# How to prepare for a disrupted climate transition

Disorder...Disruption…Disadvantage. This is the dystopian future that is forecast to become a reality if world leaders continue to tackle climate change without urgency. Prudent risk management might need to include preparing for such a disorderly climate transition.

This piece dips into these challenges as we look at the concept of a disorderly transition; a stark warning issued in the World Economic Forum's 2022 Global Risks Report.



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## I don't have time for this

If the pandemic has taught us anything it's that nature doesn't wait.

Leaders and decision makers across sectors have faced arguably the most testing time of their career...including chief audit executives. It's also been a time of great learning, particularly in terms of managing risk, implementing change and motivating employees. Now is the time for internal audit to build on this and continue the momentum on advising on organisational resilience, to provide assurance that it is fit for the future.

If the prospect of a dystopian future sounds too far off and nebulous, take comfort in drawing parallels with the familiarity of managing information security risk. Both are rich in known facts about vulnerabilities yet are



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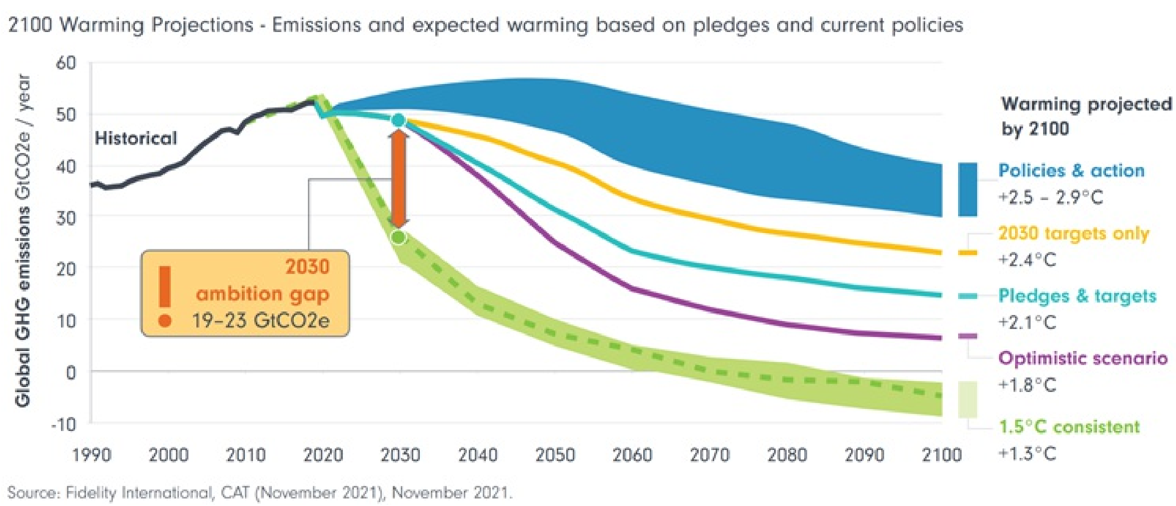
prone to new weaknesses being identified. A data breach WILL happen but WHEN is the uncertainty. Climate impacts WILL happen but WHEN and to WHAT severity is the uncertainty.
Being ready to respond is essential. A

# What is a disorderly climate transition?

Climate transition is about shifting to a low-carbon economy. It's one of three risks of the climate emergency.

1. Climate risk is physical. It includes immediate extreme weather events and chronic trends such as prolonged drought and rising sea levels. It's also transitional due to the shift to a low-carbon, sustainable economy.
2. Transition risks include the impact on financial markets of revalued assets and investments, change to policies, legislation and regulation, technological innovation and shifting consumer sentiment.
3. Liability risk is also emerging as a theme with compensation and litigation sought by parties suffering loss due to climate change.

The Paris Agreement signed by 195 countries includes a key commitment to limit global warming to 2C, making every effort to achieve 1.5C. Current projections show the 'ambition gap' between that commitment and the reality of actions to date.




A disorderly transition is one of four scenarios developed by the Network for Greening the Financial System (NGFS) to understand a range of future possibilities: orderly, disorderly, too little too late, hot house world. The NGFS aims to support the financial system to manage risks and to mobilise capital for green and low-carbon investments to meet climate targets and aid the broader context of environmentally sustainable development.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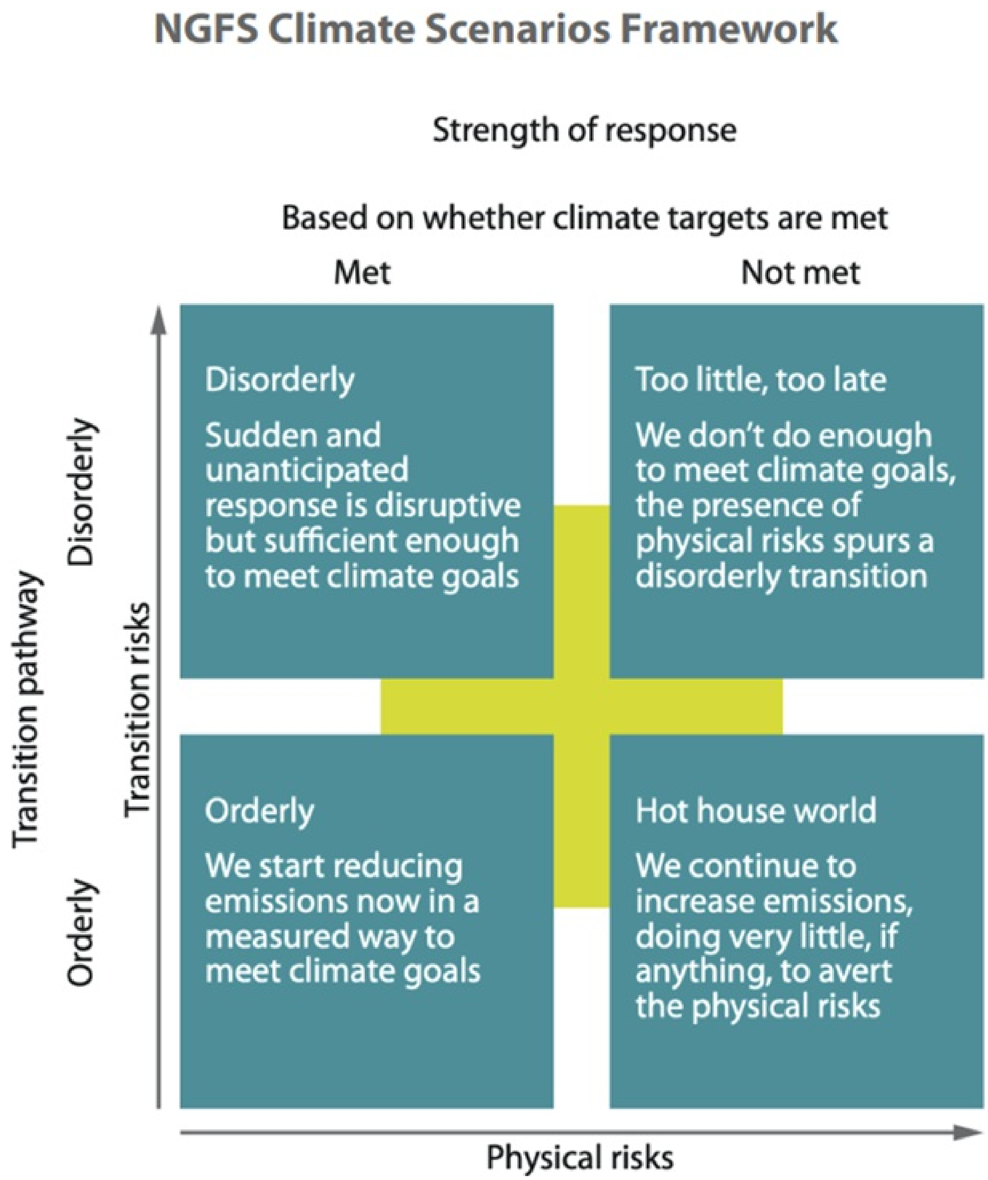


Source: Network for Greening the Financial System

Disorderly assumes climate policies are not introduced until 2030. Since actions are taken relatively late and limited by available technologies, emission reductions need to be sharper than in the orderly scenario to limit warming to the same target. The result is higher transition risk.
Disorderly is a combination of limiting warming and CO2 removal (Carbon Dioxide Removal):

It can be summarised as follows:

- Delayed 2°C with limited CDR
- Immediate 1.5°C with limited CDR
- Delayed 2°C with CDR

Before the pandemic, climate risk was complex; even more so now as short-term economic recovery takes priority over aspects of the green transition.


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# Why is this relevant to my organisation?

Climate-related disruption is relevant to all organisations and all sectors.
According to Christina Figueres, former UN Climate Change Secretariat, “the 2020s are the decisive decade for the world to avert the worst impacts of climate change.” Given slow progress to date this is why the risk of climate inaction is the top-rated risk for the next 2-10 years according to the plethora of global experts that contribute to the WEF Global Risks Report.

The pace of transition is critical to the impact of disruption and disorder.

Aggressive action to accelerate achievement of targets would most likely lead to misalignment between countries, industries and businesses. While averting long-term negative climate impacts, it could create severe short to medium-term impacts for the economy and society.

These impacts include:

- Threats to national energy security and volatile prices
- Viability of fuel supply shifting away from combustion engines, gas boilers and heating
- Job losses in carbon-intense industries
- Neglected systemic dependencies between technologies and systems
- Reliance on new and evolving technologies and systems
- Inadequate global governance creates monopolies of power

Maintaining a slower pace affords the opportunity for a more orderly economic transition, although it increases the likelihood of more severe physical risks with more pronounced long-term disorder.

- Disproportionate impact on large and/or developing countries
- Disruption of food supply due to loss of agricultural land
- Climate migration refugees

For full details of the disorderly transition read the NGFS article and chapter two of the WEF risk report.

The pandemic has provided insight into the way governments across the world responded to a global threat. What is the learning to date? Which adjectives would you use – collaborative, protectionist, assured, chaotic, proactive, reactive, divisive, compassionate, equitable, insular? What might we expect as the climate emergency worsens?

# Expectations of internal audit

As with any risk, the responsibility for managing it sits squarely with management. Likewise, the expectations of internal audit are generic too:

- Speak up if the risk has not been acknowledged
- Prompt improvement of relevant risk management process/framework
- Enhance governance arrangements for change
- Offer assurance relative to the board’s risk appetite
- Advance management of individual and thematic risk
- Challenge the appropriateness of the risk appetite if necessary
- Develop and encourage the skills to manage disorder and disruption


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Once all the complexities are stripped back, the expectations are quite clear: risk-based assurance; governance, risk management and internal control advisory role; and regulatory compliance.

## Readying for a disorderly transition

- A good strategy should include climate transition actions
- A good resilience plan should include transition risk
- A good continuity plan should include physical risk
- Readying involves action and preparation

Is your organisation readying itself?

Action is about taking accountability for addressing carbon usage that is within the influence of the organisation; everything from energy to investments and the business model itself.

Without exception, an organisation should by now be addressing its scope 1 (direct) and 2 (indirect) emissions, and at least getting to grips with the dreaded scope 3 emissions that encompass the whole value chain.

A disorderly transition will impact sectors, economies and people differently. Our geography and service-based economy positions the UK as low risk for a disorderly transition as does Ireland's knowledge economy. See McKinskey's Net Zero Transition report for full details of this.

However, when value chains are brought into play, few organisations are 100% domestic and will therefore be impacted by the consequences of disorder on suppliers, customers and investments.

Minimising disruption and disorder for an organisation is a realistic goal given that the extent of global disorder will be an external risk factor for the vast majority of leaders.

Immediate questions to consider include.

How does your organisation's business model and strategy align with a low-carbon economy?

- What will stop/start/adapt in your sector over the next 10 years?
- Where will value be created and destroyed?
- Are operational activities being reengineered/stopped where necessary?
- Is climate impact part of the board's investment analysis for new initiatives?

What's your organisation doing to address the transition to low-carbon?

- Is internal audit engaged with programmes and activities?
- How embedded is climate risk management throughout the organisation?
- Have challenging carbon reduction targets been set?
- Is external reporting transparent and comprehensive?

Does your organisations culture encourage or inhibit change?

Who's an advocate or a blocker at a senior level?

- Could strategic collaborations enable a more effective transition?
- Are plans, including timescales published and unequivocal?
- How engaged are employees – can they propose ideas and initiatives?



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- Do leaders have the skills to manage in a VUCA environment?

## Closing thoughts

Whether you call it a resilience, continuity or response plan it's about planning. Understanding a scenario and how the organisation can survive or exploit it. Future success may be dependent on such plans and the skills to use them. The pandemic has laid good foundations for managing disruption. Now is a great time for CAEs to continue to raise the bar on expectations of readiness to manage disorder.

"Our addiction to fossil fuels is pushing humanity to the brink. We face a stark choice: either we stop it – or it stops us."

**UN Secretary General Antonio Gutierres, COP26**

## Further reading

Global Risks Report 2022 (chapter 2) | World Economic Forum
A disorderly transition: Tracking the credibility of climate commitments |Fidelity
Global Macro Insights-Climate | Fidelity
Systems approach to a low-carbon future | Deloitte


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