Climate Change: Risk Planning & Reporting

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TABLE OF CONTENTS

Agenda

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CLIMATE RISK

"Climate change is no longer some far-off problem; it is happening here; it is happening now.“

President Barak Obama

TODAY'S GOALS

Today's session will provide you with information to continue your journey in understanding climate-related risk. Our specific goals are to:

1. Understand the definition of **ESG,** along with the **Physical Risks** and **Transition Risks** associated with Climate Change.

2. Get an overview of **assessing the impact** of Climate Change on your **Risk Management Frameworks**, and how to incorporate those changes.

3. Explore how, as an industry, we have opportunities to think about Climate Change and ESG through a **Fiduciary Risk** lens.

4. Gain a high-level understanding of current **Disclosure Schemes**, including the **SEC's Climate Disclosure Proposal**.

Definitions

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FOUNDATIONAL DEFINITION – ESG

Environmental, social, and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors can use to screen potential investments.

E
Environmental

- Climate change
- Water and marine resources
- Waste prevention
- Recycling
- Protection of ecosystems
- Carbon emissions
- Use of toxic chemicals
- Deforestation
- Growing demand for renewable energy
- Sustainable transportation networks
- Green infrastructure

S
Social

- Human rights
- Equality
- Diversity, inclusion, equity
- Labor relations
- Worker rights issues within the global supply chain

G
Governance

- Sound management structures
- Employee relations
- Shareholder rights
- Executive compensation
- Tax transparency and compliance
- Board management of risks

- How is ESG defined at your firm – both at the corporate level and client investment level?
- What does ESG mean to a particular client?

FOUNDATIONAL DEFINITIONS – CLIMATE CHANGE RISKS

Climate change is a material and foreseeable business and investment risk.

Physical Risks

Impacts on the value of financial assets that arise from climate- and weather-related events, such as floods, hurricanes, droughts, and storms that damage property and/or disrupt trade. Includes acute and chronic events.

Transition Risks

Financial risks resulting from the process of adjustment towards a lower-carbon economy; changes in policy, practices, technology, and physical risks could prompt a reassessment of the value of a large range of assets as costs and opportunities become more apparent.

RISK IMPACT CONSIDERATIONS:

- Physical and transition risks are not independent, and their evolution is uncertain
- Consider the short term vs. long term impact
- Liability Risk – impacts that could arise if parties who have suffered loss or damage from the effects of climate change seek compensation from those with alleged responsibility

FOUNDATIONAL DEFINITION – TRANSMISSION CHANNELS

Transmission channels are the connections that explain how climate risk drivers can directly and indirectly impact financial institutions.

Physical Risks

- Acute (storms, floods, wildfires, heat waves)
- Chronic (temp changes, rising sea levels, ocean acidification)

Transition Risks

- Government policy and regulation
- Technology developments
- Investor and consumer preferences

Transmission Channels

- Microeconomic (households, companies, governments, stock prices, asset values)
- Macroeconomic (government debt, labor changes, socioeconomic changes)

Variables

- Geography
- Amplifiers
- Mitigants

Financial Risks

- Credit
- Market
- Liquidity
- Operational

Non-financial Risks

- Strategic
- Reputational
- Regulatory
- Model
- Physical Security
- Fiduciary
- Resliency
- Third Party

Climate Change & Risk Frameworks

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WHAT IS THE IMPACT OF CLIMATE RISK ON YOUR EXISTING RISK FRAMEWORK?

Accurate identification of climate-related risks is key to measuring their impact.

1 Determine

- How does your firm define climate risk?
- What are the transmission channels?
- How might climate risk manifest across your existing risk themes/categories?

2 Engage

- Involve first line partners to identify climate risks and their impact.

Ask:

- What climate risks is the business exposed to?
- What is the materiality of the risks?

3 Enhance

- Add climate risk inventory IDs to your existing risk management framework based on your assessment.
- Integrate climate risks into all aspects of your risk management framework and reporting.

INCORPORATING CLIMATE INTO RISK FRAMEWORKS

Once your firm understands exposure to and materiality of risks, enhance your existing Risk Management Framework through the addition of climate-related risk.

Embed in Taxonomy

- Benchmarking to peers as a diagnostic
- Climate as a risk driver, not stripe/theme/ category
- Integrate into existing framework

Metrics & Reporting

- Data currently available for use
- Determine additional data needed
- Key Risk Indicators

Governance & Oversight

- Risk appetite statement
- Board & committees
- Update policies with climate risk considerations

Risk Assessments

- Embed climate risks (physical and transition) into RCSAs and other risk assessments
- Highlight areas of concentration & exposure

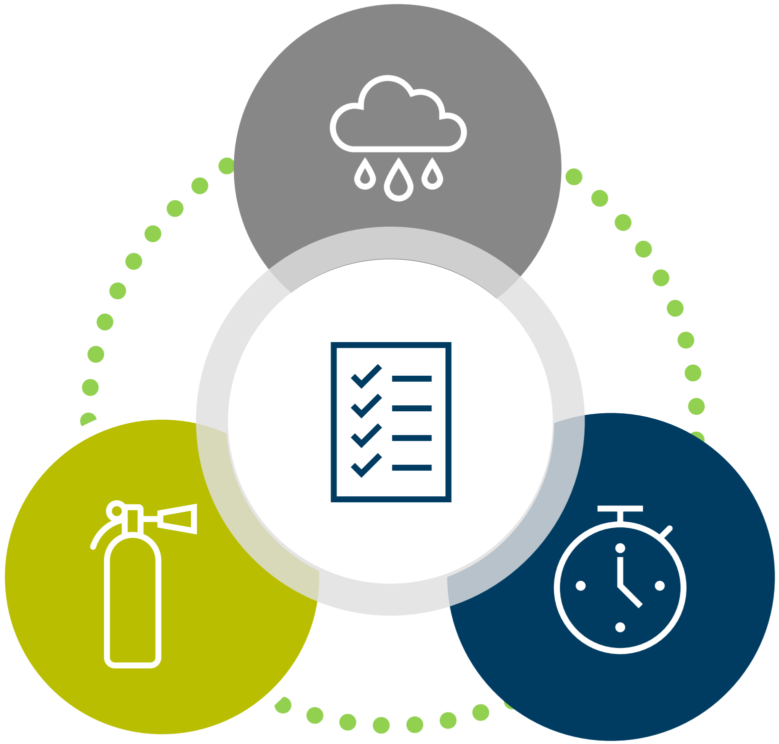
Scenario Analysis

- Longer time horizon
- Climate-related exposures & opportunities
- What business may deteriorate most under a severe scenario?

FRAMEWORK INTEGRATION CONSIDERATIONS

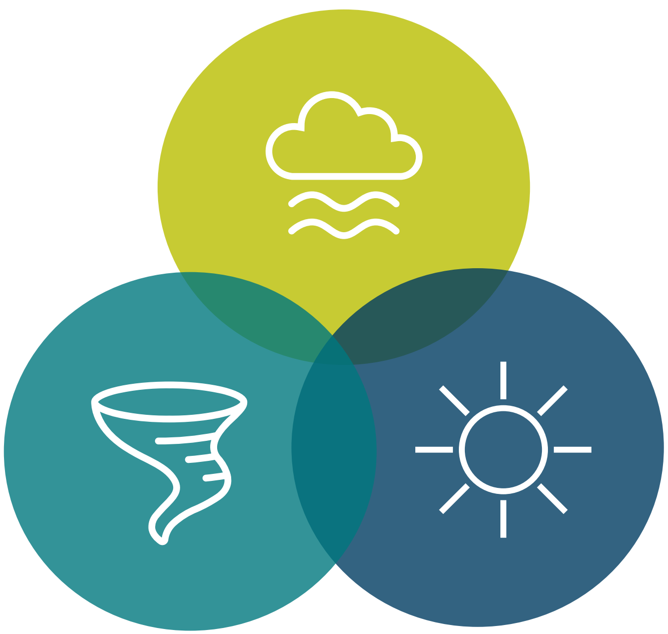
Enhancing your Risk Management Framework with climate-related risks will be an evolving process.

- Climate-related risks can have an extended time horizon and can be difficult to quantify, especially in early stages of integration.
- Initially, it may be easier to understand and potentially quantify impacts to certain risk themes, like Strategic and Reputational.
- It is very unlikely that historical loss history has any losses directly attributable to climate change.
- Identifying initial key metrics and developing scenario analyses will assist in greater understanding of potential loss events.



CLIMATE RELATED SCENARIO ANALYSIS

Climate scenario analysis should include short, medium, and long-term assessments to cover different situations across a firm.



- US regulatory landscape is still evolving when it comes to climate-related risks. Eventually, scenario analysis & stress testing will be important in assessing these risks.
- Modeling both physical risks (climate-related events) and transition risks (related to moving to a low-carbon economy) is essential.
- Climate-related risks are unique, and therefore create new challenges around scenario analysis. It will be difficult to rely on historical financial losses in this context.
- Supervisory guidance on scenario analysis is expected, though timing is uncertain.

Climate Change & Fiduciary Risk

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CLIMATE CHANGE & FIDUCIARY RISK CONSIDERATIONS

The foreseeability and materiality of climate-related risks makes them impossible to ignore. The process of identifying, assessing, and determining potential mitigants is key when applying them to a fiduciary standard.

Climate-related risks are relevant to a fiduciary's duty of care to the extent the risks intersect with and drive a fiduciary's ability to act in the best interest of a beneficiary/client.

For prospective business, climate-related risk assessments should ideally take place as a part of pre-account acceptance due diligence. What sort of analysis should be done for existing clients? At what frequency?

What risks are embedded in investments and portfolios? Understand how climate risks are affecting investments being made AND how those investments are affecting the climate.

Consider: Is it in investors' best interests, and therefore consistent with fiduciary duty, to actively support low-carbon transition to potentially avoid the worst climate scenarios, which will very likely have a negative impact across sectors and asset classes**?**

ESG, CLIMATE CHANGE & FIDUCIARY RISK: HYPOTHETICAL

Should a fiduciary "put its own spin" on ESG and climate investment types/asset classes? Or should there be an objective, uniform approach to due diligence to mitigate individual biases?

FACTS:

- A portfolio manager in New York desires to take ESG and climate into account from an investment perspective. Your firm doesn't have a standard approach to ESG from a fiduciary investment perspective.
- The bank is trustee; the trust document is silent when it comes to ESG/climate. State governing law doesn't specifically address ESG.

CONSIDER:

- If the document and state law are silent, is ESG a sound investment strategy from a prudence perspective? Industry studies on performance remain inconclusive and ESG investments generally cost more.
- Is there enough evidence that investing in ESG investments is sound and prudent with the appropriate long-term benefits for future generations of beneficiaries?

What if the facts change, and the portfolio manager is in Texas, which has an economy that is driven by oil and gas, and she doesn't want to take ESG or climate into account from an investment perspective?

CLIMATE RISK EFFECTS ON FIDUCIARY INVESTMENTS

How do climate-related risks potentially change a fiduciary's prudent investment analysis?

	Physical Risks	Transition Risks
Oil & Gas	✓	✓
Agriculture	✓	
Real Estate	✓	
Manufacturing	✓	✓
Digital Assets	✓	✓

Additional Considerations:

- Closely-held assets
- Trust loans
- Concentrations
- Controlling asset among several trusts

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Climate Change Disclosure Schemes

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DISCLOSURE SCHEME HIGHLIGHTS

Regulators, investors, and other stakeholders have increased the demand for more detailed and timely disclosure of climate-related risks and opportunities. There is no common framework for comprehensive corporate climate reporting, but there are a few standard schemes.

Task Force on Climate-Related Financial Disclosures (TCFD)

- TCFD framework discloses impact of climate risks on financial metrics to manage climate change
- Requires reporting across four pillars: governance, strategy, risk management, and metrics and targets

Global Reporting Initiative (GRI)

- GRI standards allow organizations to share how they're managing impacts on society and the environment
- Mission of GRI is to empower decisions that create social, environmental, and economic benefits for everyone

Sustainability Accounting Standards Board (SASB)

- Issues guidance on topics for investors, including ESG and climate technical bulletins
- SASB guidance framework sets standards for the disclosure of financially material sustainability information by companies to their investors.

International Sustainability Standards Board (ISSB)

- Launched in late 2021, and meant to be a comprehensive global baseline of high-quality sustainability disclosures
- Will consolidate Climate Disclosure Standards Board (CDSB) and Value Reporting Foundation (which includes the SASB standards) by June 2022

Securities and Exchange Commission (SEC)

- Proposed climate disclosure issued on March 21, 2022
- Relies heavily on the TCFD four pillars approach and would apply to disclosures by domestic and foreign companies that file reports or registration statements with the SEC

DISCLOSURE SPOTLIGHT: TCFD FOUR PILLARS APPROACH

The TCFD focus is to report on the impact an organization has on global climate in four categories.

GOVERNANCE

- Board oversight
- Role of management

STRATEGY

- Risks & opportunities
- Impacts on business
- Resilience

RISK MANAGEMENT

- Risk ID & assessment
- RM Process
- Integration into overall RM

METRICS & TARGETS

- Metrics in line with strategy and RM
- Climate-related targets & performance

DISCLOSURE SPOTLIGHT: SEC CLIMATE DISCLOSURE PROPOSAL

The SEC proposal would be a substantial change to existing law, and would have broad implications for companies, both from a disclosure and an internal procedural standpoint.

Proposal Details

The SEC proposal would require a public company to disclose certain information in registrations and periodic reports:

- Climate-related risks and their actual or likely material impacts on company's business, strategy, and outlook
- The governance around climate-related risks, including processes around identification, assessment, and management of those risks
- Whether climate-related risks are integrated into risk management frameworks
- Information on certain climate-related targets and goals
- Direct and indirect greenhouse gas (GHG) emissions, which would require third-party attestation for certain types of emissions
- Note, there is some strong opposition related to the proposal, which will continue to evolve via comment and potential legal challenge

Proposal requirements are modeled in part on TCFD and Greenhouse Case Protocol frameworks.

Standards are needed to facilitate compliance, but the sheer volume of information proposed to be required could have a great effect on disclosure costs.

IN SUMMARY

Climate change and its related risks are a threat to the U.S. financial system – it is a material and foreseeable business and investment risk.

Climate change should be thoroughly integrated into your existing risk taxonomies and risk management frameworks. Consider how climate risk may uniquely impact different risk types, including Fiduciary Risk.

Climate disclosures have yet to be standardized, but current frameworks and proposed schemes give an indication of what will need to be disclosed in the near future. Final disclosure obligations could increase costs and compliance time pressure.

Questions?

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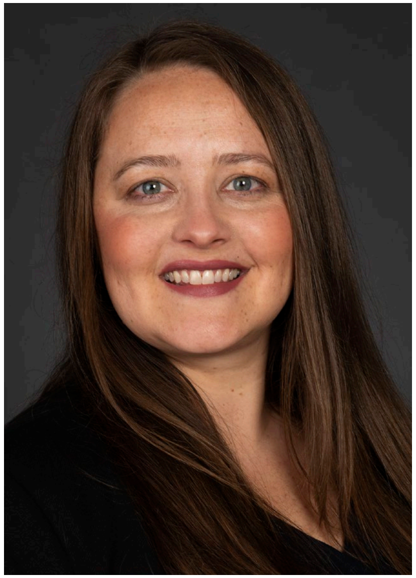
“The time is past when humankind thought it could selfishly draw on exhaustible resources. We now know the world is not a commodity.”

Francois Hollande on Climate Change

President of the French Republic

BIOGRAPHY



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Holly Bailey is a Senior Vice President and Manager of the Global Fiduciary Risk Management team at Northern Trust. Holly has spent the past three years at Northern Trust leading the Global Fiduciary Risk Management team, with responsibility for the identification of and advising on fiduciary risk and compliance issues in all Business Units at Northern Trust, as well as oversight of global fiduciary risk management programs and policies.

In her role, Holly acts as a Risk Advisor for Northern Trust Cayman International, Ltd. and serves as a Director of Northern Trust Fiduciary Services (Guernsey) Limited. She also leads the North American Diversity, Equity & Inclusion Risk & Compliance Champions within Northern.

Prior to joining Northern Trust, Holly held a variety of roles in Legal, Risk Management, and the line of business at BMO Harris Bank, including Senior Counsel, National Director of Trust Fiduciary Risk, and Chief Trust Officer. She began her career as an attorney, where she spent over a decade in private practice, focused on estate planning, trust law, estate administration, family office services, business and real estate transactions, and tax compliance.

Holly received a Bachelor of Arts degree in Business Administration and Communication from Alma College in Alma, Michigan, and a Juris Doctor from Chicago-Kent College of Law, Illinois Institute of Technology in Chicago, Illinois. She is a member of the Chicago Estate Planning Council, and is a past president of the Corporate Fiduciaries Association of Illinois. She is also a member of the bar in the State of Illinois, the United States Court for the Northern District of Illinois, and the United States Tax Court.

Holly is a frequent participant and speaker at FIRMA Conferences as well as other industry events, and is a FIRMA Peer Group leader and member.

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