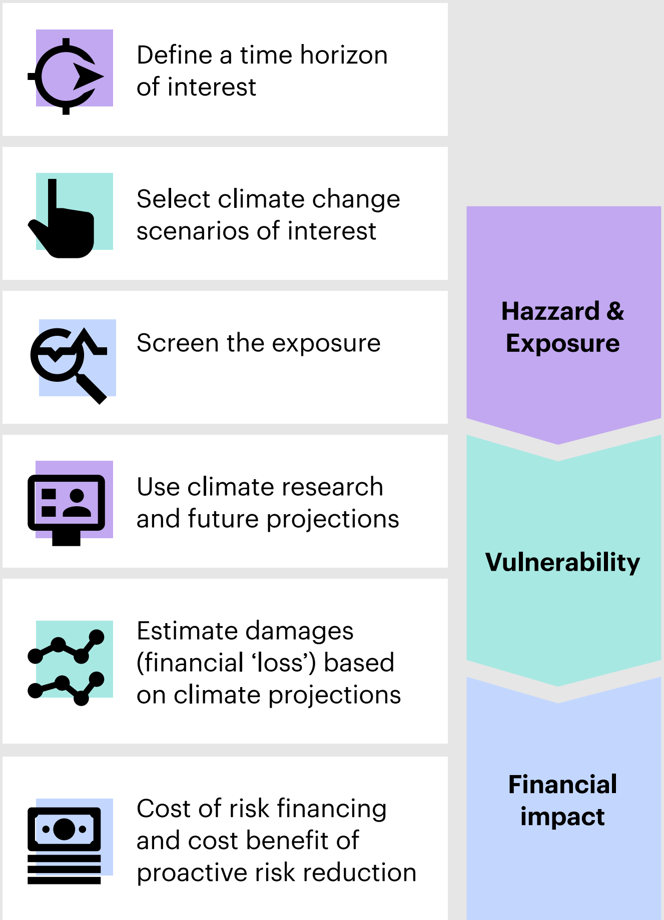


Figure 3: Example of the physical climate change impact assessment journey for risk managers. Source: WTW. For illustrative purposes only.

TCFD is here to stay and TMT companies need to respond accordingly. As an example: The UK Government has set out the expectation that all listed companies and large asset owners need to disclose their financial climate change risks by 2022. The Financial Conduct Authority (FCA) has introduced a new listing rule which requires commercial companies with a UK premium listing to include a 'comply or explain' statement. This rule applies for accounting periods beginning on or after 1 January 2021. Mandatory TCFD-aligned disclosures across major segments of the UK economy need to be completed by 2025, with a significant portion of requirements to be introduced by 2023.

What makes a good quality transition plan?

While there is not yet one standard view on what a good transition plan looks like, the leading methodologies have several common themes for assessment:

Greenhouse gas emission reduction targets that are aligned in short, medium and long term to the Paris Agreement's goal of restricting climate change to well below 2°C and aiming for 1.5°C.

Capital expenditures aligned to low carbon research and innovation, abating current emissions, and investing in renewable generation assets.

Governance, including accountability and remuneration of boards and management in delivering climate strategies and managing risks

Strategy and business models that align to the transition goals of the Paris Agreement

Engagement with policy makers through trade bodies and lobbying

Disclosure against TCFD to demonstrate performance against climate strategy and transparency

Considering sustainability in a holistic way represents a tangible opportunity for tech companies when it comes to market differentiation and talent acquisition. There are roles for everyone, and TMT companies can facilitate them in key areas, including:

- **Governance,** including the board's role in providing oversight of climate risk responses and defining management responsibility for climate risk and ESG
- **Risk identification,** identifying the key channels through which climate risks can impact the company
- **Risk appetite,** including forming a view as to whether climate risk should be considered as a separate element or part of aggregate risk
- **Risk measurement and reporting,** including how to incorporate climate risk into financial risk models and reports and deciding on relevant metrics for decision making, a key element of TCFD disclosure
- **Reputation risk,** including identifying public communications needs and a strategy for communicating a firm's climate and ESG response
- **Opportunity identification,** informing strategic decisions on changes (or not) to operations, products and services

Having a solid understanding within the business will not only prepare TMT companies for the changes that are already happening, but also those that are coming down the pipeline. Companies can benefit from a structured, data-driven, and strategic approach that delivers deeper insights into climate issues and, by being proactive, they can be better prepared to meet the growing demands of all stakeholders.

WTW views and observations

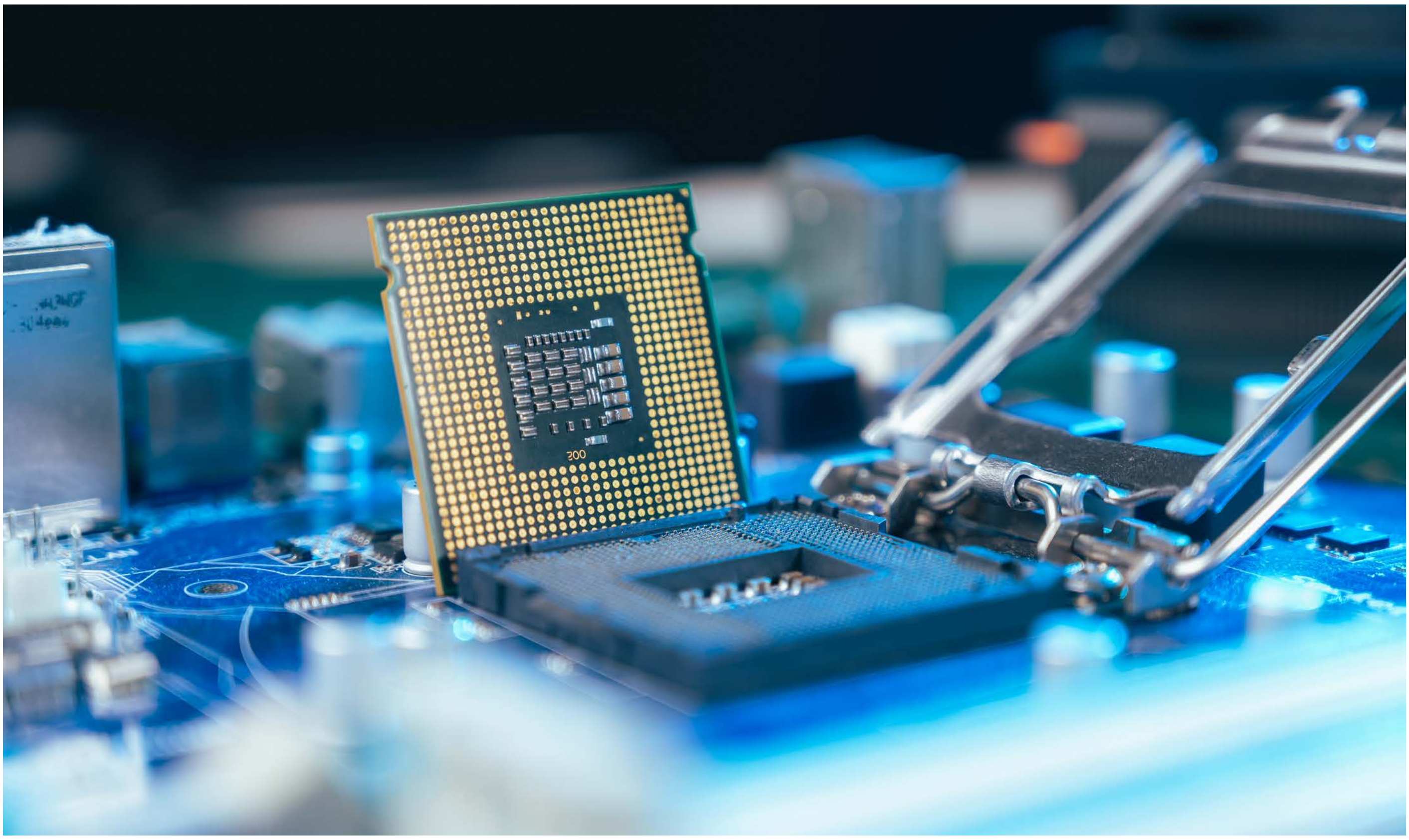
The TMT sector needs to be ready to meet a burgeoning array of climate-related regulatory and reporting requirements. Companies should take stock of the many and potentially confusing range of initiatives and see how they fit together and/or can contribute to a company's thinking and planning.

Longer term, we would suggest a longer-term, more sustainable approach to climate risk planning will involve measures such as:

Using disclosure and reporting requirements as a catalyst for wider climate action. The move to make TCFD reporting mandatory in several parts of the world is indicative of how climate-related disclosure requirements are expanding. Think of this as a useful steppingstone for all industries, including of course for TMT. Companies that are proactive in their stance towards climate disclosures can reap benefits (for example within the investor community) and embed good climate-based practices within the business sooner that should help generate a competitive advantage.

Expanding understanding and use of forward-looking climate scenarios. A key but so far under-utilized aspect of corporate transition planning in our experience is assessing and quantifying the potential impact on the business of different rates of economic and industry transition on the road to Net Zero. Such understanding, aided by tools such as the Climate Transition Index, will become increasingly essential to evaluate the advantages and disadvantages of various strategic and operational options and communicate them to company stakeholders.

Operationalizing climate risk management. The evidence from the TCFD status reports is that parts of the TMT sector (along with other sectors) has taken on board the need to map out climate strategy and implemented some targets and metrics to measure progress. While this work continues, more effort needs to go into how to bring strategy to life (through employee engagement for example) and use climate data metrics in day-to-day risk and operational management.



A topic worthy of debate

This and the upcoming blogs in the series are all opinion based. Each blog concludes with our views and observations that are based on extensive background reading, the research findings, and supporting data, interview feedback and the experience and expertise of both academics and WTW experts working within the TMT sector and the company's dedicated Climate and Resilience Hub.

Opinions, of course, are open to be debated. Indeed, we welcome this on a subject that transcends the TMT sector as a generational challenge.

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