



COVID-19: key lessons for climate change

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What can we learn from COVID-19 about how we approach climate change-related risks?

COVID-19 has caused unprecedented disruption, triggering simultaneous global market lockdowns. While the consequences of COVID-19 are ongoing, many are already questioning why so few companies and markets were adequately prepared to address the impacts of a pandemic, a well-documented risk that has appeared throughout history.

Pandemics or spread of infectious diseases have frequently featured in the World Economic Forum's (WEF) Global Risks Report for the last 10 years. Despite these warnings, the acute impact of COVID-19 has highlighted a clear gap between identifying risks and developing mitigation or response strategies. This has come at enormous health and economic cost. The low point on 23 March saw around \$26 trillion wiped off the global stock market valuation. Coupled with record breaking global unemployment levels, drastic declines in consumer spending, and widespread factory shutdowns, it suggests there is a long road to economic recovery.

The lack of existing government and organisational mitigation and response planning highlights the need to ensure we learn from this crisis in order to better manage other systemic risks in the future.

So, what can we learn from COVID-19? There are 3 key lessons:



1. Human behavioural bias may be limiting our current response planning

A number of studies show that humans generally fail to intuitively understand risk if its probability falls outside of 'moderate' (c. 15%-40%) chance of it happening. Furthermore, humans have a natural tendency to avoid risks that are too big and too complex, and therefore the low-probability, high-impact risk of a pandemic meant it was overlooked. This has particularly been the case for traditionally non-financial risks, given the economic implications are often indirect and difficult to quantify.



2. Any response planning must consider the network effects of risk

The traditional risk models often used in crisis response will typically focus on the probability and impact of individual risks, but in the COVID-19 crisis we are seeing that there are much broader indirect environmental and social consequences, which have amplified the impact of the direct pandemic risk. COVID-19 demonstrates that we work and live in a highly connected world, which can be severely compromised by seemingly unrelated issues.



3. A globally co-ordinated response is key

Managing the impact of COVID-19 has required a globally coordinated response. We have seen many governments collaborate: sharing essential equipment, coordinating on a vaccine, and implementing stricter border controls.

A coordinated exit plan will be critical to prevent a second wave of COVID-19 infections.

Without exception, climate change could be swapped in for pandemic/COVID-19 in the paragraphs above. Particularly when we consider:

- Climate risks, including climate action failure, extreme weather and water crises, occupied all the top five risks identified in the WEF's 2020 Global Risk Report¹.
- Climate change is already having major financial impacts which are likely to continue to grow. The Bank of England have suggested that £20tn of assets could be wiped out by climate related events if institutions and companies fail to prepare². The aggregated impacts of climate change have been forecast to cost \$4tn of GDP by 2030, even without further major catastrophic extreme weather events. This has the potential to create crippling, long-lasting impacts and limit our ability to recover.
- The planning fallacy, a human behavioural bias, is often used to describe the lack of preparation for pandemic response. In the case of climate change, where transitional and longer-term physical impacts are slow to materialise, it is likely that our responsiveness to these risks will be even more limited.

- Climate risks have significant risk networks, both between climate risks (such as droughts leading to wildfire onset), but also to other significant indirect risks such as macroeconomic impacts which can trigger significant systemic impacts at rapid velocity.
- Climate change will require a cohesive approach driving consensus on global activity through ongoing intergovernmental negotiations such as seen at COP25. However, the failure to reach any consensus on Article 6 at COP25 provides a key signal that there is still more to be done in achieving this globally-coordinated approach.

While climate risk continues to grow, we can learn from the impact of COVID-19 about how to develop better crisis prevention and response. This will require organisations and governments to act rapidly to deliver integrated risk, strategy, governance and reporting on climate risk.

¹ World Economic Forum, *The Global Risks Report 2020*, January 2020

² The Telegraph, *Climate change could wipe out \$20 trillion of assets, Bank of England warns*, April 2019

How can we use the lessons learnt from COVID-19 to better prepare for climate change?

More robust planning to manage climate-related impacts is crucial to prevent the systemic impact of COVID-19 happening again.

Over the next 18-24 months all organisations will go through the phases of Reaction – Resilience – Recover – New Reality, learning from the experience of COVID-19 to embed and think about risk in the right way. Businesses and organisations need to consider two approaches simultaneously:



Disaster response planning: how do you respond to future shocks?

The early stages of the pandemic have shown that there is a disadvantage and more severe impacts seen by the countries who appeared to “under” respond. In the short-term this can be seen in the case rate in countries such as the US vs. the numbers seen in South Korea or Hong Kong. It is worth noting however, that the long-term metrics haven’t been seen yet. Unemployment rate or economic recovery, as 2 examples, are likely to be exacerbated by a delayed recovery in the health system. Therefore, having a robust crisis response plan that allows early implementation when crisis hits is key.



Proactive risk mitigation and adaptation: how do you mitigate future shocks?

Developing robust mitigation measures will help minimise impacts of future risks. This is particularly relevant when looking at climate risks, which are much slower to impact and result from compounding localised actions. Compared to pandemics where it’s more difficult to predict when and where they will originate and how they will manifest, we know some of the key drivers and causes of climate change, and their resulting consequences, so we can start mitigating these risks now.

For a lot of companies, climate related risks are unlikely to be standalone principle risks, instead being one of the key causes of principle risks that already exist. If the impacts of climate change are not taken in to account when considering the impact and likelihood of the principle risks then the quantification of the principle risks is likely to be understated – and the strategic response not adequate. We recommend that companies use the guidance set out in the Task Force on Climate-related

Financial Disclosures (TCFD) recommendations to ensure that there are appropriate levels of governance in place around climate risks and opportunities; that appropriate metrics and targets are set to measure the company’s ability to respond to the risks and opportunities identified; and that controls are put in place to ensure the appropriate monitoring and reporting of climate related risks and opportunities throughout the organisation.



How do you put climate risk at the top of your organisation's agenda?

Prior to COVID-19, companies were already under pressure to address environmental issues from governments, consumers and employees, as well as investors and lenders. COVID-19 has shone a light on how difficult it is to comprehend and prepare for major risk events. This has exposed the disconnect between risk management and business strategy for many companies.

As companies move through the 4 R's of the pandemic – React, Resilience, Respond, New Reality – there will be very few who do not need to reset their approach to emerging risks.

1. Rethinking reaction

Companies need to acknowledge their vulnerability to high-impact shocks such as pandemics and climate-related risks and be better placed to prepare and react to them in the future. For climate risks this means having a plan before the crisis hits by embracing long term discipline, overcoming the biases that prevent us acting on climate change, and integrating mitigation and adaptation planning into business strategy.

2. Focus on becoming more resilient

The key to business survival and future success is resilience. Companies need to have a real understanding of the risks they face against a broad set of interconnected scenarios which demonstrate the cumulative impact of direct and indirect climate related risk impacts.

3. Understand your supply chain

It has been made clear through the COVID-19 pandemic that knowledge and understanding of the risks facing supply chains is generally unclear. The past four decades have borne witness to almost exponential growth in global trade flows. COVID-19 has demonstrated how vulnerable global supply chains are to any sort of disruption, be it political, economic or human. Businesses of all sizes and complexity need to take time to fully understand the risks in their supply chains and consider how to respond decisively and proportionately if disruption emerges in the supply chain.

4. Defining your business in the New Reality

Defining a new reality can be seen as a chance to lean into the future and support the 'just transition' addressing all elements of the ESG agenda. Organisations should be developing strategies to ensure they are mitigating climate risks and ceasing climate opportunities.

How can we help?

KPMG's Climate Risk and Decarbonisation Strategy team can help you understand the nature and scale of the risks and opportunities your business faces from climate change, embed effective risk management and implement the right strategic response.

Our experts can guide you at every step of the way as you prepare your business to thrive in a low-carbon world. Our 4 step process can help you to:

- identify and quantify climate risks and opportunities across supply chains under a range of scenarios and understand the impact on business performance
- undertake options analysis to help you assess proposals for mitigating and adapting to risks and seizing opportunities
- implement the agreed strategic response to transform your organisation for the future
- measure progress, ensure robust reporting and communicate your climate strategy effectively to investors.

Conclusion

Climate change is the next high impact, high probability risk that requires urgent action. Meeting global decarbonisation targets will require economic transformation, led by fundamental business model change. Failing to act is likely to lead to severe financial implications. Now is the time to mitigate your risks and realise the opportunities that climate change presents.







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