

## WASHINGTON WARMS TO CLIMATE CHANGE REGULATIONS, CAN COMPANIES TAKE THE HEAT?



### HOW SHOULD COMPANIES PREPARE FOR NEW ENVIRONMENTAL LEGISLATION?

#### Strategic Response to Climate Change is No Longer Optional

The combination of increased risk to operations and property linked to the effects of global warming, and the high probability of near-term federal legislation on greenhouse gas emissions puts climate change risk in the middle of business planning initiatives in 2009 and beyond. Formulating a strategic response to climate change is no longer an exercise, it's imperative. Reinsurance giant MunichRe recently reported that overall losses as a result of natural catastrophe totaled approximately US\$200 billion versus US\$82 billion in 2007. Insured losses in 2008 rose to US\$45 billion, about 50% higher than in the previous year, driven by high losses from weather-related natural catastrophes. Torsten Jeworrek, a senior executive

of the firm stated, "Climate change has already started and is very probably contributing to increasingly frequent weather extremes and ensuing natural catastrophes."<sup>1</sup> Insurers and auditors have concluded that climate change and the resultant changing weather patterns will bring a fundamental shift in the probability of the insured's loss.<sup>2</sup> Concurrently, President Obama has introduced a sense of urgency to climate change risk management. In his February 24 speech to the joint session of Congress the new US president acknowledged the ravages of climate change and called on Congress for "new legislation that places a market-based cap on carbon pollution and drives the production of more renewable energy for America."<sup>3</sup> President Obama has radically shifted the global momentum on climate change, placing the US at

the forefront of the international initiative and raising hopes that an effective international accord might be possible.<sup>4</sup> If that isn't evidence enough of climate-related legislation advancing in 2009, the EPA is poised to act on a 2007 Supreme Court ruling on the EPA's authority to regulate CO<sub>2</sub> and other green house gas emissions under the Clean Air Act.<sup>5</sup> In addition, climate change is a big part of the EPA budget for FY 2010—which includes a proposed \$19M increase for greenhouse gas emission inventory development and inventory reporting for affected industry sectors.<sup>6</sup> This is viewed as a significant first step toward implementing a comprehensive climate bill. Companies can no longer afford to delay incorporating a comprehensive strategic approach to climate change vulnerabilities including regulatory compliance into their business plans.

#### Strategic Plans Must Deal With Emissions, Energy Conservation and Renewable Energy

In the past, chief environmental concerns tended to focus on air, water and site contamination from the byproducts of production and distribution. Environmental issues were handled by various departments such as Legal, Facilities, Procurement, and even Treasury functions. More recently, forward thinking companies have broadened the agenda to address stakeholder demands for improved environmental stewardship and sustainability through newly created Environmental Health and Safety (EHS) departments. Often EHS is not directly connected to traditional risk management and insurance departments.



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— **Dr. Torsten Jeworrek**  
Member of the Board of Management  
Chairman Reinsurance Committee  
MunichRe

The urgency instilled by the new Administration coupled with the influence of public opinion dramatically increases the significance of climate change risk for most companies. This will include consideration of an entity’s exposure to climate change effects as well as its contribution to climate change—notably emissions of heat-trapping green house gases, and their inextricable link to energy usage.

Situation specific or tactical accommodations to meet the patchwork of local, state and international regulations will not yield a competitive advantage. With the United States poised to join other foreign governing entities to draft the successor agreement to the Kyoto Protocol, establish emissions standards and

embed them in trade agreements and treaties, companies will have to adapt quickly to a carbon constrained existence and develop clear, consistent strategies to stabilize or reduce their GHG emissions to stay competitive. Many will use this as an opportunity to steal a lead on their competitors. In addition to energy consumption, long-term corporate growth and risk management strategies will need to address their environmental impact in the areas of transportation and distribution as well as the sustainable management of water and resources and the reduction of waste and emissions.

As the evidence of the damaging effect of climate change mounts, a company’s environmental risk exposure is becoming more complex and expensive. Exposure to climate change liability will have to be factored into risk management strategies, along with more traditional considerations such as pollution, property and business interruption risks to vulnerable properties.

### **What Voluntary Measures Make Sense Now?**

With litigation and legislation on the causes and effects of climate change still unfolding, embarking on untested environmental risk management strategies may seem imprudent or unwarranted. However, foreign and domestic regulations, environmental advocacy groups and shareholders demanding greater action on energy and climate change generate unavoidable pressure for companies to manage their environmental impact. Each industry and every company will be impacted in different ways and it is essential that the risks are understood and tracked. Regardless of their sophisti-

cation, from a risk management perspective, every company should begin with a thorough examination and quantification of their climate change risk and financial exposure. Multi-discipline team collaboration, including risk management professionals and their EHS colleagues can create a shared climate change strategy for the firm. It would be prudent for companies to take steps to measure and benchmark their current carbon emissions. Companies unfamiliar with GHG emissions measurement techniques and tools can consult with their industry associations, government agencies, expert non-governmental agencies such as the Pew Center on Global Climate Change, or Environmental consultants for guidance. This assessment serves as a foundation for developing practical emissions reduction strategies. To better navigate the complexities of climate change risk management, companies with GHG emissions may want to attempt to gain experience with emissions reduction and other environmental strategies by piloting their strategies in limited rollouts with clear objectives, timeframes and metrics.

## **5 BEST PRACTICES FOR POSITIONING YOUR FIRM FOR CLIMATE-RELATED REGULATIONS**

### **1) Build up your company’s in-house environmental expertise.**

Particularly in the area of climate change risk management. This expertise, held in a cross-functional team including your insurance professional, can properly

identify and analyze the financial risks faced, and evaluate the risk and return associated with available climate change risk management options. Consult with outside experts from your industry, government agencies, non-governmental organizations like the Intergovernmental Panel on Climate Change (IPCC) or environmental consultants for current information and resources.

## 2) Audit your risk mitigation options for climate change risk annually along with other assessments.

Environmental liabilities are increasing in complexity, while markets are tightening coverage. Property programs, general liability programs as they relate to third party liability for damages caused by greenhouse gas emission, and directors and officers and errors and omissions coverage for corporate leaders who may be liable for stewardship of their company's GHG emissions should be reviewed with your insurance professional. This exercise may reveal that now is the time to explore how a pollution liability policy could fill some of the environmental liability gaps that may exist in your current program—before climate change regulation and litigation potentially result in coverage restrictions for greenhouse gasses under pollution policies.

## 3) Consider undertaking a carbon audit to define your carbon footprint.

A carbon footprint represents a measure of the total amount of carbon dioxide emissions that is directly and indirectly

caused by an activity or is accumulated over the lifecycle of a product.<sup>7</sup> Accurate calculation will enable measurement of reductions over time, particularly important if emission reductions will be used in carbon trading and carbon offsetting transactions.

## 4) Begin scenario planning.

Use modeling or simple “what if” analysis to assess the physical, financial and regulatory risks associated with climate change on business operations and refine mitigation strategies and resource application.

## 5) Consider establishing appropriate environmental risk tracking and reporting mechanisms.

Directors and officers as well as senior management are required to disclose environmental risk in company annual reports and tax documents. In an era of emissions disclosure standards and reduction targets, accurate tracking and reporting mechanism are critical to compliance and receipt of performance incentives.

### FOR MORE INFORMATION

Please contact your local Willis representative or call 1-866-406-0608, email [insights@willis.com](mailto:insights@willis.com), or visit [www.willis.com](http://www.willis.com).

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## QUICK FACTS

- To return our greenhouse gas emissions merely to 1990 levels we would have to cut carbon dioxide emissions by more than 60%, methane by 8 to 20%.
- More than 200,000 people died of natural catastrophes through-out the world in 2008.
- In 2006 Wal-Mart cut down packaging on children's toys to achieve a savings of \$2.4 million a year, or more than 1,000 barrels of oil.

### Quick Facts Sources

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