QIC

Climate risk assessment and disclosure due diligence

In today's dynamic business environment, we believe understanding climate-related risks and opportunities is vital for investors, board members, and stakeholders when evaluating investments and projects.

This involves assessing both transition and physical risks. Additionally, existing portfolio companies should follow a comprehensive framework aligned with Taskforce for Climate-related Financial Disclosure (TCFD) recommendations, covering governance, strategy, risk management, metrics and targets, and executive incentives. We believe this approach empowers decision-makers to manage climate-related financial risks, consider opportunities, and meet regulatory obligations effectively.

Investment due diligence

To better support our stakeholders, we have developed a list of key questions which can be tailored to suit when considering stand-alone investments, mergers or acquisitions, or significant projects.

- Is the organisation's sustainability capability, resourcing, systems, processes and governance adequate?
- What is the quality and completeness of climate-related data measurement and monitoring? Has the data been assured?

Transition Risks

What is the company emissions profile? Including:

- Scope 1 — Direct emissions within the operational control of the company
- Scope 2 — Emissions associated with electricity use
- Scope 3 or indirect emissions — Emissions associated with the supply chain or use of the product/asset.
- Does the company have a decarbonisation target? How mature is the decarbonisation strategy? Are the assumptions underpinning the strategy reasonable? Have the potential financial impacts of achieving the strategy been included in the business plan?
- What and how significant are the risks/opportunities of climate-related disruption to the business from regulatory/policy change, market shifts, reputational changes and technology? (consider for the company as well as the supply chain, customers and industry)

Steps to prepare for climate change disclosure[1]

In response to the recent regulatory changes, specific to climate change disclosure, we believe companies and boards should begin preparing for the potential adoption of these changes. The proposed rules encompass a wide range of requirements, necessitating the development and disclosure of extensive climate-related information. To prepare, David Lynn from Morrison & Foerster[1] suggests companies should:

Take an inventory	Draw a map	Revisit targets and goals	Get the governance right	Preview financial statement changes
Review existing disclosures, assess data processes, and close any data gaps.	Map existing disclosures to regulatory requirements and allocate resources effectively.	Review and adapt climate goals and consider disclosure implications.	Establish robust climate risk governance and continuous improvement.	Prepare for enhanced financial statement disclosures by engaging the audit committee and auditors.

1 Source: *How to prepare for mandatory climate change disclosure* (Lynn, 2022) https://www.corporatesecretary.com/articles/esg/32983/how-prepare-mandatory-climate-change-disclosure

- Have the financial returns of the business plan been modelled under different low carbon transition scenarios, including an accelerated decarbonisation? (what scenarios have been used and are they based on robust assumptions?)
- Is there evidence of the company already addressing its emission profile and climate transition risks?

Physical Risks

- What is the exposure to current and projected physical impacts of climate change?
- What climate scenarios have been used in the assessment?
- Can the models and assumptions used in these assessments be relied upon?
- If material exposure is identified, have the potential financial impacts (asset replacement and maintenance, people and operational) been included in the business plan?
- Does the company have a climate resilience strategy? Does it include:
  - Integration with the asset management plan
  - Measurement and monitoring processes
  - Emergency response planning
  - Collaboration with third parties (e.g. suppliers, customers, government, stakeholders around the asset)
  - A process for continuous improvement.

Investor/Board questions for existing portfolio companies

In addition to the questions relevant for new investments, the following questions can be used by Directors and Shareholders to evaluate in more detail the preparedness of the company to manage its climate-related financial risks and opportunities, the emerging regulatory disclosure requirements and to fulfil the Director and fiduciary responsibilities. They have been categorised using the TCFD recommendations.

Governance

- Is the organisation's sustainability capability, resourcing, systems, processes and governance adequate to measure and manage the climate-related risks/opportunities/responsibilities? This may include specific assessment of:
  - The Board and Management team's climate-related competencies
  - Management and Board reporting — frequency and detail
  - Effectiveness of integration into strategy, business case evaluation, risk management and procurement systems
  - The adequacy of climate considerations in policies and processes? Does the company include environment or social obligations in its contracts for the supply of goods or services?
  - Is there clear, appropriate and documented accountability for the oversight of climate-related risks and opportunities?
- Do the executive incentive schemes address the material climate risks and opportunities?

Strategy

- Does the company strategy adequately address climate transition and physical risks?
- What scenarios have been considered in evaluating the impacts on the company's capital requirements, revenues and operating costs?
- What benchmarks/comparisons are used to evaluate the company performance?

Risk Management

- Are material climate-related risks adequately addressed through the risk management framework?
- Have material climate-related risks been effectively prioritised and addressed?
- Is the risk review period relevant?

Metrics and Targets

- Are the metrics used by the organisation sufficient and relevant to understand the material climate-related financial impacts on the company?
- Do the metrics adequately cover historical performance and are there useful indicators of future risks/opportunities?
- Do the company's financial disclosures cover the implications on current and expected performance from material climate-related issues?
- Are climate-related targets (e.g. NZE, emission reduction, climate transition, investment alignment) based on reasonable assumptions and projections?
- Is there sufficient external assurance to provide confidence on the accuracy of climate-related reporting?
- Have existing disclosures been reviewed for 'greenwashing' risks?