MEMO

BSR

BSR's Value Chain Risk to Resilience Initiative: Climate Risk Integration Framework

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Value Chain Risk to Resilience Initiative: Building climate resilience for communities, farmers, and workers along the value chain

Value chains are opaque and complex, making it difficult for companies to understand and identify climate-related vulnerabilities across the value chain—including the exposure of its suppliers, employees, customers, and local communities. Addressing value chain risk requires collaboration across the company, industry, and with other stakeholders. In response to this challenge, BSR's Value Chain Risk to Resilience Initiative (the Initiative) was formed as a collaboration of companies working to build climate resilience for communities, farmers, and workers across the value chain. To accomplish this outcome, the Initiative is developing standard approaches, methodologies, and metrics for business action on resilience, emphasizing collaboration among businesses.

In 2020, the Initiative developed a standardized framework to help companies assess and integrate climate risks into existing risk management systems and governance practices. This framework provides the first step in a company's journey towards better understanding and managing its climate risks. The implementation of this framework should also help build the business case for a climate integrated Enterprise Risk Management (ERM) system.

This briefing is intended to provide an overview of the frameworks and key lessons learned from the Initiative. This document was developed by BSR, in collaboration with Initiative members, to share our insights with the broader business community. This is the first in a series of resources that will be published over the forthcoming months in 2021. We believe these resources can help companies, at all stages of their climate journey, make progress toward managing climate risk while building community, farmer, and worker resilience throughout the value chain.

KEY INSIGHTS

- The Value Chain Risk to Resilience Initiative ("the Initiative") is a collaboration of companies working to build climate resilience for communities, farmers, and workers across the value chain.
- Addressing climate risks across complex value chains requires collaboration within and across companies and with local communities.
- Climate change is increasingly recognized as an urgent risk to business performance, strategy, and goals.
- Integrating climate elements into existing risk assessment, management, and governance processes brings these issues into the mainstream, improves resource deployment, and enhances internal engagement. It is an effective first step toward building business resilience to climate change.
- Many climate risks fall into conventional enterprise risk categories, introducing an additional variable, or 'climate multiplier' to an existing risk, affecting its impact or likelihood of materializing. Others are independent and need to be added as discrete risks.

Climate Change Is a Material Risk to Business

The "failure of climate change mitigation and adaption" was identified as the #1 risk by impact and #2 by likelihood in the World Economic Forum's 2020 Global Risks Report. Furthermore, the COVID-19 pandemic is an unprecedented test of the economy and society's ability to manage external disruption and compounding risks. As climate impacts cause disruption across the globe – from devastating tropical cyclones to historically large wildfires – the cascading impacts on businesses, workers, and communities vital for sourcing cannot be ignored. As a result, stakeholder expectations for companies to measure, manage, and disclose their exposure to climate risks are rapidly increasing.

Convened under the G20, the Task Force on Climate-Related Financial Disclosures (TCFD) published voluntary recommendations in 2017 on how companies should disclose climate-related risks and opportunities. Widespread adoption has made the TCFD's recommendations the de facto standard for climate risk management and disclosure, with support from 1,500+ organizations representing market capitalization of over USD 12 trillion, roughly half investors and half disclosing companies. Other sustainability and risk management frameworks (the Sustainability Accounting Standards Board and ISO31000) are coalescing around the TCFD recommendations, enabling consistent, high-quality implementation. Further, a handful of jurisdictions, from New Zealand to the United Kingdom, have announced plans to make the TCFD recommendations a mandatory part of financial disclosures.

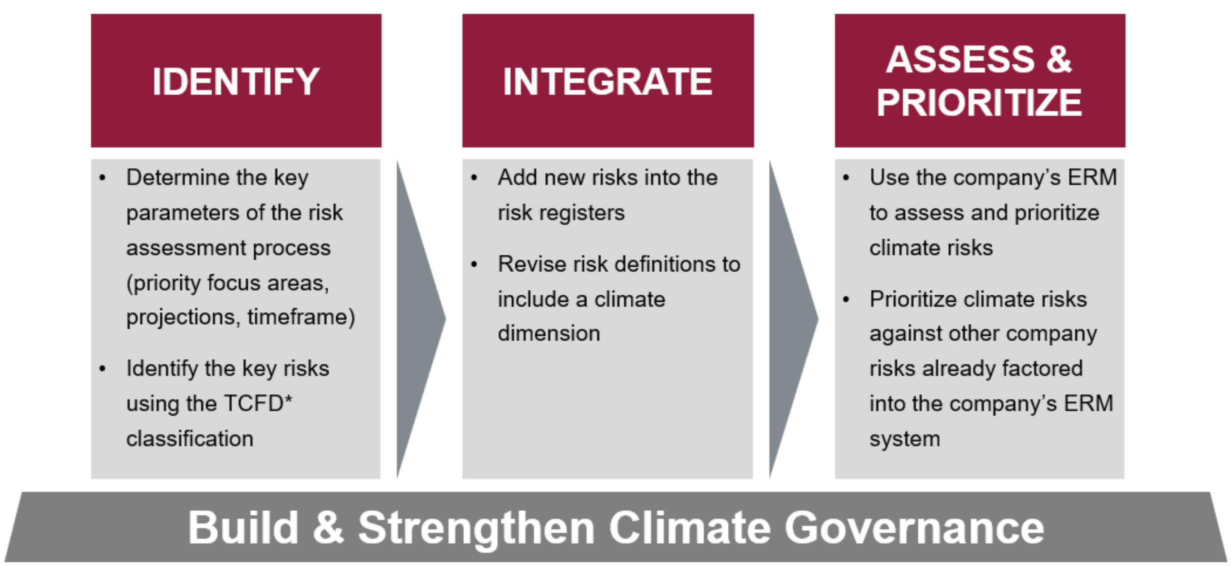
Despite the momentum, climate risks are still not typically discussed at the Board level, given misconceptions about their relevance, magnitude, and time horizon. In general, very few companies are taking action to identify, assess and mitigate climate risks effectively. As climate impacts and stakeholder expectations grow, it is critical for companies to understand how climate change can affect business performance and their capacity to achieve their strategy and goals, and importantly, what to do about it.

The Climate Risk Integration Framework

OVERVIEW

Building upon existing research, the TCFD recommendations, and insights gleaned from interviews with corporate sustainability and risk management professionals, the Initiative developed a standardized framework to help companies identify, prioritize, and integrate climate risks into existing risk management and governance processes. The framework (Figure 1) is designed so that each step can be tailored according to a company's constraints and specificities.

Figure 1: BSR's Climate Risk Integration Framework | 4 Steps

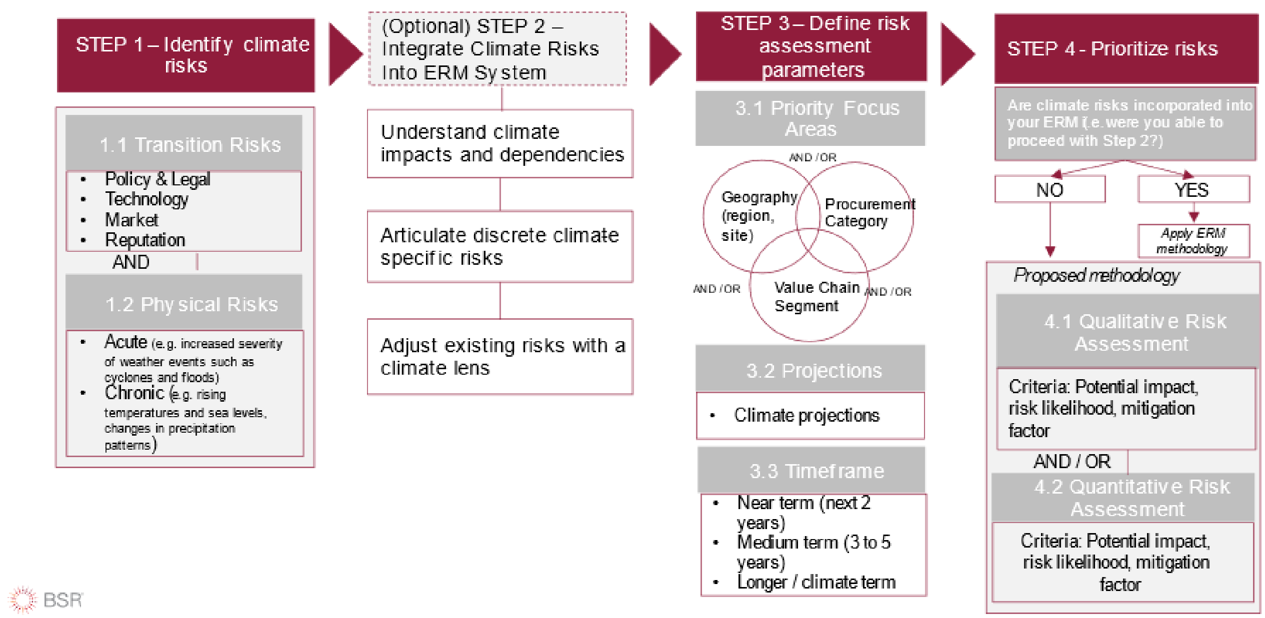


1. **Identify:** The first step of the framework focuses on conducting a climate risk assessment – offering guidance for defining assessment parameters and identifying potential climate risks in accordance with the TCFD.
2. **Integrate:** Second, the framework identifies three complementary approaches and practical guidance for integrating climate risks into the company's ERM system.
3. **Assess & Prioritize:** Next, the framework offers qualitative and quantitative methodologies for assessing and prioritizing climate risks, based on likelihood, potential impact, and a mitigation factor.
4. **Build Governance:** Parallel to this process, the framework recommends specific actions to build and strengthen climate governance.

The Initiative offers **two options for implementing the framework**, recognizing that companies may benefit from different approaches depending on its sector, organizational structure, risk appetite, and maturity. The recommended model (Figure 2) involves integrating climate risks within the ERM system prior to conducting the risk assessment, enabling a more focused assessment.

Alternatively, companies can integrate climate risks into the ERM system after assessing and prioritizing them, understanding that this may require further work on ERM integration.

Figure 2: Aligning Climate Risks with the ERM Prior to Risk Assessment.



INTEGRATING CLIMATE RISKS INTO THE COMPANY'S ERM SYSTEM

Many climate risks fall into conventional enterprise risk categories, as they are operational or financial in nature. Climate risks often introduce an additional variable, or 'climate multiplier' to an existing risk, affecting its impact or likelihood of materializing. For example, climate change impacts often increase cost fluctuations of raw materials, which is already a risk for many companies.

As such, the framework offers three complementary approaches for integrating climate risks into a company's existing ERM system. The approaches should be considered a set of options you can choose from and / or combine depending on your company's level of maturity on the topic.

A good first step for companies starting the integration process is to **better understand potential climate impacts and dependencies**. This can be done by reviewing location-based data tools as well as relevant reports issued by governments, insurers, think tanks, consultancies, non-profit organizations, and/or industry associations to identify variables that affect the magnitude and timing of climate impacts and understand how they may evolve overtime.

After this foundational knowledge is captured, companies can begin modifying existing risk categories and / or adding new risk categories to capture climate-related risks. To **adjust existing risks with a climate lens,** companies can incorporate a climate component to relevant risk definitions or define a climate multiplier. Companies can also **add discrete climate-specific risks** directly to the ERM system inventory, ensuring an individual is assigned to manage those risks.

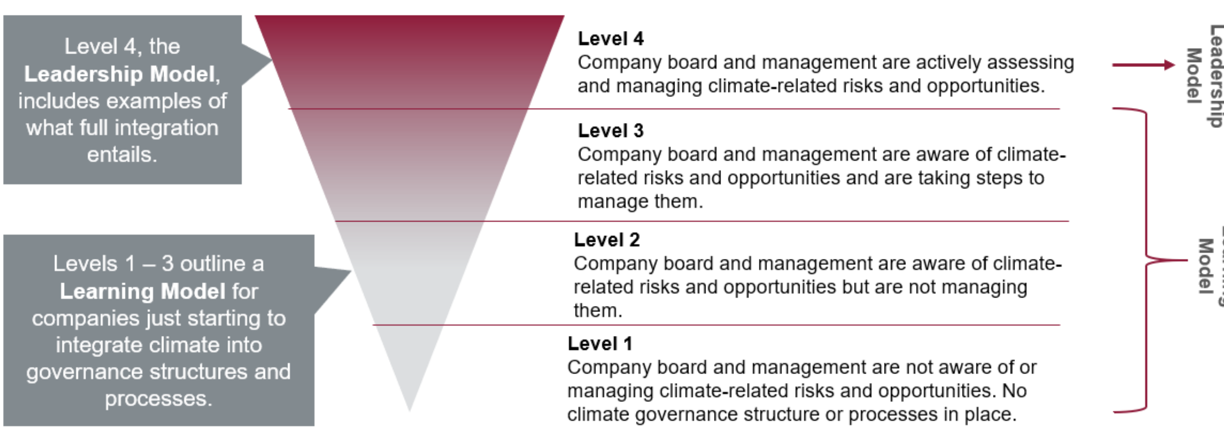
BUILDING AND STRENGTHENING CLIMATE GOVERNANCE

Boards play a critical role ensuring that companies can navigate an evolving risk landscape. Directors need to consider oversight of these issues as part of their fiduciary responsibility ("duty of care"). Although the potential impacts of climate change are widely recognized, the uncertain magnitude and long-term nature of the problem means it is often not discussed as a financial risk in boardrooms, which tend to focus on short-term business cycles.

To address this gap in governance oversight, the Initiative developed climate governance models (Figure 3) that companies can use to assess its current level of integration and identify next steps towards climate governance leadership. Levels 1 through 3 outline a Learning Model for companies that are just starting to integrate climate into governance structures and processes. Level 4, the Leadership Model, includes examples of what full integration entails.

Best practice is to align climate elements into existing governance structures and systems. Therefore, a company may need to adapt the model to reflect its unique practices. Many of these elements, such as assigning climate responsibilities to managers, should be informed by the climate risk assessment and ERM integration results.

Figure 3: BSR's Climate Governance Learning & Leadership Models



What Comes Next

Over the forthcoming months, the Initiative will be focused on addressing challenges associated with climate risk mitigation efforts, developing climate resilience metrics, and crowdsourcing solutions for scaling risk management activities across the company and value chain. Additional resources – including blog posts and webinars – will be made available throughout 2021.

Any questions or comments?

Please reach out to Samantha Harris (sharris@bsr.org) or Ricki Berkenfeld (rberkenfeld@bsr.org) if you have any questions or comments on this document or would like to learn more about the Value Chain Risk to Resilience Initiative and its ongoing work.