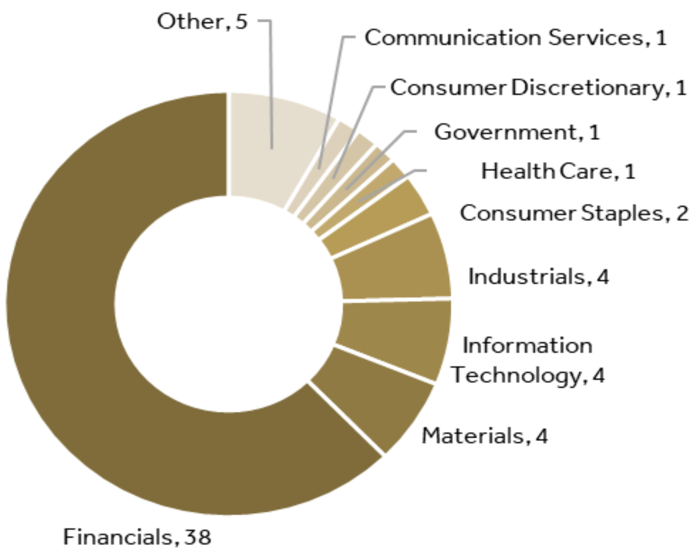
How to back climate action and reporting with appropriate governance and incentives?

With climate change impacts on the rise, physical, and transition climate risks pose a substantial threat to exposed businesses. In particular, in a globally interlinked economic system, the risks of physical climate impacts affect supply and production chains as well as sales markets. Swiss businesses, especially capital-intensive ones, and supply-chain-dependent sectors operating in more vulnerable parts of Switzerland and the world face the biggest impacts. Due to the consequences caused by the materialization of these risks, companies, stakeholders, and financial markets require clear, comprehensive, and high-quality insights on the financial risk due to climate change. One framework to disclose such risks and opportunities has been created by the Task Force on Climate-related Financial Disclosures (TCFD), an expert group mandated by the Financial Stability Board. This framework covers the four pillars 'governance', 'strategy', 'risk management', and 'metrics and targets', and has quickly been adopted as international best practice.

Climate and TCFD reporting on the rise

Since the publication of the recommendations in 2017, momentum behind the framework has grown significantly worldwide, now totaling:

Switzerland officially became a supporter of the TCFD in 2021 and after the consultation in 2022, **TCFD-aligned reporting will now become legally binding starting with the financial year 2024**. Alongside the counterproposal to the responsible business initiative, this ordinance will affect public companies, banks, and insurance companies with more than 500 employees, CHF 20 million in total assets or CHF 40 million in turnover.



So far, some Swiss companies have already adopted TCFD requirements on a voluntary basis with supporters increasing from 8 in 2018 to 61 in 2022, mostly from the financial service sector. Also, size seems to play a role with 65% of SMI companies already following the TCFD framework[1].

TCFD supports strategic decision-making, also regarding physical climate risk

Apart from mandatory disclosure, the TCFD framework is also a means of preparation for the future, from identifying climate change risks to designing climate change mitigation- and adaptation plans, as well as realizing opportunities. The forward-looking aspect of TCFD disclosure makes it a powerful instrument for internal decision making and external stakeholder engagement on climate-related financial risks and opportunities, their impact and targets set to address them. This allows a company to communicate its strategy and better link climate disclosure with governance.

1 TCFD Website https://www.fsb-tcfd.org/supporters/

An aspect often neglected by TCFD supporters is physical climate risk. Over the past years, however, the intensity, frequency, and impact of extreme climate and weather events has increased. According to the World Economic Forum's 2022 Global Risk Report, damages from extreme weather and climate are perceived and identified as the second most severe risk and 5 of the 10 most severe risks are related to climate. To further reinforce the incorporation of physical climate risk into Swiss companies' operations and disclosure, exposed companies need to put appropriate governance structures and targets in place. A mean to reach the desired outcome can be by designing appropriate incentives.

Physical climate risks need to be incorporated in incentive plans for full alignment

So far, however, physical climate risks are only rarely incorporated into compensation-relevant targets. While internationally more than 30%[2] of companies disclose environmental topics for their variable compensation plans, physical climate targets are rarely published. In Switzerland, the consistency between TCFD reporting and incentive designs is even less obvious. For SPI companies, so far, no explicit link between TCFD-related physical risk targets and compensation is disclosed. However, with TCFD reporting becoming mandatory and stakeholders requiring more specific climate action plans, the integration of appropriate targets and incentives is essential for Swiss companies affected by climate change and the related consequences on physical assets.

TCFD recommendations expected to increase consistency

Looking forward, the TCFD recommendations are expected to become the basis of financial climate reporting with multiple long-term benefits vis-à-vis investors but also from a risk prevention perspective. In addition, the link of identified measures with variable compensation is expected to increase, supporting overall credibility with regards to internal and external stakeholders that want to ensure that adequate measures are applied throughout the company thanks to effective and purpose-driven incentives.

About HCM International

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HCM International is one of the leading consulting firms focusing on corporate governance, sustainability/ESG, leadership & performance management, and compensation. In the area of ESG, we specialize in the development of ESG strategies - from the definition of ESG focus areas and the implementation of appropriate governance processes to the consideration of ESG issues in performance management and compensation. Our clients are large multinationals as well as small and medium-sized private and listed companies. As a partner-led firm, we are independent and have decades of cross-industry experience in advising supervisory boards and executive boards as well as other management functions. With roots in Switzerland, we have grown globally since 2001 and have a strong international presence with the Global Governance and Executive Compensation Group (GECN Group).

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About CelsiusPro

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CelsiusPro is a Zurich-based boutique climate risk and NatCat InsurTech company. Over a decade, globally, CelsiusPro provides customized and comprehensive natural catastrophe and climate risk reports and climate risk-transfer products for clients across public and private sector. Our independent expertise optimally positions us to translate the scientific consensus of climate models and provide data driven insight into climate risks and opportunities. Given the magnitude of the challenge of climate, we engage with a network of partners spanning academia, insurance, and technology. We are proud members of the following associations: Swiss Green Fintech Network, Swiss Capacity Building Forum, Weather Risk Management Association, Insurance Development Forum, Swiss Sustainable Finance and Supporters of the Task Force of Climate-related Financial Disclosures.

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2 GECN Group Global Trends: The Cross-border Growth in the use of ESG Plus Metrics in Incentives 2021-2022.